

## OWNERSHIP TRANSFORMATION PROCESSES IN POLAND BETWEEN 1989 AND 2014 – SELECTED ISSUES

### ABSTRACT

The article presents a legal analysis of regulations dealing with ownership transformation in Poland in the period 1990–2014. The paper also makes reference to the social and economic conditions at the time, which influenced the character of the first regulation for state-owned enterprises and subsequent evolution of the Polish legal framework for ownership transformations. The author underlines frequent changes to the laws which resulted from the necessity to reach privatizations goals as set by the Minister of the State Treasury.

### STRESZCZENIE

Przedmiotem artykułu jest analiza dogmatycznoprawna obowiązujących przepisów regulujących problematykę przekształceń własnościowych w Polsce w latach 1990–2014. Merytoryczny zakres badań odnosi się także do uwarunkowań społeczno-gospodarczych, które miały wpływ na kształt pierwszej regulacji dotyczącej przedsiębiorstw państwowych, a następnie ewolucję ustawodawstwa regulującego przekształcenia własnościowe. Autorka zwraca uwagę na dużą dynamikę przepisów, która wiązała się z koniecznością osiągnięcia przez ustawodawcę celów prywatyzacyjnych określonych przez Ministra Skarbu Państwa.

**KEYWORDS:** *privatization, state-owned enterprises, commercialization, ownership transformation*

**SŁOWA KLUCZOWE:** *prywatyzacja, przedsiębiorstwa państwowe, komercjalizacja, przekształcenia własnościowe*

**Key terms used in the text:**

<b>the Ministry</b>	refers to the Ministry of the State Treasury unless otherwise noted
<b>the Minister</b>	the Minister of the State Treasury
<b>the Act</b>	refers to the Act on Commercialization and Privatization of State-owned enterprises of 1996 unless specified otherwise
<b>a State-owned enterprise</b>	a legal form created by the Act on State Enterprise of 1981
<b>an enterprise</b>	is a collection of intangible and tangible assets (i.e. all assets) as defined by Article 55 of the Polish Civil Code
<b>an Organ</b> of a company/ state enterprise	a statutory body within a company or state enterprise existing to perform certain (well-defined) statutory duties (e.g. director, supervisory board, workers' council)

## INTRODUCTION

Political and economic changes in the 1980s had a fundamental impact on creation of a new market economy in Poland in the 1990s. The beginnings of the transformation from the centrally-planned economy to the market economy had their source already in the 1980s with the creation of the “Solidarity” labor movement, and with the passing of the Act on state enterprises in 1980 (Journal of Laws of 2002, no. 112, item 981), as amended. In this act, the communist government for the first time decreed a separation of state assets and enterprise assets with the latter formed on (and subject to) the principle of “3S”: self-sufficiency (i.e. independence from the state), self-rule, self-financing. Over the past 25 years, the Polish economy has profoundly changed its ownership structure: in 1990 it was composed in 95% of state enterprises; by 2014 this rate had dropped to ca. 20%. In light of the most recent data, at the beginning of the transformation, the entities under supervision of the Minister of the State Treasury numbered ca. 8.500. Today his office supervises only 249 companies (*Ocena przebiegu prywatyzacji w 2013 r.*, p. 3). The ownership transformation taking place in Poland is considered to have been the biggest in the world thus far (See R. Frydman, A. Rapaczyński, 1994; Bednarek M.,

1994). This article presents its main aspects and discusses an underlying legal framework. The goal is to present the ownership changes after 1990 in the context of political changes of the late 1980s, analyze key legal regulations, discuss fundamental terms and privatization methods employed. In the last section, I present salient statistics in order to better illustrate the scope of undertaken changes.

## **ORIGINS OF THE MARKET ECONOMY IN POLAND**

The decade of the 1990s may be seen as a triumph of capitalism. The fall of the Berlin Wall and victory of the Polish “Solidarity” opposition movement marked a victory of democracy and free-market capitalism. The reforms initiated at the end of the 1980s by the communist regime (meant to preserve the old system) clearly did not succeed. This led to consensus-seeking by both the communists and the opposition.

