TAB E

2. "Legal and Tax Considerations in Privatization" by Peter Thomas

LEGAL AND TAX CONSIDERATIONS IN PRIVATIZATION

Prepared by

Peter A. Thomas
The Hay Group
Washington, D.C.

February 18, 1986

CONTENTS

Section Page

1.0 INTRODUCTION AND OVERVIEW 1

2.0 THE RANGE OF PRIVATIZATION CATEGORIES 1

3.0 GENERAL AND UNIVERSAL LEGAL ISSUES 2

3.1 The Basic Power to Privatize 2

3.2 The Advantages and Complications of Sovereignty 3

3.3 Contractual Restrictions with International Lenders 3

3.4 Dispute Settlement 3

3.5 Labor and Employment Concerns 4

3.6 Monopoly Concerns 4

3.7 Financial Concerns 4

4.0 LEGAL ISSUES BY TYPE OF ACTION 5

4.1 Contracting Out 5

4.1.1 The Planning Process 5

4.1.2 The Bid Process 5

4.1.3 The Evaluation and Selection Process 6

4.1.4 The Monitoring and Follow-up Process 7

4.1.5 Disputes and Termination 7

4.2 Divestiture (Sale) of State-Owned Assets 8

4.2.1 Form of Ownership 8

4.2.2 Structuring the Organization 8

4.2.3 Use of an Underwriter/Advisor 10

4.2.4 The Offering 11

4.2.5 Special Considerations 13

4.3 Leases 14

4.4 Program Shedding 14

5.0 SUMMARY 15

LEGAL AND TAX CONSIDERATIONS IN PRIVATIZATION

1.0 INTRODUCTION AND OVERVIEW

Privatization is not only a political, social, economic and technical phenomenon; it is also, quite fundamentally, a legal one. From start to finish, the legal and regulatory requirements effectively shape the work of privatizers and beneficiaries alike, no matter what types of action are involved.

There are as many categories of legal issues as there are approaches to privatization itself. Furthermore, the number and complexity of problems multiply as one moves from a local context to an international one. One of the primary reasons for this is the fact that political complexity increases along with both the expanding numbers and sophistication of interested parties, and, since political needs are most often met by legal or quasi-legal mechanisms, the legal and tax picture grows more complex in parallel with the political.

A prime operating premise here is that the requisite rules and procedures needed to carry out a privatization -- especially one in which all relevant parties are protected -- must be laid out in the form of laws and regulations. Some of these are se forth in books, and some are handed down by tribunals, but in general they all follow certain patterns which reflect some "universal" rules. Therefore, these laws and regulations can be described for heterogeneous audiences such as this, and one can identify both familiar rules and new rules one must adapt to a variety of needs. In short, what follows is a broad-brush enumeration of legal and tax concepts to think about when planning an action -- both good themes to follow, and pitfalls to avoid.

2.0 THE RANGE OF PRIVATIZATION CATEGORIES

This paper analyzes the legal and tax aspects of four principal categories of privatization action: Contracting out (management contracts); divestiture (sale); lease; and abandonment. While there are many other species which embody elements of several categories (for example, the French sociétés d'économie mixte -- which provide large scale public projects such as roads and water and sewer systems), this generalized review will cover the basic elements of most of them.

Other related initiatives, such as the removal of regulatory restrictions on competing activities, while very supportive of privatization -- are only covered if such an act is part of the privatization action.

In contracting out, the government is acting within the context of a basic contract performance regime, albeit one of a rather exptic breed: government contracting (or public sector procurement). The government is paying money for the services of a private sector vendor, and the rules governing service or management contracts are of primary concern.

In the sales category, the principal focus is on the rules of securities law and stock transactions, since an owner (government) is selling a

transferable piece of property to new owners. Tied into this, of course, are elements of contract law and property law.

The lease category is interesting in that it could be analogized to either of the two foregoing groups. Specifically, one sort of privatization might involve the government leasing property from a private owner (money outflow), and another have government property leased to private interests (money inflow). Here contract and property law are of great interest.

