The Portuguese Privatisation Programme

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1. Introduction

In order to reduce the public deficit below the 3% limit required by the European Union, Portugal expects to raise approximately €6 billion with the privatisation of several State owned companies.

In this study we review some legal aspects of the Portuguese privatisation programme and provide an update on privatisations scheduled to take place in 2012 and 2013.

In May 2011, the Portuguese Government negotiated with the International Monetary Fund (**IMF**), the European Commission **(EC)** and the European Central Bank (**ECB**) a €78 billion bail-out programme containing measures to bring the Portuguese deficit below the 3% limit by 2013 (the **Bail-Out Programme**).

Pursuant to the Bail-Out Programme, Portugal will implement measures in several areas, such as financial sector regulation and supervision, public private partnerships, labour market, housing market, judicial system (insolvency proceedings) and competition, public procurement and business environment.

In addition to several structural reforms, Portugal agreed in the Bail-Out Programme to undertake an aggressive privatisation programme involving seventeen companies, nine of which are presently fully owned by the State.

In 2011, the Portuguese Government successfully completed the privatisation of EDP – Energias de Portugal, S.A. (**EDP**) and REN – Redes Energéticas Nacionais, S.A. (**REN**) for a total of €3.2 billion.

As agreed in the Bail-Out Programme, the Government is now preparing the privatisations scheduled for 2012, which include, among others, the airport management company, ANA, and the airline company, TAP.

The Government estimates that the revenues of the Portuguese privatisation programme will reach approximately €6 billion.

2. The regulatory framework

Law 11/90 of 5 April 1990, as amended by Law 50/2011, of 13 September 2011, establishes the legal framework for all privatisations (the **Privatisation Law**).

Article 1 states that the Privatisation Law is applicable to companies that went through a nationalisation process following the Revolution of 25 April 1974.

Although the Privatisation Law does not expressly refer to other State-owned companies, all privatisations have followed the procedures set out in the Privatisation Law since 1989, including companies that were held by the State before 1974.

Under article 4 of the Privatisation Law, as a condition for the privatisation, the public undertaking must be transformed in a public limited liability company through a decree-law enacted by the Government. Such decree-law will also approve the company's new articles of association. The new company will be ruled by private law and it will succeed in all rights and obligations of the former public undertaking (section 3 of article 4 of the Privatisation Law).

In other words, any debts of the former public undertaking must be transferred to the new company. This bears some importance regarding loan agreements since the new company is no longer ruled by Decree-Law 558/99, of 17 December 1999, which approved the rules regarding the relations between public undertakings and the State.

Under the Portuguese Companies Code (*Código das Sociedades Comerciais*), the company's liability is limited to its share capital, while State-owned companies may not have statutory capital.

During the procedures leading to the transformation of a public undertaking, the companies' assets should be separated from the State's assets, together with a precise definition of the relations between the State and the company.

In most cases, the company and the State will enter into a concession agreement, under which the company will render public services and the State will pay a compensation for the provision of such services.

As far as big industrial companies are concerned, such agreements should be entered before the beginning of the privatisation procedure. The concession agreements are subject to Portuguese and European competition rules.

3. Privatisation methods

3.1. Overview

Under article 6 of the Privatisation Law, a company can be privatised through two procedures:

(a) Selling of shares; and/or

(b) Share capital increase.

The previous procedures may follow one of four different methods:

(a) Public tender;

(b) Direct negotiation;

(c) Initial public offer; or

(d) Public subscription.

The Government will choose the method that it finds appropriate considering some issues, *e.g.* the shares to be sold, the revenue it wishes to obtain, the convenience or the need of a foreign participation regarding the importance of the sector involved or the advantages of maintaining a measure of State control over the company.

3.2. Public tender

The Government sets the requirements, including the financial conditions that the candidates should meet to acquire the company's shares.

Under section 3 of article 6 of the Privatisation Law, the Government may set a limited public tender should the national interest, the strategy previously defined for the sector or the financial situation of the company requires it.

Since limited public tender is an exceptional method, the choice has to be justified. Under section 4 of article 6 of the Privatisation Law, the shares will be nominative shares.

3.3. Direct negotiation

Direct negotiation is an exceptional method which operates under the same conditions of the limited public tender by governmental decision (section 3 b) of article 6 of the Privatisation Law). Section 4 of article 6 of the Privatisation Law is also applicable.

This method allows the Government to keep more control over the final ownership of the company, by selling a small share of the company's capital, and also to choose who will acquire the majority of the company's shares, thereby selecting a strategic partner.

We may, however, question its legality under European competition rules: negotiations with private undertakings may be subject to prior approval by the European Commission, and some of the early privatisations did not follow this procedure.

3.4. Initial public offer (IPO)

IPOs are often chosen by the Government, especially when profitable and well-structured companies are involved.

Together with the dispersion of the capital, small investors and employees of the company are given special conditions and price discounts in the purchase of shares.

The greatest advantage of resorting to IPOs is the possibility of obtaining high revenues while retaining the strategic control of the company. The Government may control the management of the company with shareholdings of less than 50% if the company's shares are dispersed among several shareholders.

Although some issues may arise for the Government regarding the information obligations, IPOs are the most transparent method of privatisation, as both the Government and the company are responsible under the Portuguese Securities Code (*Código dos Valores Mobiliários*) for any misrepresentations.

