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Ownership Transformations in Poland: Implications for Foreign Investors

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■ Introduction

Depending on the pace of privatisation in Poland a major proportion of 8,441 state owned enterprises (SOEs) which existed in 1990 will be privatised in the 1990s.[2] This plan, currently involving 2334 SOEs, has been the legacy left to a new social-democratic government standing now behind the development of a juridical framework for the transition to a market economy in Poland. The plan should attract foreign investors to that country, but also offer them a strategic foothold for a possible expansion of markets to the Commonwealth of Independent States, while significantly reducing investment risk.

This article reviews three basic legal processes at work in ownership transformation, especially insofar as they have implications to foreign investments in Poland: re-privatisation, privatisation through liquidation and privatisation through commercialisation.

■ Re-privatisation

In transition from a centrally planned to a market type of economy lies the issue of re-privatisation of property nationalised by the State after the Second World War. Current privatisation depends partly on re-privatisation, as some of the state owned enterprises and real estate were owned privately before that war. Owners of that time have to seek a legal title to re-claim their property which otherwise will or may have been sold to new owners and thus cause conflicts in the validity of legal titles of private ownership.

By mid-1993, 3,972 re-privatisation claims had been submitted to the Ministry of Ownership Transformations and about 100,000 to the regional administrative authorities. Estimates suggest that re-privatisation claims vary between Plz 16,25 billion (about US$80 million at the current exchange rate) and Plz 250 billion (about US$135 million).[3] Only a fraction of those claims (298) were sent from abroad, but the number may increase as the law is finally enacted. The draft law, work on which started three years ago, has the title 'On the satisfaction and recovery of property' and will, hopefully, be enacted by the Polish parliament, and then signed by the President.

Other than excluding the question of real estate in the capital city Warsaw (left for a separate regulation), the draft law addresses comprehensively the question of expropriation, including expropriation of real estate earmarked for public purposes in war time.[4] The expropriated owners may claim recovery of their agricultural property. The parliament will decide whether there will be limits on the maximum size of land (eg up to 100 ha and forrests up to 25 ha) or not. Recovery includes buildings, however the Ministry of Culture lists historical monuments as being excluded from re-privatisation.

All adult Polish citizens will have the right to re-claim their property, even those who did not have citizenship at the time of confiscation of their property but obtained it later on the basis of the 1946 law concerning applicants living in the so-called 'regained territories' in Western Poland, as a consequence of the Second World War. All the applicants, including foreign ones, will most probably have to have permanent residence in Poland. Applicants without Polish citizenship would have to apply for it and take residence in Poland before the deadline for submission of re-privatisation claims.

The property would be returned in the following order: first, in nature, then as a substitution and, finally, as a non-taxable and interest free re-privatisation coupon. The coupon would entitle purchase of shares sold by the State Treasury or SOEs in liquidation; purchase of farming land owned by the State Treasury, forests and other real estate.[5]

In general, claims would be processed in an administrative way. The head of regional administration (voivod) in whose area the applicant seeking compensation for lost real estate in former Eastern territories lives or where the real estate is located, would be authorised to take decisions on the claims. It is proposed that such a decision will be taken in two instances: first, as a preliminary act determining existence of the right to claim (it may be appealed to the Minister of Ownership Transformations), and, secondly, as a final decision.

The deadline for applications would be six months from the time of the entering of the reprivatisation law into force.

From all of the above, and particularly because of the proposed limitation of the right to regain property in nature, it is clear that the draft law approaches re-privatisation in a way that secures the viability of existing investment infrastructure (Polish and foreign) and thus is supportive, on the one hand, of the idea of '*Wiedergutmachung*' and, on the other hand, of making future investments in Poland.

■ Privatisation through liquidation

Against this background, and as was the case in most Eastern European countries, privatisation has started with changing the legal status of around 5,500 small enterprises with the average number of 360 employees. Possibilities for their legal transformation were provided for in the amended Law on Bankruptcy (Journal of Laws of 1990, No 14, pos 87) and, especially, in the Law on Privatisation of State Enterprises of 13 July 1990 (Journal of Laws No 51, item 298 with later amendments) in conjunction with other Acts, especially the much amended State Enterprises Act of 25 September 1981. These possibilities involve either liquidation of enterprises or their transformation into enterprises with capital funds. In both cases this amounts almost to 75 per cent of all SOEs being privatised, in comparison with 25 per cent privatised through commercialisation. Liquidation may lead either to a bankruptcy of an economically weak SOE or the conversion of a healthy SOE into a private enterprise. Altogether 1,824 enterprises are involved in both processes of which 829 are becoming private enterprises.

