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CONSTITUTIONAL LIMITATIONS ON PRIVATISATION

The Constitution of the Portuguese Republic
and the constitutional case-law
— a few notes —

I

The 1980s were fertile in many a country as far as privatisations are concerned and Portugal did not escape such general trend, with a particular feature — privatisations were carried out few years after the Revolution of 25 April 1974.

In fact, one can say that it was in the aftermath of the Revolution that a State's direct intervention in the economy actually occurred (although the State used to intervene in some sectors of the economy before, but to a rather small degree, and in the framework of a State which called itself corporatist).

The first provisional government following the Revolution envisaged to nationalise the central banks, other activities would follow, including the insurance groups, electric supply industry, basic sectors of industry, capital market, etc.

The 1976 Constitution of the Portuguese Republic, the first Constitution enacted after the Revolution, **safeguarded the nationalisations accomplished, and forbade the privatisations.**

In its Article 83, the Constitution recognised that all nationalisations carried out after 25 April 1974 "*shall be irreversible conquests by the working classes*", a principle which apparently finds no corresponding provision in other countries, at least in the western world.

Nevertheless, paragraph 2 of the said Article provided that including in the private sector, in very special circumstances, small and medium-sized enterprises indirectly nationalised which were **outside the basic sectors of the economy** (as specified in the law) was an exception to the principle of the irreversibility of nationalisations (provided that the employees did not opt for self-determination or co-operative systems).

On the other side, Act no. 46/77 of 8 July (the first law enacted after the Revolution on the delimitation of the public and private sectors), under which private undertakings and other entities of a similar nature were barred from operating in certain sectors, forbade only the private acquisition of nationalised enterprises, whilst those acquired through other means were left outside this prohibition. Foreign businesses listed in the law were likewise excluded.

Since the measures taken were focused on enterprises rather than on economic sectors, it is no wonder that the privatisation issue had to be addressed, to some extent, on a case to case basis.

At that time, the private sector in the ownership of the means of production was enshrined in Article 89 of the Constitution of the Portuguese Republic (and the public and co-operative sectors as well), and the property ownership and the social form of management were the two criteria under which certain property and production units would be included in one of such sectors (Art. 89, para. 1); then, the question was immediately raised whether the ownership of nationalised enterprises where the concession of exploitation was granted to private bodies under certain conditions (employees had to be heard, if it was deemed necessary for a better achievement of the public interest and of the objectives of the Plan, and never with a final character) would be transferred to the private sector.

The answer to that question was given by the Constitutional Commission [1] which declared that such enterprises would not return to the private sector whereas, by inserting the expression "*social form of management*", the legislator "*wanted to introduce a new element for a better characterisation of the public property, since the classic or civil concepts were recognisedly insufficient to characterise the so-called administrative property; it was meant to refer to the more or less real and effective mode of ownership and exploitation of the property which is the object of such form of ownership and of social relations of production that can arise therefrom. It is thus an element which is economic rather than legal in character.*

An element which, in any event, shapes or affects not only the public sector and the co-operative sector, but the private sector itself (...); this is easily understood, because, as regards the private sector, one can also speak of a social manner, form or relation of production, although differing from that which corresponds to the public sector and even to the co-operative sector" (Opinion no. 15/77, in *Pareceres da Comissão Constitucional*, vol. 2, p. 67).

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[1] The Constitutional Commission was an advisory body to the Council of the Revolution as far as the abstract review of the constitucionality was concerned. It was extinguished when the Constitutional Court was set up in 1982.

Until 1987 it was understood that the prohibition of privatisations would encompass the impossibility to achieve the privatisation of a public enterprise, even if it was partial and a minority of the assets was to be transferred.

Yet, since then, as a consequence of a parliamentary majority which advocated a large-scale reprivatisation programme, the privatisation of 49% of the capital of public enterprises was allowed, by way of transformation of such enterprises into mixed companies under state control.

