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The Management of the Privatization Process
The Portuguese Case and its Implications in the EU Context

- Preliminary and comprehensive considerations based on the experience of the Portuguese privatization process
- General Overview of the Portuguese privatization process since it started in 1988
- The evolution of the Portuguese privatization process since 1988
- Key legal issues arising from the Portuguese privatization process in terms of enforcement of EU law and competition law
- Key lessons arising from the Portuguese experience of privatization in the European context
The experience of various privatization programs in several EU Member States shows a willingness to combine different and sometimes conflicting goals, namely, (a) financial goals of maximizing the proceeds of the transactions, (b) social and economic goals envisaging the development of a broad base of shareholders, including workers of the privatised undertakings or (c) strategic entrepreneurial goals oriented towards the restructuring of a specific economic sector or towards the formation of strategic groups of shareholders (whether or nor in the context of certain international alliances).

The combination of very diverse goals has seldom proved successful due to trade-offs between those goals.
In the global design and macro-management of privatization processes these is advantage in prioritising – to define upfront priority goals (instead of trying to pursue and harmonise conflicting goals.

Also, in the global design and macro-management of privatizations there are efficiency advantages in pursuing transparency – transparency is not only a matter of public interest and of safeguarding financial public interests (lato sensu) but also ensures a more efficient management and outcome of the privatization procedures.

The design and management of privatizations should be closely related with the proper development of economic regulation and regulatory structures – ideally hasty privatization processes should be avoided allowing the parallel development of regulatory structures. Also, ideally privatizations should be combined with prior and ongoing restructuring of privatized entities (or assets).
General Overview of the Portuguese privatization process since it started in 1988

- Portuguese privatization process started in 1988 – Law 84/88 (20 July). At that time due to constitutional constraints (Constitution of 1976) no denationalizations were allowed – since most of the state owned undertakings (SOEs) had resulted from nationalizations occurred after the revolutionary period of 1974-75, Law 84/88 only provided for partial privatization (sale up to 49% of the share capital).

- Constitutional constraint removed through the second reform (1989) of the Constitution of 1976, allowing denationalization of SOEs, provided certain key principles established in the Constitution were observed.

- The 1989 reform of the Constitution determined that privatizations (implying a denationalization – majority of cases) were to be based on a Framework Law approved by a special majority at Parliament.

The Framework Law (Law 11/90) develops the **constitutional principles established for the privatization of SOEs**, including a preference for methods of privatization allowing for the open participation of all potentially interested parties, the mandatory participation of workers of privatized SOEs in the privatization of those entities under special conditions and a mandatory prior evaluation of every SOE to be privatised by at least two independent entities to be selected by public tender

According to Law 11/90 every privatisation is, accordingly, to be preceded by a valuation involving at least two independent entities – these entities are periodically (eg every 5 years) selected by public tender and may be chosen in each case from a list of pre-qualified banks.
According to Law 11/90 privatization transactions are preferentially based on fully transparent procedures, namely public bid or public offer in organised markets – However, it also allows that, in special cases, due to the economic situation of a particular SOE or due to a particular strategy defined for a certain economic sector, privatizations may be carried out through direct sale or through a special bid limited to pre-qualified entities.

Originally, Law 11/90 also determined that as a rule – except in the cases of direct sale – a certain percentage of the share capital of SOEs should be sold to small investors (under special conditions). Recently this idea of ‘popular capitalism’ has been mitigated and that option is no longer mandatory.
General Overview of the Portuguese privatization process since it started in 1988 - CONT

- On the basis of the Framework Law (Law 11/90) the Government should approve through Decree-Law and observing the general parameters of Law 11/90 the specific conditions under which each SOE will be privatised.

- Accordingly, it is up to the government – through Decree-Law – to determine the share-capital to be privatised (the prevailing option has been for gradual privatisation of the larger SOEs in various successive stages), the percentage of share capital to be allocated for preferencial acquisition by small investors and workers of the privatised SOEs (in general only a smaller fraction or even a residual part of the share capital has been thus allocated and it is understood that as regards workers such option is only mandatory in one of the stages of privatization). In those cases the government also determines the more favourable conditions benefiting small investors and workers.
Law 11/90 determines that proceeds of privatization must be used only for four mandatory goals – to repay the public debt, to repay the debt of SOEs, to new investments in the productive sector or to repay debt arising from nationalisations. Periodically the Government determines the prevailing goals to be observed (the prevailing goal has largely been the repayment of public debt).

