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LEGAL STATUS AND CREDITOR'S PROTECTION OF ASSOCIATION AS AN ENTREPRENEUR

1. Introduction

As a rule, an association is thought of as an entity associating citizens, the fundamental objectives of which are not-for-profit. A similar definition was included in art. 2.1 of the Law of Associations Act (Journal of Laws of 2017, item 21, as amended, hereinafter referred to as the LAA), under which an association is a voluntary, self-governing, permanent society operating not-for-profit. It should be emphasized that under art. 2.2 of the LAA, an association determines its objectives or operation programs on its own. The fact that the objectives of an association are of non-profit character does not mean that an association may not conduct business activities.

First of all, it should be indicated that the association assets mainly result from membership fees, donations, inheritances, bequests, incomes from own activities, incomes resulting from assets and from public generosity (art. 33 of the LAA). The above-mentioned assets are often insufficient for covering the outlays associated with executing the statutory objectives of the association, and so the managing body may make the decision on starting business activities. In the light of art. 34 of the LAA, an association may conduct business activities in accordance with the general principles specified in separate provisions. However, it should be emphasized, that that entitlement is vested solely with the associations that are legal entities, entered in the register of entities of the National Court Register (*hereinafter referred to as:* an association or a registered association). The Law of Associations Act also regulates the functioning of unincorporated associations which, however, are not vested with the above-mentioned entitlement. Furthermore, it should be emphasized that due to the non-profit character of an association, the income from its business activities must be used solely for execution of statutory objectives and may not be distributed among its members.

What is more, it should be noted that the fact that a registered association conducts business activities means that it has the capacity to declare bankruptcy under the Bankruptcy Law Act (Journal of Laws of 2017, item

2344, as amended, hereinafter referred to as the BLA) (1, P. 288). As a result, if an association becomes insolvent, the members of its management board may incur liability for damages under art. 21.3 of the BLA, which constitutes a necessary mechanism of protecting creditors. That is because the provisions of the LAA do not introduce liability of members of the management board of an association or members of an association for its liabilities in the case when enforcement from association assets proves ineffective.

2. Types and Characteristics of Associations

As indicated above, under the Law of Associations Act, there are two types of associations: registered and unincorporated associations. The names introduced by the Act are not random, mainly because of the legal character of both entities, as well as their organizational structure and entitlements granted to them.

Under art. 17 of the LAA, registered associations are the legal persons, the legal personality of whom appears upon entry in the National Court Register. A registered association may be established by at least seven persons with full capacity for acts in law and not deprived of public rights (art. 9 in conjunction with art. 3.1 of the LAA). As a side note, it should be added that prior to amendment of the Law of Associations Act, the minimum number of members was fifteen and it was the largest number of members necessary to establish an association among all the European statutory laws (1, p. 105). These persons are obliged to adopt the association statute, to elect the founding committee and the bodies. As a legal person, under art. 38 of the Civil Code (Journal of Laws of 2018, item 1629, as amended, hereinafter referred to as the CC) a registered association acts through its bodies, i.e. the meeting of members, management board and internal control body. It should also be emphasized that one person may not hold the mandate of member of the management board and the mandate of member of the internal control body (1, p. 166). In turn, the Law of Associations Act does not introduce additional requirements for the minimum number of members of the bodies or for the name of the supervisory body. Therefore, those issues, as well as the term of members of bodies and the rules of appointing or dismissing them, or representation, should be specified in the provisions of the association statute.

A simplified type of association is unincorporated association that does not have legal personality. However, it may acquire rights on its own behalf, including ownership and other property rights, or contract liabilities, sue and be sued. The result of lack of legal personality of an unincorporated association is liability of each member of an association for the liabilities of that association. Under art. 40 of the LAA, that liability is unlimited, joint and several with the remaining members and with the association. What is important, it appears

at the moment when enforcement from association assets proves ineffective. Just like in the case of commercial partnerships, the fact that the liability of members appears only at the moment of ineffectiveness of enforcement, does not constitute an obstacle to suing a member of an association before enforcement proves ineffective.

As indicated above, an unincorporated association may conduct business activities and is not subject to entry in the register of associations of the National Court Register. Those associations, however, are entered in a special register of unincorporated associations, maintained by the head (starosta) of each commune (gmina), i.e. the smallest self-government unit in Poland. Under art. 40 section 2 of the LAA, three persons are needed to establish an unincorporated association who need to adopt regulations and appoint a representative or a management board. Contrary to a registered association, the appointment of a supervisory body is optional.

The only possibility of conducting business activities after establishing an unincorporated association, is to transform it into a registered association. In the light of art. 42a sections 1 and 2 of the LAA, an unincorporated association with at least seven members may transform into a registered associated under a resolution, in which all of its members consent to the transformation. The subject resolution should also include the name and registered office of the association, appointment of bodies, adoption of statute, as well as the financial statement of the unincorporated association drawn up on the given date in the month prior to the month of adoption of the transformation resolution. The transformation itself takes place upon entering the association in the register of associations of the National Court Register (art. 42c of the LAA). It should be added that in the light of art. 42d of the LAA, as a result of transformation is that the registered association retains all the rights and obligations of the unincorporated association. The doctrine is correct to indicate that that provision expresses the principle of continuity and not universal succession (1, p. 465), because a transformed registered association is not the legal successor of the unincorporated association, but the very same entity. As a side note, members of the unincorporated association are responsible as before, i.e. jointly and severally with the association, for the obligations of the unincorporated association occurring prior to the date of transformation for the period of one year of the date of transformation. That liability appears when the enforcement against the assets of the association proves ineffective.