### **Roundtable Talks**

In 1989 the Polish Communist Party (PZPR) was forced to reopen talks with the Solidarity Movement and other opposition groups to defuse growing social unrest. The so-called Roundtable Talks took place in Warsaw from 6 February to 4 April 1989. The result was the first (partially) free elections held in June 1989. The Solidarity Movement took all but one of the 35 per cent of seats it was allowed to contest in the Lower House (Sejm) and 92 of 100 seats in the Upper House (Senat). In September 1989 Tadeusz Mazowiecki became prime minister in Poland’s first non-communist government for 40 years. Despite overwhelming public will to do so, implementing a market economy was not straight-forward. It is sufficient to note that there had been no free market in Poland since 1945. During this time the market was centrally-planned with a directed economy. The Polish system of law did not contain even basic regulations which might have functioned as the basis for a market economy (for instance the law at the time did not envision a private undertaking, but only a socialist entity called “social economic entity” – „jednostki gospodarki uspołecznionej”). In practice there was no private ownership of productive assets. There was no real competition (which of course was due to the lack

of a free market). There were no administrative institutions (Ministry of the Economy, Ministry of the State Treasury) or financial institutions (a stock market, an independent central bank).

### **The Big Bang of 1990**

In January 1990, the so-called „shock therapy” (see Sachs, 1994, p. 35–78, Frydman, Rapaczyński, 1994, p. 11; Hardy, 2009, p. 90) was carried out virtually overnight. These policies immediately reduced public spending and froze wages. However, it remains a debatable point whether this mix contained more shock or therapy. Implementation of the „shock therapy” resulted in closure of many state-owned enterprises leading to rising unemployment. The intention was to jump start a market economy: It was assumed that a period of 2–3 years of sacrifices “belt-tightening” would suffice to reconfigure the economy into to a market-oriented one.

## **THE MOST IMPORTANT CHANGES IN COMMERCIAL LAW AND COMMERCIAL ADMINISTRATION FROM 1989 TO 2014**

Early changes in the economic environment naturally (and forcefully) brought about changes in the law. The first important regulation was the Act on commercial activity of 23 December 1988 (Journal of Laws of 1988, No. 41, item 324), which was enacted by the last communist government already acutely aware that a change was required. This Act was in force for 10 years and was called the “Commercial Constitution”. It introduced the legal notions of “commercial activity”, “commercial enterprise” (it did not use the term “undertaking”, which was later judged to be its major shortcoming). Above all, however, it introduced the principle of freedom of commercial activity, and in one of its provisions referred to the ancient principle that “whatever is not prohibited is allowed” (Art. 4 of the Act of 23 December 1988 on commercial activity). In spite of all above, the new commercial regime had to be reflected in the Constitution. Between the fall of 1989 and October 1992 the Constitution was amended eight times (Kosikowski, 2002, p. 39).

Those changes of “commercial” character introduced into the Constitution came to be known as the “Small Constitution”.

After 1990 there were also numerous changes in the central government administration, particularly those that dealt with the economy and economic (ownership) transformation. Those included creation of the Ministry of Ownership Transformation, the Office of the Minister for Industry and Commerce, and the Antimonopoly Office. The goal of the new commercial administrators was to strengthen private ownership and establish orderly competition.

New laws began to be applied to capital markets. Those included the new Banking Law of 31 January 1989 (Journal of Laws of 1989, no. 4, item 21), and the Act on the National Bank of Poland of 31 January 1989 (Journal of Laws of 1989, no. 4, item 22) The former allowed creation of new private commercial banks. The latter laid foundations for the creation of the National Bank of Poland (Poland’s central bank).

## **OWNERSHIP TRANSFORMATION IN POLAND**

In order to better understand the privatization process, one needs to revisit the political and economic changes taking shape after World War II. Due to the communist takeover of the country in the second half of the 1940s, public (state) ownership of assets became the principal form of property ownership due to nationalization acts, e.g. the Act on Nationalization of Fundamental Branches of National Economy of 3 January 1946 (Journal of Laws of 1946, no. 3, item 17). By the 1960s Poland had become a folly-fledged socialist economy. The economic system rested on two tenets: a centrally-planned economy and public ownership of productive assets. [Although (very) small private ownership did flourish in the 1970s and 1980s.] For more on the institution of ownership in Poland after 1945 (Sitek, 2013, Nr 1/16/2013 Journal of Modern Science, p. 147–165). The foundation for private enterprises was created by the following legal acts: (a) the Act on Manufacturing and Organization of Crafts of 8 June 1972, Journal of Laws of 1972, no. 23, item 164), (b) the Act on Small Manufacturing of 31 January 1985 (Journal of Laws of 1985, no. 3, item 11), (c) the Act on the Principles of Commercial Activity in the Form of Small Manufacturing by Foreign Legal and Natural Persons on the Territory of the People’s Republic