In the first instance, the assets of the enterprise are sold through public tender. This form of liquidation, the basic mandate for which can be found in Art 19 of the Law on State Enterprises, enables the Polish or foreign investor to buy a part of or the entire assets of the enterprise and, of course, to satisfy the claims of creditors. No differences exist between those investors. Liquidation in this form is slow and difficult. Parts of assets offered in public tender do not find buyers; in critical cases the courts are reluctant to proceed with the bankruptcy procedure if the procedural costs are higher than the value of remaining assets. Moreover, until recently, cases of filing for bankruptcy were relatively frequent but the whole procedure was slow (about seven per cent of procedures finalised as of the third quarter of 1992). At present, as the recession is weakening, liquidation is more often preceded by the attempts to salvage the enterprise.

In the second instance, generally regulated by article 37 of the Law on Privatisation, the assets of SOE are sold, leased or contributed to a newly formed private company on the principle of equal treatment of Polish and foreign investments.[6]

Leasing of the SOE is the most popular path to privatisation involving about 80 per cent of the market value of all liquidated enterprises. Leasing is one of the forms of so-called 'non-nominated contracts' provided in the Civil Code of 1964, that is, contracts not individually classified in that code. In article 38, the Law on Privatisation specifies an obligation for leasing a minimum of 20 per cent of the combined value of the liquidated enterprise's basic-assets fund and enterprise-operations fund of the former SOE to management and workers and leasing the rest to others, ie Polish and/or foreign investors. The employees may later buy, on an annual installment basis, the portion originally leased to them.

Leasing of assets to a foreign company (as a form of offering stocks to a third party) may be up to 80 per cent of remaining assets in cases where the employees did not exercise their right of purchasing more than 20 per cent of assets, provided that the workers' council will agree to the offer. In case the liquidation leads to the establishment of a 'one person company' of the State Treasury, the foreign company has the same right to buy out the stock of that company as the Polish company. In both cases, the Polish law stipulates that respective international agreements for the protection and promotion of mutual investments between Poland and the investor's home country apply and in their absence, the Private International Law Act of 12 November 1965 applies. In some cases,[7] the foreign investor may be obliged to obtain an *ex-ante* licence to run the newly formed company.

Basically, the company will have to be regarded or established as a joint venture (either joint stock or limited liability company), in accordance with the new Law on Joint Ventures of 14 June 1991 (Journal of Laws no 60 pos 253), if it makes a legal statement to that effect. However, depending on the date of legal creation of that company (prior or after entering of that Law into force), different taxation rules apply.

Because of gradual ownership transformations (first lease then ownership) this slow privatisation path is suitable for small size enterprises requiring relatively little capital investment. The foreign party, which is put on equal footing here with the Polish company, may make various contributions. In this connection, the Law specifies the value and the mode of making cash and non-cash contributions which will form the part of the capital of joint venture. Cash contributions by foreign party are found very helpful, as only 5–10 per cent of SOEs

which did not have them are running the risk of bankruptcy.

Non-cash contributions include eg 'know-how' and also, subject to possible ministerial permits, may include limited rights on property in Poland (premises, land, company) acquired in relation to other investment activities, including eg debt-to-equity swaps or a right of usufruct by a newly formed joint venture (art 163 of the Trade Code of 1934 in connection with the decision of the Supreme Court III CZP 32/91). Indeed, in comparison with cash contributions this method is all too frequently used by foreign investors and slows down this form of privatisation process.

Privatisation of medium-sized and large enterprises through contributions-in-kind or sale to private investors

Privatisation of medium-sized and large enterprises may be successful where foreign investment is more evident and improves access to advanced technology or to foreign markets. A slightly quicker privatisation method involves, therefore, liquidation of a medium-sized or large enterprise and contribution of its assets or their sales to another existing company or to a joint stock or limited liability company created expressly to purchase the SOE. The process of ownership transformation (which has so far involved about 70 enterprises of the former kind and 60 of the latter kind) is relatively fast, as the assets (stock) change owners without an interim stage of leasing. Article 37.1.1 of the Law on Privatisation makes no difference between the rights of the Polish and foreign parties which in both cases could be either natural or legal persons, in accordance with general provisions on equal treatment of Polish and foreign parties in the investment process.

The fastest method of all, however, is selling the enterprise after a simplified financial evaluation of its performance (art 37.1.1 of the Law on Privatisation in conjunction with art 18 a of the Law on State Enterprises). So far this method of purchasing the enterprise has been available to Polish citizens only. However, foreign parties were recently admitted to that privatisation path in areas endangered by high unemployment. In that case, the enterprise may be bought with cash at the exchange rate preferential to the seller. Moreover, the foreign investor will be obliged to maintain maximum employment and to protect the environment, and, also, to invest in restructuring the plant and its production.