By and large, the prevailing method of privatization is the sale to private entities of the share capital of SOEs but Law 11/90 also provides for privatization through lease contracts (which entitle private entities with the right to manage privatised undertakings) – this method has been seldom used so far.
Globally, we may identify 2 major influences in the design and development of the privatization process in Portugal – (A) influence from the UK privatization process of the eighties (concerning the goal of the so-called ‘popular capitalism’ that influenced the option of allocation of a part of the share capital of SOEs to workers and small investors) and (B) influence from the French privatization process of 1986-88 (restarted in 1993) – in this case such influence had to do with the adoption of specific solutions to ensure the comprehensive transparency of the process.

Such transparency was envisaged through the institution of a Privatization Commission with independent and qualified specialists to which the government had to submit all legislative proposals and all valuations (prepared by independent banks).
Although the Opinions of the Privatization Commission were not binding in practice they corresponded to a significant element of accountability (e.g., in every case the government followed its recommendations on valuation and pricing although it was not binded by a minimum threshold established by such independent Commission, as it happened in the case of the ‘Commission de privatisation’ provided for under French law)

Although the Framework Law (Law 11/90) did not provide for any special vehicle or entity with the specific assignment of conducting the privatization procedures, in time and particularly as regards transactions involving public offers in organised markets the government recurrently used a state holding company (Parpublica) as a vendor, albeit with the key conditions being established by the government through Decree-Law and several Resolutions of the Council of Ministers
Since full privatization started in 1990, only two changes were introduced in the Framework Law (Law 11/90), through Law 102/2003 (of 15 November) and through Law 50/2011 (of 13 September).

The 2003 change had to do with the elimination of the rule that enabled the government to establish, in the context of the privatization of each SOE, a limit to the total share capital that, as a whole, foreign entities could acquire – such legislative reform arose from the condemnation of the Portuguese State by the Court of Justice of the EU (an issue referred *infra*).

The 2011 change has reduced the focus on small investors (no longer targeted, as a rule, as acquirors under special conditions), eliminated special rights shares (or ‘golden shares’) – an issue referred *infra* – and replaced the Privatization Commission by special ‘ad hoc’ commissions for each privatization process, for flexibility reasons and considering the privatization program is already entering its last stage.
On the whole we may tentatively identify 3 major stages in the Portuguese privatization process, although its legal and financial framework has been considerably stable.

First Stage – between 1990 and 1996 – Sectoral focus quite intentionally on the financial sector – up to 1983 all the financial sector was publicly held; conversely in 6 years all state owned financial groups were privatised with the exception of one remaining public group (Caixa Geral de Depósitos).

Second Stage – between 1996 and 2006 – Sector focus on utilities – in parallel with the development of regulatory structures (independent agencies) - the telecoms operator was fully privatised. Also fully privatised the cements and wood pulp groups and largely privatised the electricity and oil groups and the national electric grid (that was fully unbundled). These transactions were chiefly developed through bookbuilding procedures targeting reference institutional investors.
Third Stage – After slowing down between 2007 and 2010 – under the Memorandum of Understanding concluded in the first semester of 2011 between Portugal and the European Commission, the European Central Bank and the International Monetary Fund – the Portuguese privatization process was reactivated and entered its last stage – commitments to complete the privatization of the electricity and oil companies and of the electric grid (although the utilities were, by and large, already privatised) and to privatize the post office and transport SOEs (including air transport) and the SOE that owns the Portuguese airports.

Due to time constraints (a quick process is envisaged) and the need of tracking down particular investors that may participate in restructuring of SOEs (especially needed in the transport sector) a new preference is evolving towards direct sales and towards a more limited/flexible involvement of supervisory commissions (which implies risks)
The design and development of the Portuguese privatization program (in its several stages) has led to various legal issues as regards EU law and competition law – in an extremely brief and simplified perspective, five types of issues are noteworthy.

(1) Issues concerning EU internal market rules – (A) Portuguese Republic condemned by the Court of Justice of the European Union for maintaining a rule that enabled the government to establish limits in the shareholding acquired by foreign entities (Ruling of 4 June 2002 – Case C-367/98) and – (B) Portuguese Republic condemned for establishing special rights shares (golden shares) in Portugal Telecom (Ruling of 8 July 2010 – case C-171/08), EDP - Energy of Portugal (ruling of 11 November 2010, case C-543/08), and Galp (oil company) – Ruling of 10 November 2011, case C-212/09.
(2) Issues concerning restructuring operations prior to the privatization of major utilities (and in view of their privatisation) – in various cases the government envisaged a new design of certain groups of undertakings in the field of utilities giving rise to concentration operations that met with objections at EU level – the landmark or paradigmatic case here was the EDP/ENI/GDP case – EDP – Electricity of Portugal together with ENI tried to acquire GDP – Gas of Portugal involving a concentration with EC dimension that was blocked by the European Commission in a decision challenged in the General Court – Ruling of the General Court (then Court of First Instance) upheld the decision of the Commission – ruling of 21 September 2005, case T-87/05
Key legal issues arising from the Portuguese privatization process in terms of enforcement of EU law and competition law - CONT