of Poland of 6 July 1982 (Journal of Laws of 1982, no. 19, item 146), it could not hope to significantly change the overall character of the economy. In consequence, the transformation processes of the early 1990s had to introduce freedom of commercial activity, and to privatize state assets. A further impetus to this process was given by the Poland's Accession Agreement to the EU of 1991, which explicitly required that Poland become a market economy. When Poland became a member of the EU on 1 May 2004, it explicitly agreed that the State's participation in the economy should not exceed 20%. It was further assumed that by the end of 2006 Poland should reach the ownership structure of the economy close to that of the EU countries where state ownership generally ranges from 10% to 20%. This goal was not reached until 2007. The ownership transformation in Poland can be seen in a broader context of privatization programs conducted in a majority of European countries beginning in the early 1980s. These programs have frequently led to extreme social tensions due to their size, industries concerned, and methods employed [for more on this topic see: (Privatization Experiences in the European Union) edited by Marko Köthenbürger, Hans-Werner Sinn, John Whalley, 2006].

### **State-owned enterprises**

The privatization process dealt primarily with state-owned enterprises. As discussed below at present, state-owned enterprises no longer presently exist in the "old" form (there have been "commercialized" in the sense explained below, although the state still retains 100% ownership), but more detail is provided here to better describe the privatization starting point.

In accordance with the Act on State-owned Enterprises of 1981 (Journal of Laws of 2002, no. 112, item 981, as amended), a state enterprise is an autonomous, self-governed, and self-financed enterprise which is also a legal person (Kosikowski, 1991, p. 215–220; A. Walaszek-Pyziół, 1984, p. 103). These three qualities are the basis on which state-owned enterprises have functioned. Until 1981 (that is until the Act was passed), state enterprises had been dependent on the government, which directed all their decisions. Subsequently their internal decision authorities independently managed and organized activity in all matters in accordance with legal regulations. State-owned enterprises were classified into:

enterprises operating in accordance with general principles and public utilities (defined by their function to provide certain services in an uninterrupted manner) (see Bieniek, 1997). The regulations of the Act on state enterprises applied to state-owned enterprises operating according to general principles, and it is those enterprises that will be described in more detail.

### **Founding entities**

State-owned enterprises were created by supreme and central organs of public (government) administration, the National Bank of Poland, and national banks. These entities have been called the “founding entities”. The founding entities had to promulgate an act on establishing a state enterprise, which specified its name, type (whether this is an enterprise operating according to general principles or a public utility), seat, and scope of activity. The statute of such an enterprise governed its organizational structure and other matters as set forth by the Act on state enterprises of 1981. The statute was then approved by a general meeting of workers at the motion of the state enterprise’s director. A state enterprise became a legal person upon entry into the Domestic Court Register („Krajowy Rejestr Sądowy”). A state enterprise’s statutory organs included: the general meeting of workers, the workers’ council, the state enterprise’s director.

A legal analysis of Polish ownership transformation would be incomplete without an analysis of key legal regulations underlying that process. Naturally these regulations have evolved, and have been customized to the needs of the privatization process. It is therefore incumbent upon us to discuss these key regulations, fundamental terms and methods employed by them, and their development. (The legal foundations for the privatization process were established in the 1990s).

### **Legal basis for privatization**

The privatization process of state-owned enterprises, with the exception of state farms, has been conducted on the basis of the following acts:

- a) In spite of numerous amendments, the basic privatization framework is still set forth in the Act on commercialization and privatization of 30 August 1996 (Journal of Laws No. 118, item 561; uniform wording in

Journal of Laws No. 2013, item 216) as amended. (See more: B. Kozłowska-Chyła, 1997, "Przegląd Prawa Handlowego" 1997, Nr 6; Katner, 2003, p. 26; Bieniek, 1997, cz. I, "Praca i Zabezpieczenie Społeczne", Nr 6).