Finally, when government properties or programs are abandoned, interesting legal issues in the nature of public trust, stewardship, and basic issues of alienation of public property come to the fore.

In the following pages, a very wide range of legal issues is reviewed; the issues are described and placed in a context vis-a-vis privatization, in both a program and action sense.

This is a sui generis, to appropriate a legalism. Privatization legal issues have never been addressed in a systematic way in the literature. Rather, one must begin an analysis by establishing an outline of privatization modes -- as we are doing -- and then reach into the various areas of law for appropriate rules applicable to a given situation. There are no practitioners of "privatization law" per se; rather, many people in different fields sometimes find themselves involved in privatization work along with other daily tasks. Examples which come to mind are: securities transactions, taxation, contracts (and government procurement), property, mergers and acquisitions, and banking and finance.

Addressed first by this paper's review are universal, and hence over-riding, legal and tax issues, followed by a delineation of the particular legal concerns corresponding with the four principal categories of privatization actions, and concluded with a summary. Specific examples are kept to a minimum in the text; these will be maximized, as appropriate, in the forum for which this paper is prepared.

3.0 GENERAL AND UNIVERSAL LEGAL ISSUES

The issues discussed in the following sections relate closely to privatization initiatives, but cannot be specifically linked with to particular type of action.

3.1 The Basic Power to Privatize

Before any privatization can take place, the inherent authority of the government to carry out the action must be established. Sometimes rules are based on the "commanding heights of the economy" philosophy, such as the Mexican constitutional mandate that "national strategic" enterprises must be state owned. Thus affected are, for instance, telephones, railways, electric power, uranium, shipbuilding and repair, petrochemicals, steel, and airlines. In other cases, restrictions are based on momentous shifts in government

policy, e.g., the Portuguese constitutional prohibition on divesting entities previously nationalized.

3.2 The Advantages and Complications of Sovereignty

One of the key factors rendering privatization so unique a phenomenon is that it involves transactions between a sovereign and private individuals (both human and corporate). A government possesses sovereign immunity, unless it is waived, and this will protect the government from many types of claims brought by individuals or corporations in the private sector. Similarly, the doctrine of "Act of State" can further shield the government. The degree to which these protections can or should be utilized is an important question, since the faith of the private sector (and thus the marketability of shares or desirability of contracting) is at stake. Further, issues of sovereign debt, placed under one set of (sovereign) assumptions, can complicate a sale if a bond issuer subsequently adopts a new set of assumptions. The result might be fluctuating valuations, or possibly litigation.

3.3 Contractual Restrictions With International Lenders

The conditionality of financial assistance offered by, for example, the multilateral development institutions or individual governments is always a legal consideration for privatizers. Can a government do certain things? Can it use or co-mingle certain monies? Must it secure approval and oversight before embarking on a given action? On the other hand, is the diminution of the public sector a requirement or condition precedent for funding or technical assistance? Often the retaining of outside experts by a government is a condition of the contract with the World Bank. For example, contracted-out training services are generally recognized by the Bank as being of great importance to government operations.

These restrictions and requirements are embodied in the loan agreements the government has with the providers of assistance and are of key importance, since in the case of many legal systems, this agreement has the force of law and overrides inconsistent text in statutes or decrees.

3.4 Dispute Settlement

One of the most critical needs faced in a sale or contracting out, or other type of action, is to convince foreign participants that their legitimate grievances can be resolved fairly. This will not be an easy task, as international law generally favors the government. It is difficult to make a claim against a public body because of the sovereignty issues noted above, as well as such factors as requirements for standing (for the party), jurisdiction (for the tribunal as well as over the parties), and a convenient locus for the determination of the action.

3.5 Labor and Employment Concerns

The protections afforded to labor, whether organized or not, throughout the world are sufficiently strong that the legal status of current and potential employees of any affected body should always be scrutinized. The ability of unhappy employees to halt a privatization action is significant. Beyond the mere legal issues, the employee population is a valued ally in this process, and should be nurtured. One should look closely at the particular rights granted under domestic law, as well as the tax aspects of any transaction. Can public employees be terminated, or must they be hired by the new operator? Can Employee Stock Ownership Plans (ESOPs) be set up? Are vested rights preserved on transfer?