According to the first version of the Constitution (Art. 85, para. 3), it was incumbent upon the State to ensure that the Constitution of the Portuguese Republic, the Law and the Plan were complied with by the private undertakings, and the State could intervene in the management thereof with a view to safeguarding the general interest and the employees' rights, in a manner to be determined by law.

Under Article 81 (j), the State had the prime duty to ensure fair competition between undertakings, protection being afforded by law to small and medium-sized enterprises which were economically and socially viable.

In view of such principles, the private sector, although protected by the Constitution, had no relevant role to play in the economic order under the Constitution.

The public and co-operative sectors were of the utmost importance.

II

The **first constitutional amendment of 1982** modified the wording of the provision which allowed the State to intervene in the management of the private undertakings, so as to establish that the State might intervene in the management thereof *temporarily.*

Act no. 84/88 of 20 July sets out the basic legal framework in which the first partial privatisations of state-owned enterprises would take place.

It enables the transformation of such enterprises, even nationalised, into public companies, in accordance with the Constitution and the law, where the whole or the majority of the capital is owned by the State.

Such transformation would take into account the requirement that it should not include the reprivatisation of the nationalised capital, with the exception of the cases provided for in Article 83 (2) of the Constitution of the Portuguese Republic (the wording of this Article, which has already been mentioned, remains

unaltered), and the public stake which represented the capital assumed by the State at the time of the nationalisation should always be maintained.

Moreover, the absolute majority of the share capital should always be in the public ownership and there should ever be a public majority stake in the corporate bodies.

Without prejudice to Article 83 mentioned above, the State or any other public entity could dispose of their shares in the company, subject to the following rules: ***(a)*** at least 20% of the shares to be offered for sale would be reserved for small shareholders, employees of the company and former employees who had worked for the company for over three years; ***(b)*** up to 10% of the shares to be offered for sale might be reserved for small subscriptions by emigrants; ***(c)*** natural or legal persons which were outside the public sector would not acquire more than 10% of the shares, otherwise the transaction would be declared null and void; ***(d)*** the number of shares allotted to foreign entities, whether natural or legal, or those entities with a majority of foreign shareholders would not exceed 10%, otherwise the transaction would be declared null and void, too.

We will not examine this enactment further, once it is no longer in force; but it is noteworthy that there was some doubt, at the draft stage, about its conformity with the Constitution.

Under Article 83 (1) of the Constitution of the Portuguese Republic, the act of denationalisation was forbidden and, owing to the special historic environment which fuelled the appearance of this provision, the principle of the irreversibility of nationalisations contained another barring dimension: the prohibition that either the capital existing at the time of the nationalisation, or the capital derived from the incorporation of the reserves existing at the relevant time, be disposed of in favour of private bodies.

Article 89, which provided for the delimitation of the sectors in the ownership of the means of production, based on property ownership and form of management (para. 1), set forth that the public sector was composed of the property and production units belonging to public bodies or to communities, under the following social forms of management:

a) Property and production units which are managed by the State or other legal persons under public law;
b) Property and production units which are used and managed by workers;
c) Community property which are used and managed by local communities.

Article 89 (3) established that the private sector comprised the property and production units owned or managed by natural or legal persons under private law, without prejudice to the provisions of the following paragraph.

The following paragraph (para. 4) provided that the co-operative sector was composed of the property and production units owned and managed by members of co-operatives, in accordance with the co-operative principles.

Now, the Constitutional Court, which had been set out in the meantime, held (Judgment no. 108/88, published in *Acórdãos do Tribunal Constitucional*, vol. 11, pp. 83 *et seq.*) that the said enactment (at the stage of the preventive review of constitutionality — we mention it again) would not respect the principle of the irreversibility of nationalisations only if, in the light of the system arising therefrom, it was ascertained that it enabled, in any way, the transfer of such enterprises from the public sector to the private sector of the means of production, or the disposal in favour of private bodies of the capital existing at the time of the nationalisation or of the capital resulting from the incorporation of the reserves existing at the relevant time.