This act amended the Act on privatization of state-owned enterprises of 13 July 1990.

Between 1990 and 1996, the Act on privatization of state-owned enterprises of 1990 had been amended six times. Nevertheless, this Act has never been subject to an ex ante or ex post evaluation as to what results it will bring or has brought about. When the Acts of 1990 and 1996 were passed, new regulations were not assessed for their impact on the country and the economy. This has led to unanticipated short-term and long-term consequences (see: Brzęk 2013, Nr 1/16/2013 „Journal of Modern Science”, p. 239–258). It appears that the overriding goal of the government was to privatize and create a competitive economy based on private assets, seemingly without due consideration as to the social and economic consequences in the long term.

Nevertheless both lawyers and economists have been very critical of these regulations claiming that it opened the door to sale of state assets below their intrinsic value. Critical voices regarding privatization valuations and methods appeared as early as 1990s, but they are more and more frequent today among contemporary commentators of the Polish ownership transformation. (Ona. Za kulisami Trzeciej RP., 2014) – an opinion of J.K. Bielecki, – an opinion of J. Olszewski. Even Leszek Balcerowicz, the main architect of the economic transformation, confirmed negative impact of privatization scandals on the evaluation of the overall process and pace of legislative works (Ona. Za kulisami Trzeciej RP 2014 – an opinion of L. Balcerowicz).

The Act on commercialization and privatization of 30 August 1996 has so far been amended 50 times (until 2014), which resulted in changes to tens of executive acts detailing privatization means and methods. The remaining part of the paper will discuss in more detail the most popular privatization methods:

- b) the Act on state-owned enterprises of 25 September 1981 (Journal of Laws No. 18, item 80 published in 1991) as amended.
- c) the Act on national investment funds and their privatization of 30 April 1993 (Journal of Laws No. 44, item 202) as amended.



## Definition of privatization

The fundamental term which needs clarifying is „privatization”. In addition to its common, everyday use, “privatization” is a well-defined legal term indispensable to any discussion of the process. Article 1.(2) the Act on Commercialization and Privatization uniform wording in Journal of Laws No. 2013, item 216 as amended, sets forth the following definition of privatization: “Privatization, within the meaning of this Act, shall consist of:

1)2) taking up shares in increased initial capital of sole shareholder companies of the State Treasury, established as a result of commercialization, by subjects other than the State Treasury or other State legal persons within the meaning of the Act of 8 August 1996 on the rules of exercising the powers of the State Treasury;

1a)3) transferring shares held by the State Treasury in companies;

2) a disposal of all material and non-material component assets of a State enterprise or a company established as a result of commercialization in accordance with the principles specified by this Act in one of the three forms: a sale of the enterprise, a contribution of an enterprise to the company, giving an enterprise to be used for a consideration”.

In accordance with articles 2(b) and 2(c) of the Act on Commercialization and Privatization, privatization proceedings are documented in a privatization “card”, which contains inter alia information about the parties in the process, their obligations and fulfillment of those obligations.

The legal interests of the State Treasury in privatization proceedings are guarded by the State Treasury Solicitors’ Office.

## Privatization methods

The above-mentioned laws give rise to three principal privatization methods (M. Bałtowski, 1998):

1. an **indirect privatization** consisting of two stages: an initial stage called “commercialization”, which is followed by the privatization proper. (See: Bandarzewski, 2003, p. 431–433; Walaszek-Pyziół, 1997, p. 527). The author is critical of the term commercialization in the Polish regulations. The Polish term “commercialization” corresponds

to the term “corporatization” in other systems. Commercialization may mean either:

- (a) a transformation of an enterprise into a company where the State Treasury is the only shareholder (such a company is called a “one-shareholder company of the State Treasury”) (See: Baehr, 1992 “Ruch Prawniczy, Ekonomiczny i Socjologiczny”, z. 1, p. 1–3; Adamski, “Prawo Spółek” 1999, Nr 11).