3.6 Monopoly Concerns

One of the primary reasons for privatizing is to undo the effects of a government monopoly. Therefore, care must be taken to ensure that private monopolies do not evolve. Legally, this is especially important since, in most nations, the law does not look favorably on monopolies or trade restraint. As one privatizes, one should investigate the powers of existing regulators (such as the Federal Trade Commission or the Justice Department in the United States or Monopolies and Mergers Commission in the U.K.) and determine whether new mechanisms should be put in place, as has been done with British telecommunications and gas (Oftel and Ofgas, respectively).

Bear in mind that privatization by itself does nothing to prevent the potential for monopoly abuse, and in some cases (e.g., a placement), sets the stage for it. It is a good program of regulation in conjunction with the privatization that makes the difference.

3.7 Financial Concerns

Legal issues are embodied by a wide variety of financial and economic issues. Several of these legal issues have special importance in the case of an international privatization. Currency rules, for instance, warrant particular concern, especially restrictions or rules controlling valuation, convertability, controls over use and possession, and the like. Another, more general, concern relates to a government's budgetary restrictions -- when it has access to monies, and under what circumstances.

How will such constraints limit foreign participation? Are they consonant with loan agreements? Do all planned privatization agreements clearly state the restrictions?

4.0 LEGAL ISSUES BY TYPE OF ACTION

The following sections relate to the range of legal and tax considerations confronted within each of the four principal modes of privatization.

4.1 Contracting Out

Contracting out is the contract use of private individuals or firms to manage or implement programs, while the government maintains ownership of assets, policy-shaping control, financial oversight, and ultimate power to return to full operation. It is a growing phenomenon for several reasons. For one thing, budgetary benefits are widely seen, as private contractors often beat government employees in cost comparisons, this due to a number of factors, such as tax benefits available to firms but not agencies. Also, shifts are occurring in the nature of work requirements.

An increasing volume of projects being conducted in conjunction with the World Bank are in the category of maintenance and rehabilitation, as opposed to new construction. This has traditionally been done in-house, but contracting out of the requirement is an acceptable mechanism; in such cases, a basic set of rules a government can use to ensure the sufficency of its bidding practices is to follow strictly the rules set forth the the World Bank's Guidelines.

Further, while recurrent costs of government operations are, in the World Bank's practice, on the account of the borrower, there are cases where it is legally permissible to retain outside experts to oversee the installation of works, or even to manage operations for a period of time, and place the costs on the accounts of the project.

4.1.1 The Planning Process

As the basic planning for a given privatization action is carried out, it is essential that all of the legal concerns to be faced are analyzed and accounted for. Is the action legally sufficient? In other words, does the government have the legal authority to enter into this sort of a contract, or are its actions "ultra vires?" What statutory/constitutional or regulatory changes should be recommended? What type of contract should be selected, and what terms and conditions should be sought? Corrections at this early stage are much less costly than those attempted later.

4.1.2 The Bid Process

The most basic and universal rule underlying the solicitation of bids or proposals from the private sector is that there should be the most widespread, transparent, and accurate statement of desires and requirements possible. When announcing a contracting opportunity, one must seek maximum participation and competition, unless there is a legally permissible reason to avoid doing so.

While international competitive bidding is the norm in conducting procurements, legally sufficient reasons for avoiding ICB in force account procurements where the World Bank is involved relate to such things as weather-related rescheduling or transportation coordination.

After the preliminary announcement of intention, an invitation for tenders/bids/proposals must go out. Documentation packages (including terms and conditions) should be distributed. Failure to provide each and every offeror with equivalent information will open the government up to a great deal of potential trouble and expense. Likewise, at subsequent phases when clarifications or supplemental information are provided to offerors -- for instance with bidders conferences -- utmost care should be taken to ensure that no one bidder is singled out for special consideration. Unless the government is prepared to reopen the bidding by providing new documents and schedules, it is legally bound to move forward under the terms spelled out to all bidders initially.