However, according to the system laid down by the said Act no. 84/88, the capital of the public companies arising out of the transformation of public enterprises was, in whole or in its majority, owned by the public stake and such companies were run in accordance with the will of that public shareholder, which always had a controlling interest in the corporate bodies.

The Court went on to state that, by comparing the definitions of the public and private sectors as enshrined in the Constitution with the status of the public companies laid down by that Act, such companies could be included in neither of the two sectors which were clearly separated by virtue of Article 89(1), in the light of two vectors referred to therein: the ownership and the social form of management.

The rules governing public companies (the possibility of integrating them in the co-operative sector being excluded, because they have no connection with this sector) could not fit either in the provision which, pursuant to Article 89(2) of the Constitution of the Portuguese Republic, defined the public sector, or in that which, according to paragraph 3 of the said Article, defined the private sector; they rather determined, in a different manner, vectors pertaining to the one and the other sectors defined in the Constitution.

Only by broadly construing Article 89(1), which relied upon the idea that situations which did not fit immediately in any of the constitutional definitions of the sectors of ownership of the means of production should be included in the sector which apparently was most connected therewith, importance being, in such reasoning, necessarily attached to the social form of management vector,

was it possible to situate the companies established by that enactment in one of the two sectors.

And, thus, the rules governing such companies tended to be nearer the constitutional definition of the public sector than that of the private sector, not only because, on the one hand, it satisfied entirely one of the vectors contained in that definition (management by a public entity), but virtually fulfilled — bearing in mind that the majority of the capital was reserved for the public stake — the other vector specified in that definition (the public ownership).

On the other hand, it did not satisfy substantially, from the constitutional point of view, any of the two alternative vectors which defined the private sector (the ownership or the management by private entities).

In these circumstances, the public companies formed with a majority of capital in public ownership and resulting — according to the rules established by that Act — from enterprises nationalised after 25 April 1974 (whether they had the status of public companies or not) would be included in the public sector.

Therefore, such rules did not entail the denationalisation of public companies; consequently, there was not, on such ground, any breach of the said principle of the irreversibility of the nationalisations.

The Court further declared that such ruling should necessarily apply to the transformation of enterprises nationalised thereafter into public companies where the capital was exclusively in public ownership as referred to in Section 1 of the Act, once such companies satisfied directly the two criteria adopted for the definition of the public sector enshrined in the Constitution.

Considering that Section (1) (a) of that Act, combined with Section 8 (the nationalised companies which are not recognised the status of public company will be subjected to the principles and rules enshrined in this Act), established that the transformation of nationalised enterprises into public companies would never imply the reprivatisation of the nationalised capital, then the principle of the irreversibility was not, vis-à-vis this safeguard, called into question.

Neither was it challenged for the fact that the said enactment did not provide, at least clearly, for a similar safeguard with regard to the capital derived from the incorporation of the reserves existing at the time of the nationalisations.

As a matter of fact, the Court held that the said provision, in establishing that the transformation of the nationalised enterprises into public companies would not amount to the reprivatisation of the nationalised capital, and the shares representing the capital assumed by the State at the time of the nationalisation should at all times be held by the public stake, permitted two possible interpretations.

Indeed, the provision that kept the capital in the hands of a public entity could refer to the so-called share capital or legal capital of the nationalised enterprise, as well as to the economic capital thereof which would incorporate, besides the share capital, the reserves at the time of the nationalisation.

Since these two interpretations are possible, and since one of them, by contrast to the other, though being possible, did not satisfy the principle contained in Article 83(1) of the Constitution of the Portuguese Republic, one had to opt, in accordance with the principle of the interpretation consistent with the Constitution (which supposes that a rule contains, *prima facie,* various meanings and that one of such meanings, contrary to others, is compatible with the constitutional text), for the reading according to which there was an absolute safeguard to protect the economic capital existing at the time of the nationalisation of each company.