This is done so that for instance in an indirect and capital privatization these shares can be contributed to a national investment fund until 30 April 2004. Commercialization also means a transformation of an enterprise into a company owned by (previous) debtors whose debts were converted into shares (a type of debt-for-equity conversion);

2. a **direct privatization**;

3. **liquidation** of an enterprise because of economic reasons (Bieniek, 1992, PiZS, Nr 2) We will not be discussing the liquidation method further in this article.

### **Indirect privatization**

State-owned enterprises were converted into joint stock companies (spółka akcyjna) or limited liability companies (spółka z o.o.) at the request of the enterprise director and the workers’ council, its founding organ, or at the initiative of the Ministry of the State Treasury (in the process called “commercialization”).

Once such a company was created and until privatization proper took place, the State Treasury took over 100% of the shares. Further, the company assumed all rights and obligations of the state-owned enterprise, and from the conversion date operated pursuant to the provisions of the Commercial Companies Code (Kodeks Spółek Handlowych) and the Act on commercialization and privatization of 1996. The Minister of the State Treasury represents the State Treasury as the only shareholder of the company at a general shareholders’ meeting. Stage two of the indirect method, i.e. the privatization proper concerns a public sale of shares in newly created companies by the State Treasury. The prospective investors may be selected through the following methods: publicly announced offer, public tender, negotiations undertaken on the basis of a public invitation, acceptance of an offer in response to a call announced on

the basis of the Act on Public Offering, Terms and Conditions of Trading of Financial Instruments and Public Companies of 29 July 2005 (Journal of Laws No. 184, item 1539, as amended), publicly announced auction, sale of shares on regulated market, public offering, subsidiary stabilization, selling shares outside organized trading (The Ordinance of the Council of Ministers of 30 May 2011 on detailed procedure for transfer of shares owned by the State Treasury; Art. 33 par. 1 of the Act on Commercialization and Privatization).

A disposal of shares by any method other than those already mentioned in the Act is possible only after a consent of the Ministers' Council. Specific regulations for this are set forth in the Act on Commercialization and Privatization and the Commercial Companies Code.

Naturally a detailed analysis and valuation of the company is made before an announcement to sell its shares. Both are performed in accordance with the Ordinance of the Council of Ministers of 14 December 2004 on detailed procedure for sale of the enterprise (Journal of Laws No. 277, item 2744).

It is also possible to alienate the shares belonging to the Treasury otherwise than by the public procedure referred to in Article 33(1) of the Act, without applying for an approval of the Council of Ministers, if the buyer and the price are specified in a privatization agreement, and the subject of transaction are shares of companies, where the Treasury owns less than 50% of the share capital or if the subject of transaction are shares owned by the Treasury, constituting less than 25% of the share capital (Art. 33 par. 5 of the Act on Commercialization and Privatization).

The following methods have been most frequently used since 1991 in the second stage of indirect privatization (i.e. privatization proper):

### **A public offer**

As the name indicates public offers of the State Treasury are flotations of shares on the Warsaw Stock Exchange. Before a company is admitted to public trading, it must satisfy requirements imposed by the Polish Securities and Exchange Commission (and all other relevant regulations). They concern for instance a minimum size of the company, its value, financial track record, business prospects. Complete information is prepared by an independent

adviser or advisers and published in the form of an IPO prospectus. The sale is preceded by a promotional campaign in the press, on the radio and television, and “road shows” addressed to institutional investors and their advisers. A share sale takes place through a procedure set forth in the Ordinance of the Council of Ministers of 14 December 2004 on detailed procedure for sale of the enterprise (Journal of Laws No. 277, item 2744).

The offer to sell the shares (owned by the State Treasury) contains detailed information about the company, the period during which the offer is valid, the place where written declaration on acceptance of the offer should be submitted, and the amount of the required (initial) deposit.

In certain situations the State Treasury decides to sell some of the shares to retail investors, some to institutional investors (for instance banks or investment funds), and retains some of the shares to be later sold to a strategic investor.

There are clear advantages to the public offer method of privatization. Chief among those are increased recognition of the company and its products (due to a marketing campaign), increased credibility in the eyes of clients and banks (due to a detailed due diligence process the company underwent pre-IPO – Initial Public Offering), and the potential to obtain future funding via issuance of shares. A clear political gain is also participation of retail investors (often at a discount to offer price), who by purchase of financial assets become directly involved in the privatization process. One should also note that through this method of privatization employees of the subject company receive for free up to 15% of all shares. Following a two year lock-up period, they can then sell the shares.