1. (3) Issues concerning the use of national powers based on reasons of public interest (regulatory or of other nature) to block transactions between private entities in partially privatised undertakings – landmark case involving the use of powers of the Minister of Finance under Decree-Law 380/93 (of 15 November) – in the meantime revoked – submitting to prior authorisation of the Minister transactions between private entities involving more than 10% of the share capital of undertakings which were not still fully privatised (in order to safeguard the key goals established for its privatization process) – in the Secil/Holderbank/Cimpor case the European Commission examined under the EU merger control rules the public offer launched for the cement undertaking and cleared the transaction disallowing the decision to block it by the Minister of Finance.
Key legal issues arising from the Portuguese privatization process in terms of enforcement of EU law and competition law - CONT

- **(3 - cont)** – this case involved the special type situations in which national authorities may block concentrations of EC dimension, cleared by the Commission, on grounds of public interest (article 21/3 of Merger Regulation 4064/89 corresponding to article 21/4 of Merger Regulation 139/2004). The case was taken to the Court of Justice that ruled on 22 June of 2004 against the Portuguese Republic (and in favour of the Commission – case C-42/01).

- **(4)** Issues concerning financial restructuring of SOE in view of its privatization and with significant state involvement/financial input leading to potential state aid problems – landmark case – EPAC case (SOE operating in the corn/grain sector) with the Commission prohibiting ‘ex post’ a state guarantee provided to EPAC in the context of its restructuring (as a non admissible state aid). Commission decision of July 1997 – upheld in case C-404/97
(4 – cont) - These state aid cases have also comprehended privatization transactions through direct sale which involve a presumption of state aid – several cases favourably evaluated by the Commission in this domain, eg. on October 10, 1995, the Commission decided not to raise objections to the privatisation of CNP (petrochemical company) through a direct sale to Borealis. However, in the context of the last stage of privatizations initiated in 2011 with a more recurrent use of direct sale further attention will have to be paid to potential state aid problems (particularly when the direct sale is used for the privatisation of SOEs that did not depend on previous public restructuring or financial support)
(5) Issues concerning the general interplay between the special rules establishing the procedure for the privatisation of each SOE under the framework Law (Law 11/90) and the merger control rules (including national merger control rules when applicable) – After some hesitations in this domain, a general orientation prevailed according to which the rules applicable to each privatization transaction acknowledge from the start (particularly in public bids) that the acquisition proposals must disclose the merger control requirements to which they are subjected and must establish that the acquisition even if accepted in the context of the privatization procedure is conditional and may only be fulfilled with a clearing decision by the competent merger control authority.
Closing the circle and coming back to our initial considerations - after a very brief review of some key features of the design and management of the Portuguese privatisation process – some tentative conclusions and inferences may be taken into consideration. One of the most important of those is the lack of success of the simultaneous pursuit of largely conflicting goals – in most of the cases, the attempt to establish a broad social basis of shareholders only implied a loss of proceeds since shares traded at more favourable prices were quickly resold by workers or small investors.

The attempt to foster stable core/strategical shareholders – strategically planned by the State in the design of certain privatization procedures – has also been by and large unsuccessful (the process of change of the core shareholders after the privatization has been only temporarily delayed in the cases in which the State retained golden shares which have been eliminated in 2011).
Key lessons arising from the Portuguese experience of privatization in the European context - CONT

- With the process of elimination of golden shares the State only keeps two chief means of retaining some influence over privatised undertakings in order to pursue some forms of public interest, albeit of a very different nature – (a) through carefully tailored adjustments of regulation (according to what is allowed in each case by EU sectoral rules) prior to the full privatization of certain SOES or (b) through maintaining a minority shareholding in privatised SOEs combined with statutory limitation (in the Bylaws) of the exercise of voting rights applicable to all shareholders (an option which may not be feasible due to financial constraints in many cases).

- Too complex transactions relying heavily on comitments of the acquirors to be executed ‘ex post’ tend to be unfavourable to the State. In general, the public monitoring of such ‘ex post’ fulfilment of comitments by the new private owners is rather deficient.
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Key lessons arising from the Portuguese experience of privatization in the European context - CONT

- Transparency requirements should be continuously privileged – in the frequent trade-off between, on the one hand, speed and flexibility of the procedures and, on the other hand, demanding levels of transparency, the latter should prevail as a matter of global efficiency of the privatization program – However, privatization procedures developed under severe financial constraints/pressures in the context of comprehensive financial adjustment programs with deadlines largely imposed by third financing parties (in Greece, Portugal and elsewhere) generate considerable risks in terms of transparency that must be duly addressed – transparency is also a key factor in preserving minimum levels of popular/social support for the privatization programs.