

Transition and competition

The sale of state-owned assets needs an attentive and flexible approach, says Gabriela Anton of Vilau & Mitel

Following the collapse of communism, Romania experienced a long period of privatisation. While the beginnings of this process are blurred and lack legal consistency, in time Romanian legislation started to cope with the challenges of free market economies. One of the most important legal tools that smoothes the transition from centralised economies to liberalised markets is state aid.

Before accession to the EU, the Romanian public authorities were obliged to disclose state aid measures to the national Competition Council. Following accession, the European Commission (EC) became the sole authority competent to approve state aid, while the National Competition Council preserved an advisory competence. The Romanian central authorities are obliged to notify the EC, through the Romanian Permanent Representation to Brussels, of any plan to grant state aid, as well as to strictly observe EU rules on state aid measures.

Transaction

It is important to note that on first view this case was of little importance from a state aid perspective. It was only afterwards, due to special circumstances, that the case acquired

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a state aid dimension.

The object of the transaction was the state-owned Tractorul UTB (Tractorul), manufacturers of agricultural and forestry machinery. Tractorul started out before the communist regime in the 1920s and flourished during the 1980s. Due to the narrowing distribution market, flagging technological input and deficient management, the manufacturer started to lose profitability and accumulated a very large budgetary debt. After numerous failed attempts to privatise it, the Authority for State Assets Recovery (AVAS) decided to sell Tractorul through a different procedure – voluntary liquidation.

While being a shadow of its former manufacturing capacities, Tractorul's value was concentrated in the value of its vast land holdings. Taking this into account, the appointed liquidator chose, as a final strategy, sale through a public tender of Tractorul's whole platform, with a discount that resulted from a calculation of the lack of profitability of certain assets and the transaction and maintenance costs incurred in a delayed sale of the separate assets.

Argument

From a state aid perspective, the main issues arose from the miscommunication or lack of communication between the Romanian public authorities and the EC. The EC was aware of the difficulties faced by Tractorul and the previous failed privatisation attempts and was interested in the solution found by the Romanian authorities. However, the information the Romanian authorities provided the EC with was sparse. This led to a variety of surrounding issues which were elaborated in the EC's decisions to open and to close the investigation.

While the Romanian authorities failed to provide sufficient information to the EC, the transaction for the sale of Tractorul benefited from press exposure and was understood as being a case of a very large industrial operation becoming a real estate investment opportunity.

The EC based its opening decision on misleading press reports and therefore on

an incorrect interpretation of the facts. This was the first important consequence of not having – in fact not being provided with – proper legal documentation of the transaction. An adjacent consequence was the misunderstanding of the conditions and commitments attached to the transaction. These confusions undermined the EC's rationale.

The EC's main argument was that the transaction's assets were sold at a value below the real market price, the difference in price being justified by the decrease in the assets' value in consideration of the obligations ancillary to the transaction. This led the EC to conclude that the transaction offered an economic advantage to the buyer.

As part of the endeavour to rebut the assumption of the sale being below market price, the buyer (and the Romanian Government) showed that the value of the land was based on the evaluation of Tractorul's whole patrimony. This was performed by an independent specialist, in line with national and international professional standards. Additional proofs, including the actual price found in the public notaries' lists (a common and generally accepted practice when valuing real estate in Romania) were brought.

The argument for the sale being below market price was also allegedly supported by the fact that by the separate sale of the individual assets (the casting and forging unit and the tractor factory), the total sum would have been higher than the sum obtained through the sale of the whole platform. However, this argument was countered twofold: first, the potential bidders expressed an obvious interest in purchasing the whole platform and second, the discount sale of bundled assets had undeniable advantages that outweighed potential price reductions: this was justified by the different business appeal of the two functional modules. Therefore, opting for the block sale method made the most business sense, considering that the attractiveness of the land would have lured the bidders to buy the rest of the less marketable assets.

Analysis

At first, the EC did not see the fundamental differences, in Romanian law, between voluntary liquidation and privatisation procedures in the case of the sale of shares. These differences were, however, acknowledged in the closing decision. It is worth mentioning that while privatisation by sale of shares entails a post-privatisation monitoring period in which the state has the

main supervisory role, ensuring that the conditions attached to the transaction are fulfilled, there is no such monitoring attached to sale by voluntary liquidation. Also, privatisation through the sale of shares owned by the state to third parties implies the company's continuing existence under private ownership, while following voluntary liquidation a company ceases to exist: in this respect it is obviously difficult to envision the manner in which a deceased company benefits from state aid.

Apart from the misrepresentations caused by the lack of genuine correspondence and communication with the Romanian authorities, the incorrect interpretation of the facts also arose from circumstances. The EC treated, on the same page, two cases it happened to be investigating at the same moment: the case involving the sale of Tractorul and the Ford case (which followed the sale of Automobile Craiova to Ford and investigated the state aid offered in the form of obligations attached to the contract). While the EC regarded the two cases as similar, they confused essential differences as equivalences. In the Ford case, in contrast with that of Tractorul, the assets were sold through the process of privatisation by sale of shares and the obligations attached to the privatisation contract were specific, precise and therefore quantifiable. In contrast to that, the conditions attached to the agreement of the sale of Tractorul's assets were unquantifiable and not onerous, not supporting the conclusion that they amounted to state aid.