### **A public tender**

A public tender is a public invitation to investors accepted (or pre-qualified) by the State Treasury to make an offer for a significant stake in a state company. The tender offer announcement specifies (among others): the smallest number of shares which an investor must purchase, the minimum price per share, the minimum committed future investment (capital expenditures) in the company, social/employment commitments and the period when the investor is bound by the offer. (Announcements of this kind are usually published on a monthly basis, on a Friday, in newspapers with a nationwide circulation).

Within a specified time frame, potential buyers submit information about them selves, make an initial deposit, and receive written information about the company. Subsequently, in a sealed envelope they make a bid conforming to the criteria set forth in the public tender announcement. After the bid submission deadline has passed, a commission appointed by the Minister of the State Treasury opens all the envelopes, evaluates the offers vis-à-vis the announced criteria, and indicates the buyer with the best offer. The Treasury Minister may desist from the tender without making the final choice, but he may not indicate a buyer different from that selected by the commission.

The sale agreement is signed by the Minister of the Treasury. If the (finally selected) purchaser withdraws, he foregoes (loses) the initial deposit. This privatization method was introduced in 1996. Its primary limitation is the fact that it applies only to small- or medium-sized companies or those with relatively uncomplicated organizational structures.

### **Negotiations undertaken on the basis of a public invitation**

An invitation to negotiations should contain in particular data concerning the subject company; the legal basis for the disposal of shares; the number and type of shares to be sold, their nominal value; what is subject to the negotiations, deadline for and the place in which to submit an answer to the invitation. The subject of negotiations with a potential buyer is the number of shares, the price, payment terms, investment commitment (that is future capital expenditures), and the “social package”.

This method has usually been used to privatize medium-sized or large companies, whose controlling stakes should be sold to qualified strategic investors, both domestic and international. Examples of companies privatized this way in Poland so far include: breweries, household chemistry producers, pharmaceutical companies, sugar producers, some light industry, etc.

Potential investors are invited to individual negotiations on the basis of announcements published by the Ministry of Treasury in newspapers of nationwide circulation. However, before such an announcement is made, the Ministry usually commissions (to external advisers) a legal and economic analysis of the company. Frequently, a strategic analysis of the whole industry is

also performed taking into consideration individual product markets in which the company competes (both domestic and foreign).

The negotiation process itself is conducted by privatization advisers to the Ministry. As already mentioned it concerns the number of shares to be sold, their price, payment terms, future investment commitment, “social package” for the employees, and potentially other issues.

In case of a large number of interested investors, their number is reduced to two or three after preliminary negotiations. It is not unusual for the final negotiations to last a year or more. During the talks, representatives of the Ministry or their advisers do not inform third parties about potential investors or the status of the negotiations. Certain information may be made public but only after the sale agreement has been signed and only to the extent agreed upon with the buyer.

### **Acceptance of an offer in response to a call**

This method concerns a sale of shares in public companies belonging to the State Treasury without the necessity for the State Treasury to announce a public offer. This method was changed in 2005 and is governed by a new regulation: the Act on Public Offering, Terms and Conditions of Trading of Financial Instruments and Public Companies of 29 July 2005 Journal of Laws of 2005, no. 184, item 1539. As such it has not been particularly tested, the rules are relatively complex, and it applies to a limited number of companies.

Based on the above-mentioned methods, the Polish government privatized, among others, the banking sector, pharmaceutical industry, shipyards, and sugar producers. In the view of current commentators, more focus should have been placed on and support given to domestic (Polish) capital. They are especially critical of privatization of dynamically growing sectors whose economic situation was good, such as banking. According to J.K. Bielecki two of the Polish biggest banks, Bank Handlowy i PeKaO S.A, should have been merged, and „we should not have rushed with the privatization via foreign capital”; especially, since these two banks had deposits belonging predominantly to Polish citizens (Ona. Za kulisami Trzeciej RP 2014, p. 27). Privatization of banking sectors in other European countries, most notably in Iceland, also drew broad criticism. The Iceland banking sector privatization has been judged by economists to

be one of the root causes of the financial crisis in that country (for more see: Kowalczyk, Nr 1/16/2013 „Journal of Modern Science”, p. 353–371).