One should be sure to remember that, as the action is one of the hiring of services versus the purchase of goods, it turns more on quality, qualification and experience, and less on bottom line cost.

4.1.3 The Evaluation and Selection Process

If there is a rule to follow here, it is that the criteria for the evaluation of the bids or offers must be laid out in an understandable manner. At no time in the evaluation process should there be a deviation from them. Each of the offerors has shaped a response on the basis of the stated criteria, and the government would be open to a legal challenge if the rules were changed after the fact.

Likewise, the collection of responses must be fair and predictable (i.e., set time and place, established to allow for good faith compliance). One must take all appropriate steps to ensure the secrecy of the various offers. Bid openings should be carried out precisely as advertised, and late or otherwise improperly submitted offers cannot be allowed consideration, absent clearly stated exceptional circumstances.

Revieving and scoring of the offers must be carried out by an appropriately constituted (and unbiased) team that adheres to the evaluation criteria. If a special review by non-technical (i.e., policy or political) officials is desired, it must be determined that this is legally permissible under the system; early planning could have prepared government officials for whatever changes might be required.

In choosing a preliminary winner, a point is being approached at which a legally binding contract will be executed. Therefore, all issues must be very carefully double checked. Does the government have the power (or funds) to do all that is promised? Is the bidder reaponsive (i.e., did the bid or proposal address the original request) and responsible (i.e., is it a viable concern, able to do what it promises)? Can there be full compliance with the terms and conditions? It is important to note here that in a complex technical or contracting situation, the legal requirements might prove to be overwhelmingly complicated for one-time resolution. In such cases, a "two-step" procurement

might be used, in which technical responses are first sought and evaluated, and business and financial decisions are subsequently made vis-a-vis only those bidders who fulfill all of the technical criteria.

At the point of agreement and execution of a contract, negotiations with the offeror should be conducted as necessary to pin down an agreed understanding of all terms and conditions, especially with regard to the elements of the statement of work. Further, it must be determined that all critical ancillary elements are in place, for example, insurance, bonds, warranties, and compliance with all laws and regulations.

When convinced that the agreement fulfills needs and wants, the proposed contract should be submitted to several essential members of the government team. This team comprises legal counsel, the person or group making policy and political decisions, and financial/budgetary staff. When they have all signed off, the agreement is legally ready to be executed by a duly constituted government contracting officer.

4.1.4 The Monitoring and Follow-up Process

After the privatization contract has been signed, there is a long-term need to monitor and administer the program in which the contractor is running an operation for the government. The monitoring framework should be well established, and should agree totally with all contract schedules, and other terms and conditions of the contract, since the responsibility for a great deal of reporting and other compliance functions is with the contractor under the terms of the contract. Overall, one should keep in mind that the contract is a legal document, and if the contractor is not living up to its terms, the government's monitor must act as the eyes and ears of the enforcement system and take such steps as are necessary to get legal compliance, or in seeking appropriate legal remedies.

4.1.5 Disputes and Termination

No matter how well-structured a contract may be, disputes may arise between the parties, or, in the case of a contract for privatization, the government may wish to terminate the contract. In general, clearly stated rules are necessary to advise all parties of their rights and obligations. These rules certainly have to be a part of the underlying legal system, but they also should be incorporated in the terms and conditions of the agreement.

Above all, the government must ensure that fairness (sometimes called due process) exists in its treatment of the contractor. This might involve simply ensuring that the disputants are afforded a clearly delineated pathway for resolving disagreements. Thus, the first step would be to offer informal resolution processes, in which the contractor meets with technical, contracting, and policy staff to seek simple changes or pledges.

The next step up in formality is the use of a "contracting officer," whose decision would be complied with or appealed, as appropriate. An appeal could go to the administrative tribunal, and eventually to a court. The end result is either the full performance by the contractor, a modification of the contract

to allow changed performance (and payment), or the termination of the contract for non-performance.