The EC looked into whether the member state acted as any other private actor on the market in concluding this transaction: "In accordance with a constant jurisprudence of the European Courts and Commission rules and practice on state aid in the context of privatisations, when a member state owns or sells undertakings, or otherwise purchases or sells shares of undertakings, no state aid is present if the member state's behaviour is consistent with that of a private market economy investor". In order for its behaviour to qualify as equal to that of a private market investor, the pertinent question is whether a market economy operator in a similar situation would have behaved in the same way, selling the company at the same price. In this regard, elements such as the existence of a competitive tender with no conditions attached, the assurance that the highest bidder won and sufficient time was allowed for proper evaluation of the assets by all the bidders, must be proven. The need to prove

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the member state's business as if it were market behaviour influenced the buyer's choice of approach in countering the EC's presuppositions. The comments put forward to the EC were business-grounded and sought to show that the Romanian state acted on the basis of purely commercial interests.

While Article 87(1) of the EC Treaty requires a certain number of factors for the existence of state aid, the interested parties went on to demonstrate that such were not met in this case. It is pertinent to mention here that based on article 87(1) of the EC Treaty, in order for a measure to qualify as state aid it should fulfill four main criteria: i) transfer of state resources; ii) economic advantage; iii) selectivity; and iv) effect on competition and trade. Considering the

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peculiarity of the transaction (the importance of the value of the land in the sale of the whole platform), the comments submitted by the interested parties outlined the fact that the transaction could in fact be characterised as a land sale. Following this line, state aid granted in the sale of land by public authorities can be permitted under the EC Treaty if it satisfies the following requirements: (i) the sale was concluded on the basis of a sufficiently well-publicised, open and unconditional bidding procedure, accepting the best or only bid; and (ii) the sale is conducted at market value as established by independent valuers.

It is worth pointing out that regarding the first requirement triggering the application of the exemption, the tender booklet contained the obligation to maintain Tractorul's main object of activity and not necessarily and explicitly the manufacture of tractors. The obligation to maintain the activity does not imply an actual performance of such and does not encumber the buyer with any additional costs that would diminish the selling price. Other obligations, such as the obligation to give preference to former employees of Tractorul when hiring did not carry much financial significance either. Under this obligation, the buyer was not required to hire Tractorul's former employees. To that extent, the tender booklet did not contain either a precise number of employees that should be hired or a minimum employment period. Giving preference to former employees means that between two candidates having equal qualifications and professional experience, preference should

cases of the sale of state-owned assets or companies if a successful transaction is to be made.

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be given to Tractorul's employees.

In this case, Tractorul was neither a workable operation nor a profitable asset. This position was sustained by the obsolete state of the technical equipment and Tractorul's incapacity to sell the tractors on the market at a price that would cover production costs. The interested parties argued that there was no possibility to make Tractorul profitable again through the manufacture of tractors in its current configuration. The buyer's assessment was that it would have been cheaper to build a new tractor manufacturing operation rather than use the existing assets, the only potential value being in the brand and intellectual property, which could still attract a foreign manufacturer.

The EC qualified these obligations as mere formal requirements and the obligation to preferentially hire Tractorul's former employees was deemed a best efforts clause.

It was put forward that it is reasonable to assume that any potential bidders seriously interested in purchasing the assets of Tractorul would have sought advice from law firms and/or consulting companies to evaluate the investment opportunities and tender conditions before committing to an investment of this value. It is interesting to note that out of the six companies who submitted tender documentation it was widely known that three, including the buyer, were real estate developers, while the other three do not carry out any industrial activities that would even remotely link them to tractor manufacturing. All six bidders participating in the auction were real estate developers or companies active in the metal construction industry.

The closing decision reiterated and embraced the comments submitted by the parties.

Potential risks

According to European state aid legislation, only the member state concerned is under an obligation to notify the EC of the new state

aid in advance. This stipulation leaves the party most interested in compliance with state aid rules (the investor) out of the picture.

Moreover, in a case of the sale of assets, the investor deals primarily with the state-owned company and not with the public authority representing the state. Acquisition of assets through an open public bid is, for the investor, the most convenient method of dealing with the public sector, instead of lengthy negotiations. Nevertheless, the confidence of investors in procedures involving a state-owned company in Romania was considerably affected by these experiences. The risk exposure is high: while the EC has the power to assess the existence of illegal state aid, the national authorities have the duty to recover such found illegal state aid. The implementation of recovery of state aid is dealt with by Romanian Government Emergency Ordinance 117/2006. Following this enactment, the state aid grantor (the public authority) will immediately inform the beneficiary on its duty to reimburse or recover the state aid based on the EC decision. To the extent that the beneficiary does not comply with this obligation, the authority will bring the action to court, seeking the cancellation of the action under which the state aid has been granted and the recovery of the aid with interest added. The underlying consequences are therefore extreme for investors: this has resulted in extra caution when conducting business with state authorities.

In the Tractorul case, it is very likely that if the EC had received a clear picture of the transaction from the authorities from the beginning there would have been no investigation.

The tool available to investors in such cases is the raising of the public authorities' awareness of their duties and responsibilities. Moreover, the role of the legal adviser is crucial in making assessments of the state aid implications in