The most troublesome to privatize were Polish shipyards: At the beginning of the 1990s they were fairly modern, competitive enterprises. However, lack of strategic vision and loss of the main client (Russia) eventually led to their downfall and liquidation (Ona. Za kulisami Trzeciej RP – an interview with J. Olszewski, 2014, p. 141–142).

### **Direct privatization**

The principal assumption behind direct privatization is creation of a fast track ownership change in small- and medium-sized state-owned enterprises. Direct privatization can take one of the following forms: an outright sale; contribution of an enterprise to a company; use of an enterprise by a company against payment (an enterprise is understood here to mean a collection of tangible and intangible assets as defined by Article 55<sup>1</sup> of the Polish Civil Code).

Investors involved in the direct privatization process may be both private (physical) and legal persons.

The preparation and execution stages of direct privatization are decentralized. A distinctive feature of the direct privatization method is the fact that it is executed by founding organs of state-owned enterprises (16 Heads of Provinces) upon consent by the Minister of the State Treasury. At the beginning of 2002, the Minister of Treasury authorized Heads of Representative Offices of the Treasury Ministry in the provinces to issue in his name consents to direct privatizations of state-owned enterprises supervised by the Heads of Provinces. The Heads of Provinces are empowered to begin the process of direct privatization, prepare a state-owned enterprise for privatization, select investors, determine terms and conditions of the sale, and after receiving consent of the Ministry finalize the privatization process, and sign (on behalf of the State Treasury) all relevant agreements with the investor. Direct privatization is conducted taking into account obligation of the company with respect to employees (maintaining a certain employment level and providing certain social guarantees) and future investment (e.g. environmentally friendly production processes).

### **Sale of an enterprise**

This form of privatization may be applied to all enterprises, but is especially recommended in cases of enterprises weaker economically, which require substantial investment (Article 48 of the Act on Commercialization and Privatization). The sale may take the form of an installment sale. According to the Act on Commercialization and Privatization, the first installment must be at least 20% of the purchase price. The remaining amount (with interest) must be paid over a period of not more than 5 years.

### **Contribution of an enterprise into a company**

The second form of direct privatization is contribution of an enterprise into a company (Article 48 of the Act on Commercialization and Privatization). The State Treasury makes a contribution in kind to the (new) company in the form of an enterprise and receives in exchange a certain number of shares. This form of privatization may have a wider use for small- and medium-sized state enterprises requiring substantial capital infusion (including investment in fixed assets) and ensures that the company is run by credible domestic or foreign strategic investors. Employees may also become shareholders in the new company.

### **Use of an enterprise by a company against payment**

In the case of a use of an enterprise against payment (Articles 51–53 of the Act on Commercialization and Privatization), the law narrows down (limits) the group of potential users by clear preference for stock companies whose shareholders are domestic physical persons (including employees of the given state-owned enterprise). The agreement for use of an enterprise may be concluded for a term of not more than 15 years. If the company fulfills the conditions imposed by the Act, it may take over the enterprise without following a public procedure. The use against payment (as the name indicates) requires regular payments (principal and interest) to the State Treasury as set forth in the Ordinance of the Council of Ministers of 14 December 2004 on terms of payment for amounts due on the use of the enterprise (Journal of Laws of 2004, no. 269, item 2667).

Payment amounts depend on the value of the enterprise and duration of the use agreement. However, they are rather substantial and therefore this method



should really only be used (a) for enterprises of good financial standing; and (b) once the user-company has satisfied several conditions (certain amount of initial capital needs to be collected, the capital structure must be appropriate, a good business model worked out, etc.), which will ensure a timely settlement of all liabilities, including those to the State Treasury. In particular, this method of privatization is unlikely to be used in the case of cyclical businesses whose ongoing operations significantly depend on external financing (bank credit). Further, use of an enterprise against payment by a company with employee participation (as shareholders) frequently does not guarantee sufficient capital for investment and business development. Therefore the Act introduces a condition whereby at least 20% of equity of the company with employee participation be contributed by (physical) persons unemployed by the subject company, that is by “outside” investors. These outside equity investors may be either passive or active (from the managerial perspective).