3. An Association as an Entrepreneur

As indicated above, in the light of art. 34 of the LAA, an association may conduct business activities in accordance with the general principles

specified in separate provisions. What is more, the income from business activities of an association must be spent on executing statutory objectives and may not be distributed among its members. What should be mentioned here is the commendable resolution of the Supreme Court of 27 February 1990 (file reference No.: III PZP 59/89), under which the income from business activities of an association may not be distributed among its members also when those members are employees of that association. That is because the fact of employment of an association member under an employment agreement for the purpose of conducting business activities does not mean that that member is privileged in terms of having a share in the income of the association generated as a result of business activities.

Therefore, the business activities conducted by an association under the above-mentioned art. 34 of the LAA, is of subsidiary and non-independent character in relation to its fundamental – statutory activities (1, 285). The separate provisions, referred to in the above-mentioned article, include, among others, the regulations of the Law of Entrepreneurs Act (Journal of Laws of 2018, item 646, as amended, hereinafter referred to as the LOE) and of the Act on the National Court Register (Journal of Laws of 2018, item 986, as amended, hereinafter referred to as the ANCR (2, online version).

Under art. 4.1 of the LOE, an entrepreneur is a natural person, legal person or an organizational unit not being a legal person, vested with legal personality under a separate act, that performs business activities. Without a doubt, that definition allows to state the thesis that a registered association with legal personality is an entrepreneur, if it performs business activities which, under art. 3 of the LOE, should be understood as organized gainful activities performed on one's own behalf and in a continuous manner (3, p. 270). It should be emphasized that the need to spend the income generated from business activities for execution of statutory objectives and the prohibition to distribute it among the association members results in that those activities may not be called business activities. In the light of the uniform decisions issued by the Supreme Court, an example of business activity is also not-for-profit activity that only aims to cover the costs incurred with own income (Resolution of the Supreme Court of 6 December 1991, file reference No.: III CZP 117/91, Resolution of the Supreme Court of 30 November 1992, file reference No.: III CZP 134/92 Resolution of the Supreme Court of 6 August 1996, file reference No.: III CZP 84/96, Resolution of the Supreme Court of 11 May 2005, file reference No.: III CZP 11/05). One of the examples given by the Supreme Court is activity of housing associations.The business activities conducted by such associations are not conducted for gain but, due to the

fact that it is subject to the fundamental principle of economic efficiency, it is included in the term of "business activity" (Resolution of the Supreme Court of 6 December 1991, file reference No.: III CZP 117/91).

Furthermore, it should be noted that a registered associated is obliged to submit an application for entry in the register of entrepreneurs maintained by the Registry Court with jurisdiction for the registered office of the association (art. 36 point 13 of the ANCR), which application must include the subject of activity. It is only the entry in the subject registry under art. 17.1 of the LOE that allows an association to start conducting business activities. As a result, an association conducting business activities is entered both in the register of associations and in the register of entrepreneurs of the National Court Register.

As a side note, it should be indicated that an association may conduct business activities also indirectly, in the form of a separate organization, e.g. by holding stocks or shares in a commercial company or partnership (1, p. 287).

4. Business Activities and Statutory Activities

The business activities conducted by an association are of auxiliary and non-independent character in relation to main activities, i.e. statutory activities. As a result, what should be approved is the position expressed by the Province Administrative Court in Bydgoszcz in its judgement of 15 April 2014 (file reference No.: I SA/BD 223/14), under which the conduct of business activities for the purpose of financial gain may not constitute a statutory purpose of an association, and may only constitute its auxiliary activities, as one of the sources of income to be used for executing its statutory objectives. Furthermore, that Court indicated that as statutory activities of an association may not directly constitute business activities, in the light of judicial decisions the business activities of that type of entities only include external activities (among entrepreneurs), for example for the purpose of providing services to third parties. Therefore, the activities conducted for the purposes of the same legal person or of the members associated therein, do not constitute business activities. In other words, the collection of membership fees by an association that organizes classes in acrobatics, for the purpose of financing those classes, may not be considered business activity. However, the organization of an acrobatics show for which third parties have to buy tickets, will constitute business activity.

This example is consistent with the contents of the judgement issued by the Province Administrative Court in Warsaw on 18 September 2006 (file reference No.: III SA/WA 1976/06), under which membership fees are paid by the association members on account of belonging to the association and

constitute the assets to be used for executing its statutory objectives. As a result, according to the Court, there are no legal grounds for claiming that those fees constitute remuneration for execution of statutory objectives. Remuneration would appear if, in exchange for a financial gain, an association provided services within statutory objectives to the persons other than members of the association.