While all of these steps may not be appropriate or even possible in a given national context, the key point is that some steps toward ensuring a fair chance at resolving disputes is the minimum owed to contractors.

4.2 Divestiture (Sale) of State-Owned Assets

The legal issues relating to the offering of a public institution, such as a State-Owned Enterprise (SOE), for sale can be seen to fall into four basic categories: the form of ownership; the structuring of the new organization; the arrangement with the agent or advisor working with the sale; and the offering itself.

4.2.1 Form of Ownership

One of the threshold legal issues is whether the entity being privatized can easily be floated. A first question is "how is it held by the state?" Three of the most universal modes are total ownership, overwhelming, but not total, ownership, and joint ownership by state and private interests.

Wholly owned enterprises might be public corporations established under the public law in the form of a government body. Special legislation is required, and this shapes the form and powers of the body. In French jurisdictions the bodies are known as établissements publics (a caractère industriel et commercial - EPIC). Perhaps one of the basic distinctions between these companies and those organized under the companies law is the substantially lessened flexibility held by the former; on the other hand, however, they generally cannot be sold as an entity or forced into bankruptcy.

A firm that is under the overwhelming, but not total, ownership of the government, might well be organized as a limited liability stock corporation (or société anonyme) under the companies law. In the French system this would be a société d'état or a société nationale. In such a case, the autonomy of the organization would be greater than in the case of a wholly owned entity, but here the powers and rights of the government would be greater than those of the other stockholders.

A third type of organization is the one in which the state and private interests share the ownership of the organization to some degree, and the entity is a creature of the companies law; these are known as sociétés anonymes d'économie mixte in Francophone countries.

4.2.2 Structuring the Organization

While a joint stock corporation in which the government owns shares can be privatized immediately through the sale of the shares, a public corporation, wholly owned by the government, and without shares, must first be reconstituted as a share company. This is an important consideration worldwide, since most

countries don't have laws governing the divestiture process. Thus, there may be a need for a law (statutory enactment), although a decree may suffice.

The first step in this preliminary process is the determination of how it will be constituted, i.e., as a holding company or as a discrete entity, for example. It is also possible to amalgamate several government organizations and privatize them in one operation, so this must also be considered. The next step entails the determination of what sort of assets will be involved. How will they be held by the unit? All sorts of property must be accounted for; industrial and intellectual property such as patents and licenses are as important as real estate and machines. What sort of structure will the unit have to hold its assets?

One must take account of the actual valuation of the assets of the corporation. This includes consideration of, and decisions on, such issues as the type of share structure, the degree of capitalization (and whether the government will provide seed capital), and whether there will be in-place guarantees of revenue (such as franchises or licenses).

Capital restructuring of the entity in preparation for the private sector can include such losses as termination of ability to draw from a national fund for debt, and taking on of debenture stock debt and dividend obligations. A tax consequence of this might be an increased tax bill, because of a lower debt charge on profits.

Further, one should investigate whether the legislation or charter underpinning the entity allow the issuance of equity, or whether monies must be raised by debt; next, must debt be undertaken with the public authorities, or can the private sector be approached?

One of the most troubling legal issues facing the privatized firm relates to the differences between public sector accounting practices and those in use in the private sector. Examples of requirements confronted in the privatization of SOEs are: stopping the charging of supplemental depreciation; shortening of the estimated useful lives of fixed assets; stopping the capitalization of assets, with a charge against revenue as it was incurred; and writing off the backlog of depreciation against reserves.

Some Francophone African countries have adopted one form or another of the variations on the 20-year-old French OCAM plan comptable. However, it has seen a mixed success, for a number of reasons.

The accounting issues relate not only to indvidual instances of privatization, but also in the larger context. Specifically, more than 70 developing countries lack a uniform accounting system and outside participants in the privatization progress (e.g., investors) are accordingly troubled.