Both economists and lawyers have expressed reservations and doubts regarding on the one hand valuations of privatized companies, and on the other hand, regulations dealing with such valuations (see Ona. Za kulisami Trzeciej RP, 2014). At the beginning, in 1991, the government relied predominantly on experts of foreign consulting companies, who were not familiar with post-socialist economies, especially the Polish market, and learned “on the job”. This inexperience led to numerous errors and undervaluations.

## USE OF PRIVATIZATION PROCEEDS

The privatization policy and its proceeds are part of an annual national budget and subject to Art. 146, paragraph 4.1. of the Polish Constitution of 1997 charging individual Ministers with the responsibility to implement provisions of particular acts.

Under the current law, revenues from privatization are allocated as follows:

- Company Restructuring Fund – 15% of obtained privatization proceeds and the interest on these funds (Article 56 section 1 point 2 of the Act on Commercialization and Privatization),
- Re-privatization Fund – resources coming from sale of 5% of shares held by the Treasury in each of the companies formed as a result of

commercialization and the interest on these funds (Article 56 section 1 point 1 of the Act on Commercialization and Privatization),

- Treasury Fund – 2% obtained privatization proceeds and the interest on these funds (Article 56 section 1 point 3 of the Act on Commercialization and Privatization),
- Polish Science and Technology Fund – 2% of obtained gross privatization proceeds and the interest on these funds (Article 56 section 1 point 4 of the Act on Commercialization and Privatization),
- Demographic Reserve Fund – 40% of total gross privatization proceeds less the amount of obligatory write-offs for the Re-privatization Fund Reserve (Article 58 section 2 point 2 of the Act of 13 October 1998 on Social Insurance System),
- separate account of the minister responsible for matters pertaining to labor – reserve for the purposes of fighting unemployment (Article 56 section 3 of the Act on Commercialization and Privatization),
- restructuring the defense industry and technical modernization of the Polish Armed Forces (Article 8 of the Act of 7 October 1999 on Promotion of the Restructuring of the Defense Industry and Technical Modernization of the Polish Armed Forces),
- write-off to meet the claims under the sureties and guarantees granted by the Treasury (Article 25a of the Act of 8 May 1997 on Sureties and Guarantees granted by the State Treasury and by Certain Legal Persons).

The remaining funds are transferred to the state budget.

Opinions on the use of privatization proceeds have generally tended to be critical. The funds raised via privatization have either been “consumed or transferred abroad” (Ona. Za kulisami Trzeciej RP, 2014 – an opinion of J. Staniszkis, p. 87). They should have been used for purchase of import technologies, stimulation of innovations in the economy, and creation of new technologies; instead they have been almost exclusively designated for use by the state budget and the national social insurance scheme.

## SUMMARY AND CONCLUSION

The ownership transformation process initiated in the 1990s is slowly winding down. This is well underlined by statistical data: Of the **8453** state-owned enterprises in existence as of 31/12/1990 (Statistical Bulletin no. 11, Central Statistics Office (GUS), Warsaw 1991, p. 57) **6000** were subject to some form of ownership transformation between 1/08/1990 and 31/12/2013. As of year-end 2013, there were only **61** state-owned enterprises still in existence, including 21 entities which conducted any business activity (*Ocena przebiegu prywatyzacji majątku Skarbu Państwa w 2013 roku*, <http://prywatyzacja.msp.gov.pl/pr/ocena-przebiegu-prywat.> – dostęp: 20.08.2014).

Therefore it may be concluded that Poland's obligation towards the EU to reduce the state's participation in the economy has been fulfilled. Based on this analysis, it is also fair to say that the privatization process has been conducted reasonably well, not least in terms of privatization proceeds achieved during the period. Once again it should be noted that the Polish privatization in term of scale and scope was unique worldwide, and some difficulties resulted just from its size. The first privatization period between 1990 and 1996 was also the most difficult both for the society at large (in many respects) and for the lawmakers. Over the years state enterprises subject to ownership transformation lobbied strongly to amend regulations to better reflect their new needs and challenges. In this light the privatization period after 1996, i.e. under the Act on commercialization and privatization, deserves higher marks (as compared to the earlier period). Building on earlier experiences, a new legal framework was set forth in acts, ordinances, and implementing regulations to enable a better-controlled and more effective privatization process.

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