5. Protection of Creditors in the case of Insolvency of Association

As indicated above, the result of conduct of business activities by an association, is that that association may declare bankruptcy, which has been confirmed in the decisions of the Supreme Court (see Decision of the Supreme Court of 19 June 1996, file reference No. III CZP 66/96). First of all, it should be indicated that the position of the Supreme Court raises no doubts also from the point of view of literal interpretation of the provisions of the Bankruptcy Law Act. That is because, under art. 5.1 of the BLA, the provisions of that act apply to the entrepreneurs as defined in art. 431 of the Civil Code, unless the Act specifies otherwise. In turn, under the above-mentioned provision of the Civil Code, an entrepreneur is a legal person conducting business activities on its own behalf. That definition is similar to the above-mentioned definition of an entrepreneur from the Law of Entrepreneurs Act, so there are no grounds for considering that, under the Civil Code, an association conducting business activities is not an entrepreneur, and so that the provisions of the Bankruptcy Law Act do not apply thereto.

Furthermore, the above-mentioned position of the Supreme Court is commendable also from the point of view of protection of creditors. That is because it should be emphasized that under the Law of Associations Act, there are no mechanisms protecting the creditors of an association that conducts business activities that would, for example, introduce joint and several liability of members of the management board of an association for its liabilities in the case when enforcement from the assets of that association proves ineffective. It is only under the Bankruptcy Law Act that creditors may seek damages from members of the management board of the association. Under art. 21.1 of the BLA, members of the management board of an association have 30 days of the date of occurrence of the grounds for declaring bankruptcy, for filing for bankruptcy. If they do not do it, they will be liable to the creditors for the damage resulting from failure to file such a petition. In such a case, it is assumed that that damage covers the amount of unsatisfied liability of the creditor, due to the creditor from the association (art. 21.3a of the BLA).

Furthermore, it should be noted that the grounds for declaring an association bankrupt is its insolvency which, under art. 11 sections 1 and 2 of the BLA, appears in the following cases:

1) if the debtor has lost capacity to satisfy its payable liabilities. Therefore, the act introduces the presumption, under which the debtor loses its capacity to satisfy its payable liabilities if the delay in the satisfaction of those liabilities exceeds three months;

2) if the financial liabilities of a debtor being a legal person exceed the value of its assets and that condition is maintained for the period of more than twenty-four months.

As a side note, the court will dismiss the petition for bankruptcy if the assets of the insolvent debtor are not sufficient for covering the costs of proceedings or if they only suffice for covering those costs (art. 13.1 of the BLA).

6. Final Remarks

Both the literature and judicial decisions raise no doubts that an association conducting business activities is an entrepreneur as defined in art. 4 of the Law of Entrepreneurs Act. This is not changed by the fact that one of the properties of business activities is their gainful character. That is because, in the light of the decisions of the Supreme Court indicated in point four, the restriction introduced in the act, i.e. the need to spend the income from the business activities of a registered association on execution of its statutory objectives and the prohibition to distribute it among its members, does not mean that such activities may not be considered business activities as defined in the Law of Entrepreneurs Act (formerly: Act on Freedom of Business Activity).

Additionally, it should be indicated that the fact that a registered association has the right to conduct business activities is a positive thing, in particular taking into account the limited possibility of generating income for executing statutory objectives. However, it should be emphasized that the Law of Associations Act does not include provisions protecting creditors in the case of insolvency of a registered association that conducts business activities. As indicated above, in such a case there will apply the provisions of the Bankruptcy Law Act which specify liability for damages of members of the management board of an association in the case of untimely filing of a petition for bankruptcy. Despite that, the formulation of the *de lege ferenda* postulate must be considered sensible – it is associated with introduction, in the Law of Associations act, of the provision similar to art. 299 of the Code of Commercial Companies and Partnerships (Journal of Laws of 2017, item 1577, as amended). Under that postulate, in the enforcement from the assets of an association conducting business activities proves ineffective, the members of its management board you bear joint and several liability for its liabilities which would certainly constitute an additional protective mechanism for the creditors of such an association.

1. *E. HADROWICZ, Prawo o stowarzyszeniach. Komentarz (Law of Associations. Commentary), Warsaw 2016.*
2. *A. RZETECKA-GIL, Prawo o stowarzyszeniach. Komentarz. (Law of Associations. Commentary), LEX 2017.*
3. *P. SUSKI, Stowarzyszenia i fundacje. (Associations and Foundations), Warsaw 2011.*

Relidzyński P. Legal status and creditor's protection of association as an entrepreneur

The article indicates the types of associations under the Polish Law of Associations Act, and analyzes their legal character and organizational structure, with particular attention to the entitlement to conduct business activities. Then, there was presented the legal status of an association conducting business activities and there were described the requirements indicated in separate acts, the meeting of which is necessary for an association to start business activities under Polish law. What is more, as the Law of Associations Act does not include regulations regarding the potential liability of members of the management board of an association in the case of ineffective enforcement from the assets of that association, so the article analyzed the mechanisms of protecting creditors, available in the Bankruptcy Law Act. That is because that Act applies to the associations conducting business activities, which was confirmed by the Supreme Court.

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