As noted above, and generally, the Polish law makes no difference in the extent of the stock involvement between Polish and foreign parties in the joint ventures formed as a result of purchasing the assets of a liquidated SOE. Unless otherwise provided by law, especially by the Trade Code of 1934 with later amendments, and the ordinance of the Council of Ministers of 16 November 1990 (Journal of Laws No 82, pos 477), the foreign party may buy up to 80 per cent of remaining assets of an enterprise in liquidation or have a 100 per cent ownership of a newly formed limited liability company. However, such a company may only be formed by no less than three shareholders (legal or/and natural persons) regardless of their nationality.

Privatisation of medium-sized and large enterprises through restructuring

The Ministry of Ownership Transformations has experimented with an accelerated ownership transformation through restructuring (the so-called 'managerial path'). This is carried out by selected Polish or foreign expert management groups (so far 15) assisting under a performance contract with initial equity participation and five per cent of investment, respectively, relative to the market value of the SOE.

The goals of this exercise include both managerial and technical aspects of restructuring ranging from recapitalisation of the enterprise and development of various management skills (eg human resource management, access to new markets) to technological and technical restructuring (innovations, changes of physical layout). Good performance is rewarded by a combination of salaries, yearly bonuses and a commission (70 per cent) for the final sale of at least 51 per cent of the SOE's shares to private investors. That commission is also paid in company's shares and calculated as a difference between the real value and the market value of those shares. Further, the arrangements provide that the foreign investor enters into a leasing agreement with the State, whereunder the foreign party will lease the business from the State. After an agreed time the 'lessee' will be entitled to buy the enterprise at the price negotiated before entering into the agreement.

■ Privatisation through commercialisation

About 500 large enterprises, involving half a million employees, are being privatised individually, with assistance of specialised, frequently foreign, consulting firms, but also in the framework of the Law on Privatisation (art 23). This is done not by liquidation but by commercialisation of such enterprises ('capital privatisation') — a method applied also to mass privatisation, described below. The Law on Privatisation makes possible the selling

of enterprises either through negotiated sales of shares (80 per cent) or by a way of a public tender through broker houses. The third way, a public tender of shares, also possible under the Law, is unpopular, as it controls only the price of shares but does not allow the negotiations of other conditions (investment and employment levels etc).

'Capital privatisation' involves two groups of enterprises: those which are in a position to develop their own privatisation plans and enterprises which for their survival require considerable foreign investment either in capital or technology. Major Polish and foreign investors are being invited to bid for large blocks of shares and the announcements appearing in the Polish and foreign press contain a balance sheet and financial statements showing past performance and future projections. In practice, however, this form of privatisation is costly. Therefore, a sectoral approach that cuts across about 20 industry branches and combines both stronger and weaker enterprises (together approximately 300), was developed to lower the transformation costs. As of the end of 1992 the number of commercialised enterprises equalled the number of 1991 (that is 20), but the value was two to two and a half times higher than that of 1991. By the middle of 1993 there were already 17 enterprises sold through 'capital privatisation'.

Mass privatisation

Because of the large number of SOEs, the lack of sufficient domestic capital, the time limits on the privatisation programme and, finally, the need to encourage development of the securities market, the new law was enacted on 30 April 1993 'On National Investment Funds and their privatisation' (Journal of Laws No 44, pos 202) which may enable privatisation of roughly 600 industrial SOEs through sale of shares — that is, in fact, only 7 per cent of all such SOEs in Poland.

The above number of companies, starting with an initial tranche of 202, will be grouped and apportioned in a number of 'National Investment Funds' — precursor investment and venture capital funds. These enterprises, as groups, will be managed by experienced Western and Polish management experts, during the several years necessary to get them ready for privatisation. As long as the State Treasury is the sole share holder, both the chairman of the supervisory board of the fund as well as its other members have to be Polish citizens. Later on, not less than two-thirds of the board members, including the chairman, will have to have Polish citizenship.

Originally, 54 foreign firms entered into public tender and declared their interest to take part in that project after the enactment of the law on mass privatisation. Depending on the negotiated contract, selected foreign companies will either act as advisors or *per procura*. As the competition is expected to be fierce, the Ministry of Ownership Transformations encourages joint bids of Polish and foreign companies, but no preference will be given to any particular candidate, be it Polish, foreign or mixed.

33 per cent of equity will be allocated to a leading Fund, 27 per cent to other Funds, 25 per cent will be retained by the State Treasury and 15 per cent of equity will go to SOE employees. Fund certificates involved in first tranche of privatised companies are to be distributed free of charge to the retirees and pensioners. Certificates to be issued with the privatisation of the second tranche of companies will be sold to all adult Poles at the price of 10 per cent of average salary. It remains to be seen how many of the shares will remain in the hands of employees and other parties, including foreign investors. For the time being, the mass privatisation scheme awaits elections by the first and second chamber of the new parliament of some members of the Selection Commission for establishment of national investment funds, as required by the Law of 30 April 1993.