Another important category is the range of liabilities of the corporation. What obligations are being carried with the unit? What bonds, notes and accounts payable will come due? Looking into the future, one must determine whether the change in status from public to private will cause any legal problems as the marketplace begins to revalue existing or proposed obligations. Also, one must look at the tax picture and determine whether some liabilities of the unit will be eliminated, for example by a tax holiday.

Next, as one looks to the organization of the corporation, there are many legal issues to resolve. Regarding the basic issue of the charter, decide whether there will be a new incorporation, and how it will be done. Decide on the limits on operations or dealings, such as constraints on the ability of the unit to enter into contracts. Will management slots be filled before or after the sale? Will there be ownership restrictions by nationality? By the status of the potential owner of a share? By the size of the person's holding?

When privatizing a corporate entity, it is important to look into the requirements and arrangements mandated under the contrat-plan (or contrat d'entreprise) used in some French speaking nations.

If the organization and the state are linked by a binding arrangement setting forth specific controls and relationships, such as a convention d'établissement or cahier des charges, these should be investigated as a cause of privatization complications.

One must evaluate and work with the government's desires to prevent corporate takeovers, or, in the case of the placement of the ownership with a discrete group, the requirement of tailoring the sale to have the corporation fit exactly into the structure of the buyer. If the buyer has no identity at the time of planning, work with various legal prohibitions and restricitions on outside participation. This is especially critical if programs like Employee Stock Ownership Plans (ESOPs) are involved.

Finally, one must create mechanisms to ensure compliance with all relevant laws and regulations, including, if necessary, the creation of a new regulatory body.

4.2.3 Use of an Underwriter/Advisor

The government is faced with a choice of whether or not to underwrite the sale or even to retain outside expertise in marketing and/or placing shares. While the decision is one of policy and market judgment, the process involves a binding agreement with an underwriter/advisor -- who will charge siginificant underwriting or other fees -- and has legal ramifications.

In a complex operation like an ownership transfer, the government will likely require the services of advisors and agents. There are several different categories of advisor, but perhaps the most key to one's needs is the lead underwriter, who both brings in a team of secondary underwriters, and coordinates other specialists, such as law firms, accountants, personnel and operations specialists, and various technical and engineering groups.

The agent should be recognized as such, and one should ensure that all liabilities of the government that can be passed on should be overseen by the agent. The determination of, and agreement to, this transfer, comes in the form of a contract between the government and the agent. The contracting process begins when an agent is selected following an advertised action, and competitive contracting rules are applied as much as possible. Proposals from merchant banks and other candidates are sent to the government, and government staff should hold discussions with all viable candidates to secure the best

deal, i.e., terms, schedules, and financial return, along with guarantees and promises to hold the government harmless in certain situations. During the evaluation process, one should look at the structure and geographic presence of the candidate, as well as its skill. This relates to issues of legal relations between the parties as well as the success of the agent in the work.

The contract that is awarded should clearly state the terms and conditions of the arrangement. One must then be prepared to monitor the action closely, and make split-second decisions involving mid-course corrections in the interest of the government. This is critical, legally, since the government bears the ultimate onus (and possibility legal liability) for mistakes. The sharing of responsibility must be determined on a case-by-case basis, but a general rule of thumb might be that if the action is a flotation requiring vast amounts of research and dealing with the public, the agent stands much more in the shoes of the government; if it is a placement, the agent acts more as an adjunct and advisor to the government in dealing with the buyer, and exposure is therefore more direct. The amounts of fees also will depend on the exact role of the firm and the size of the action.

4.2.4 The Offering

There are many modes of sale of equity in a government owned corporate entity, and the following are among those often used:

- o Outright sale of stock
  - Single offer vs several tranches
  - Fixed price vs tender
- o Issue of convertible loan stock
- o Issue of short dated gilt-edged stock for later conversion to corporate entity

These or new combinations should be investigated from the financial/marketing perspective, and then checked for legal sufficiency.