However, there are some risks that should be considered: the volatility of the international capital markets, as well as the overrating of the company, may lead to a significant drop in the company's market value during the listing period.

3.5. Public offer of subscription in share capital increases

The public subscription of share capital increase has known very little use so far since the main goal of the privatisation programme is the reduction of the Government's debt.

Nevertheless, this method may be useful when the State's main concern is the restructuring of the company, because it allows the choice of strategic partners and the company may benefit from the revenues of the sale.

This method could be advisable for the partial privatisation of companies in need of large investments, such as rail and road transportation companies.

4. The new privatisation programme

The Portuguese privatisation programme includes companies of the banking, energy, transportation and postal service sectors.

The Bail-Out Programme sets out the full privatisation of the following companies:

(a) Banco Português de Negócios (**BPN**) (100%) (bank);

(b) Caixa Seguros (100%) (insurance);

(c) EDP (21,35%) (power generation and distribution);

(d) REN (51%) (operator of the power grid);

(e) Hidroeléctrica de Cahora Bassa, S.A. (15.00%) (power);

(f) ANA (100%) (airport operator);

(g) TAP (100%) (air carrier);

(h) INAPA – Investimentos, Participações e Gestão, S.A. (32.7%) (paper);

(i) Edisoft (30%) and EID (38.57%) (defense);

(j) Empordef TI (100%) (defense);

(k) CTT – Correios de Portugal, S.A. (100%) (postal services);

(l) Sociedade Portuguesa de Empreendimentos SPE, S.A. (81.1%) (mining);

(m) Estaleiros Navais de Viana do Castelo (100%) (ship builder);

(n) CP – Carga, S.A. (100%) (rail freight transport); and

(o) EMEF – Empresa de Manutenção e de Equipamento Ferroviário, S.A. (100%) (rail maintenance).

On the banking side, after the unsuccessful attempt to privatise BPN in 2010, the Government sold the bank on an accelerated schedule and without a minimum price to BIC for €40 million.

On the energy sector, the Government sold its stake (21.35%) in EDP to China Three Gorges for €2.69 billion and two stakes (25% and 15%) in REN to State Grid and Oman Oil for a total of €600 million. In addition, the Government sold a 7.5% stake in Cahora Bassa to REN for €38.04 million and the remaining 7.5% to the Mozambique State for €35.6 million.

These privatisations were carried out by direct negotiation, in some cases after a preliminary procedure for gathering investment intentions from potential investors.

5. Legal issues surrounding Portuguese privatisations

The Privatisation Law excluded from full privatisation the public undertakings which operated in any of the sectors governed by Decree-Law 88-A/97, of 25 July 1997 (the **Sectors Law**).

Under the Sectors Law, only State-owned companies can operate in certain regulated sectors such as the distribution of water, operation of seaports or telecommunications.

In 1989, when the privatisation programme was initiated, certain sectors had already been liberalised, *e.g.* banking and insurance, through Decree-Law 406/83, of 19 November 1983.

The Government also privatised State companies that operated monopolies while it opened up those markets to international and local competitors, *e.g* in the energy and telecommunications sectors.

In order to keep control over partially privatised companies before full liberalisation took place, the Government retained majority shareholdings and created "golden shares" that allowed it to maintain influence over newly privatised companies such as Portugal Telecom, EDP and Galp. This strategy also enabled the State to increase revenues from privatisations through the dispersion of the partially-privatised companies' capital.

Following several disputes with the European Commission, the Portuguese Government agreed to eliminate the existing golden shares in Portugal Telecom, Galp and EDP.

Future privatisations will not include golden shares but there will be cases where the Government will impose sale restrictions and other commitments to ensure that the company will maintain its headquarters and main operations in Portugal. This is particularly important in the privatisation of the air carrier TAP.

6. Lessons to be learned from previous privatisations

Past privatisation case studies enable us to draw some conclusions as to the best privatisation strategies.

The main conclusion is that the interests of the State, of the company and of the private shareholders should be adjusted.

Generally, the first step towards privatisation is the reorganisation and regulation of the sector where the company operates which is followed by the definition of the relations between the State and the company to be privatised. Such definition is usually made through the entry into concession agreements for the provision of public services before the privatisation takes place.

Simultaneously, the company's assets must be separated from the State's assets. The ownership of the assets belonging to the public domain that will be managed by the company to be privatised should be defined in the concession agreement.

It is likely that before privatising companies in the public transports sector – *e.g.* railways and air transportation (CP and TAP) and the postal and telecommunications sector (CTT) – the Government will regulate the sector before the privatisation takes place. As part of the new regulation, the Government will need to define the scope of the public service that will be provided as well as the compensation to be paid by the State.

The next step will be the choice of the privatisation method for those cases where such choice has not been taken. In this respect, the Government will consider both the revenues to obtain and the company's business strategy.

In general, public offerings are the most transparent method of privatisation but public tender offers have the advantage of allowing the Government to have a say on the choice of the buyer, which may be important when the Government is to loose the control of important State assets.

While public tenders and initial public offers seem to be the best choice for partial privatisations in normal circumstances, in the most recent privatisations the direct negotiation method has been the preferred method to facilitate the attraction of foreign investors that are interested in making long term investments in acquiring controlling stakes or, at least, large stakes that can influence the future of the privatised companies and leverage their national and international business.

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