■ Conclusion

The process of ownership transformation in Poland entails a host of other legal changes including the draft 'Covenant on Enterprises' regulating labour and ownership relationships in the SOEs, new taxation laws (VAT), stronger protection of intellectual property, better banking systems, refinement of securities law etc. In the long run, this combination of various provisions will create a new legal and economic climate for foreign investment in Poland. In sum, a new legal and regulatory framework is gradually emerging, which despite its occasional 'twists and turns' will hopefully give more open and favourable opportunities to the foreign investor than ever before in post-Second War history. Keeping abreast of those legal developments is 'a must' for the foreign investor seeking investment opportunities in East West trade relationships.

Notes

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2 All statistical data and estimates were drawn from the official documentation of the Ministry of Ownership Transformations of Poland, UNIDO and UNDP, weeklies 'Gazeta Bankowa' No 10 (228) of 5 March 1993 and No 20 (238) of 14 May 1993, 'Zycie Gospodarcze' No 51/51 (2747/48) of 23 December 1992, and 'Polityka' No 9 (1869) of 27 February 1993, and 41 (1901) of 9 October 1993, and actualised by the daily reports of

'Rzeczpospolita' — all on file with the author. Status of statistical and legal information as of 20 October 1993. For information on the sources of the Polish business law see A Tomaszek, R Poplawski, *Sources of Polish Business Law*, International Business Lawyer vol 20 No 7, July/August 1992, pp 359–363. See also, J L Huhs, *Privatisation in Poland: Obstacles and Options — An Illustration*, New York Law School Journal of International and Comparative Law, Vol 12, No 3/1992.

3 Jolanta Redo, *Real estate and foreigners in Poland*, International Legal Practitioner, no 3, 1993, p 83.

4 A Kostrz-Kostecka, *Ustawa o reprywatyzacji. Nowy projekt bez wariantów* (Law on reprivatisation. New draft without variants), Rzeczpospolita No 104 (3448) of 6 May 1993.

5 See, however, Jolanta Redo, op cit, pp 83–88.

6 The question of mandatory equal treatment of Polish and foreign investors has a basic importance throughout the entire process of ownership transformations. In principle, the Law on Joint Ventures of 14 June 1991 (Journal of Laws No 60, pos 253) in connection with the Law on Economic Activity with Participation of the Foreign Parties of 23 December 1988 (Journal of Laws No 41, pos 325 with later amendments) makes no distinction between proportions of investment of the foreign and Polish companies. Exceptions include, however, companies operating in telecommunication business (Art 16 of the Law on Telecommunications of 1990, Journal of Laws No 86, pos 504) or cases determined by the Minister of Ownership Transformations (Art 16 §2 of the Law on Joint Ventures). Specific guarantees may be found in bilateral treaties guaranteeing such treatment between Poland and a number of countries. In the years 1987–1990 14 such treaties were concluded and more are underway. In their absence there are non-binding guidelines to that effect which may be quoted during negotiations with the Polish authorities. See, for instance, *World Bank Guidelines on the Treatment of Foreign Direct Investment*, International Legal Materials, vol XXXI, No 6, November 1992, pp 1363–1384. As of June 1989, Poland became a member of the Multilateral Investment Guarantee Agency.

7 This involves licences in the area of sea and airport administration, defence industries not already covered by special licences, real estate transactions, legal counselling and retail trade in imported articles of mass consumption. See further: A Szczepankowski, *Subsidiaries in Poland*, West-Ost Journal 2/1992, Mai 1992.

ENVIRONMENTAL LAW

Germany's Packaging Ordinance and the EC Packaging Draft Directive: Pharmaceutical and Medical Industry

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■ Introduction

The management and overcoming of waste is one of the most important problems in Europe. In particular, states that are densely populated have taken drastic measures to prevent and reduce waste. In Germany, packaging waste has been tackled by means of the 'Ordinance on the Avoidance of Packaging Waste' (Packaging Ordinance)[1] that implements a new system of waste management. To reach higher standards and achieve harmonisation to some extent in the area of environmental law, the EC is also about the come up with waste packaging rules. Since 1991, the EC has been trying to agree a final version of the 'Directive on Packaging and Packaging Waste' (Packaging Draft Directive).[2] After several proposals containing significant differences to the German Packaging Ordinance, the latest one is much closer to the Ordinance. There are still, however, some crucial deviations which might require approximation of the Packaging Ordinance to EC requirements.

The pharmaceutical and medical industry is affected by the Packaging Ordinance and will therefore be affected by the Packaging Directive. In this article the legal framework of those legal instruments will be described briefly in order to