The execution phase can be said to begin with the announcement of an action, the release of a prospectus or the commencement of negotiations with a single buyer. While legal systems may differ about the degree to which the prospectus may constitute an offer of shares, the government and its agents should strive to treat it as a mere announcement of an upcoming opportunity; this guarantees the later freedom to deny some of the potential buyers their chance to purchase, should one wish to implement such a policy.

The offering documentation should clearly state the time window during which applications can be made for ownership, i.e., share purchase. This would normally be a short period of a few days at most, selected by the advisors for the best combination of timing, etc., for the government. The prospectus must set forth clearly and accurately a large amount of detail on the pluses and minuses of the operation being privatized, since large numbers of people will make financial decisions based on this information.

One should plan to include information such as: data on the relevant business environment/market; the proportion of the operation being offered and the amount retained by the government; restrictions on who may purchase, and

how much; and key information on the status and nature of resources and assets/liabilities the unit carries. It is a good idea to have a binding statement from the government that ownership of the property/unit is being sold without restriction (quitclaimed), there will be no foreseeable renationalization. An interesting point, though, is that the government always possesses the sovereign power to take the assets away from the buyers under certain conditions. If the opposition party has stated that the unit is a target for nationalization when it comes into power, such a statement should be included in the prospectus, or in negotiations with a single buyer.

A question of strategy relates to the issue of whether it is legally permissible to place a portion of the offering; this is sometimes desirable since it minimizes the chances of undersubscription, and thus keeps large buyers from holding back. However, placements may be prohibited if the purpose of the action is to generate free market price competition.

It is also possible to offer portions of the same body of shares to different comunities under different terms. For instance, one can first offer a percentage to the employees and pensioners; this can, for example, be followed by an offer to institutional investors of a percentage of the total on the basis of formal applications they make. One can make the sale of one fraction of the bloc on a "placing share" basis, in which the shares go pro rata to the applicants, and the remainder on a "commitment share" basis, to be satisfied only to the extent that there was a balance after all other applications had been met.

One can also hold back a percentage of the shares for offering overseas. If it is decided to offer in foreign markets, the government should bear in mind the fact that these shares would likely be covered by underwriting agreements in the country concerned. Since such agreements reflect the rules and practices of the particular country, the differences in terms and conditions are critical as preparations are being made. If one is unsure about foreign markets, the potential for an underwriting contract with one's own underwriting community or central bank should be checked. Since these domestic underwriters also may well be unsure of the foreign success, often such agreements will include contingency clauses to protect the underwriter, such as a requirement that they must step in to purchase the shares only if the equity cannot be reallocated and sold domestically.

When the applications for shares come in from the public during the prescribed period, they are collected by the agent with the assistance of the government. While one need not announce it in advance, the government should have a formula for culling out unacceptable applicants. One example of this is the claw-back provision with which the government can withdraw unsold shares from the process (i.e., from the oversight/control of the agent or underwriter). Often one may wish to consider a golden share held by the government with special powers, to be used to preserve the government's interests, e.g., to keep foreign groups from seizing control of an organization involved in defense work.

When the government has decided how it wants the shareholding to look (for instance, many small investors versus a few big ones), the formula is applied and share certificate and/or refunds are mailed out. At this point, the

privatization has taken place, and some or all of the entity is owned by the private sector.

4.2.5 Special Considerations

A number of special considerations might be of importance in some sales. Will the government be neutral vis-a-vis the tax consequences of the transaction (i.e., transfer and/or ownership taxes will be assessed), or will it grant a tax holiday? Will there be ancillary tax benefits, such as investment tax credits, or incentives given for small business development? Will there be special perquisites given to some buyers, such as discounted telephone service? Will some or all of the shares be offered at discount prices? Will there be ballooning options, such as warrants to buyers usable in several years to buy more stock at discounts?

The government may have to provide the public with a binding commitment that it will never seek to raise its shareholding above a stated amount (e.g., never gain a majority). Also, the government may have to pledge that it will not sell more stock before a certain date, thus ensuring the value of the stock floated. Breach of such pledges will do great harm to the privatization process.

All of these are sales promotions which have deep and inextricable links to the legal system. It is likely that some or all of them are not allowable, and one should thoroughly investigate the legal system to avoid false starts. If there are unsolvable legal roadblocks stopping divestiture, the concept of informal closure should be investigated, i.e., keeping the legal identity but winding down corporate activities. Otherwise, legal problems can generally be overcome.

On the role of the government, one must ask what is the legal effect of government announcements regarding the impending privatization on the trading in stock? Can a rise or fall in the market be imputed to the government?

If the SOE is a limited liability company subject to company law, one must protect against unpaid creditors challenging the validity of the process and maintaining claims after the completion of the liquidation. The determination of the priority of the claimants is also a legal concern. Additionally, there may well be s requirement for intensive discussions with lenders before any action is taken. When the government is trying to divest a company that has high debts, the feasibility of the government assuming all obligations should be investigated. If it has few assets, one should see whether it is legally possible to offer a foreign lender the equity in a public corporation in exchange for the forgiveness of debt. In several recent cases, governments have capitalized an entity and framed it as a joint stock corporation; ownership was then vested in the creditor bank.

Another approach to dealing with troublesome entities is a multi-step process, such as has been done in India, where a number of enterprises have been turned over to state governments, which in turn are more readily able to enter into joint ventures with the private sector.

4.3 Leases

There are two categories of lease relevant to this discussion. The first of them is a lease of private property by the government, where the government pays money out; an example is a fleet of vehicles for a motorpool. In the second category are the leases of government property to private interests, in which money flows into the government accounts; examples here are grazing and timber land rights.

Overall, the rules to apply are as described above. For leases with money going out, the procurement process is analogous to that employed in contracting out. For leases with money coming in, the rules which are applicable to a sale of stock, dealing with the public through "offerings" or "prospectuses" are appropriate. However, the legal regime of leasing has become quite an arcane specialty in the larger industrialized nations, and the trend is spreading. Thus, look further, investigate other issues, and count on dealing with specialists.

What are the tax consequences for the lessor/lessee? The way one nation's tax laws, or those of another, treat a transaction can substantially affect the consequences of a leasing agreement, and, therefore, the reaching of an agreement. Can this be done at all? Do one's constitution and laws allow the government to lease as opposed to more traditional routes, such as ownership/sale/purchase? Will there be a purchase option, and how will it be valued? Who is liable for what during the lease? This applies both to the simple questions of repair and maintenance, and to more complex legal considerations of third party liability, focusing on the doctrine of "respondeat superior."

4.4 Program Shedding

Finally, a type of privatization action in which legal issues are of some special significance is program shedding, where the government effectively "abandons" a program and lets the private sector fill the gap. The legal issues here deal less with the minutiae of the transaction, and more with the general philosophy of government and overall policies, as embodied in the constitution and laws. Is it permissible to give away ("alienate") the property of the government ("the patrimony")? Who owns the property, the government or the people? How can competition be ensured in the area? Must new regulatory structures be created? Does the government get "fair value" in terms of overall societal benefits? Can any terms and conditions of the divestiture be enforced against the general public? Is there residual liability retained by the government for pre-divestiture actions? And what is the status of existing or pending relationships with the program or unit (e.g., supplier contracts)?

5.0 SUMMARY

In conclusion, it should be reiterated that the legal aspects of privatization are pervasive, and are related to many bodies of law, rather than just one. While no single text can answer all questions, several universal rules should be satisfied in any privatization action:

- The government is spending money or shedding public property. This touches the basic roots of a country's law and constitution for governance.

- One of the primary goals of a privatization is protection against monopolistic behavior; this fact should influence all the government's actions.

- Equity and fairness must be ensured regarding all parties one deals with, both vis-a-vis each other and with regard to the government.

- Equitable compensation for property, and increased efficiency in operations are principal objectives to be realized by any government's privatization actions. The law regarding trusts provides a reasonable foundation for evaluating a government's activities. Privatization actions can positively contribute to both the perception and the fact of government fulfillment of fiduciary responsibilities.