Thus, on such ground, there was no infringement of the principle of the irreversibility of the nationalisations.

And whereas the companies with mixed capital, resulting from the transformation of public enterprises operating in the sectors barred to the private initiative, remained in the public sector, it would never be possible to put an end to the prohibition under which some sectors of the economy were barred to the private initiative.

Therefore, that Act did not violate Article 85(3) of the Constitution of the Portuguese Republic, which establishes that the law will define the basic sectors wherein private companies are forbidden to operate.

To sum up: the Constitutional Court ruled that there was no denationalisation, the principle of irreversibility of the nationalisations being observed, if a participating interest was retained by the State and there was a controlling interest in the corporate bodies.

That means that the disposal of 49% of the share capital did not amount to denationalisation.

The Constitutional Court still ruled (in Judgment no. 157/88, published in *Acórdãos do Tribunal Constitucional*, vol. 12, pp. 107 *et seq.*) that the principle of the irreversibility of the nationalisations will not demand the absurd consequence of preventing new undertakings being formed, *maxime* trade companies, even if these companies must, hypothetically, be deemed to be included in the private sector, into which a part of the assets of publicly-owned enterprises, which meanwhile ceased to exist on the ground of unprofitability, will be transferred, when simultaneously it is established that the State will retain the control of the new undertakings.

This constitutional amendment of 1982 marked an ideological weakening of several constitutional provisions, a greater openness towards the private initiative, while the role of the Plan diminished.

It enshrined the obligation on the legislator to define the sectors which are barred to the private initiative, and this would correspond to a definition of reserves in favour of the public sector.

Certain sectors which had been barred to the private initiative until then, in that they were basic sectors of the economy (as was the case of the banking and insurance sectors), could henceforth be privatised, owing to the amendments of the Constitution.

III

Notwithstanding, it is the 1989 Constitutional amendment Act that more extensive changes introduced in the Constitution, the safeguard of the nationalisations was eliminated as the principle of the irreversibility was deleted, the role of the planning was reduced, whereas the private sector of the economy was strengthened, in short, the ideological weight of a "*transition to socialism*" was removed.

Article 85 (1) henceforth reads as follows:

1. The reprivatisation of the ownership of, or the entitlement to exploit, the means of production and other property nationalised after 25 April 1974 shall be carried out only in compliance with a framework law adopted by the absolute majority of the Members of Parliament entitled to sit therein.

2. Small and medium-sized undertakings indirectly nationalised which are outside the basic sectors of the economy might be reprivatised in accordance with the law.

As regards the sectors in the ownership of the means of production, Article 82 sets forth:

1. The coexistence of three sectors with respect to the ownership of the means of production shall be safeguarded.

2. The public sector shall comprise the means of production that belong to and are managed by the State or other public bodies.

3. The private sector shall comprise the means of production that belong to or are managed by private persons or private corporate bodies, without prejudice to the provisions of the following paragraph.

4. The co-operative and social sector shall comprise the following:

a) The means of production that belong to and are managed by co-operatives in accordance with the co-operative principles;
b) The community's means of production that belong to or are managed by local communities;
c) The means of production that are collectively exploited by workers.

The reference to the building up of a "*socialist society*", to "*the classless society* ", to the "*development of social property*" were deleted by this amendment, Article 2 of the Constitution of the Portuguese Republic now providing that the aim of the State is to achieve economic democracy and to push participatory democracy further as objectives of the democratic political organisation.

The private sector now comprises the property and production units that belong to or are managed by private natural or legal persons.

All publicly-owned means of production which are run by private bodies under a contract are included in this sector.

The **framework-law** referred to in Article 85(1) shall observe the following fundamental principles, in accordance with Article 296 of the Constitution:

a) Re-privatisation of the ownership of or the right to exploit the means of production or other property nationalised after 25 April 1974 shall, as a rule and preferably, be carried out by way of competitive tendering, flotation on the stock exchange or public subscription;
b) Revenue obtained from the re-privatisation shall be used only for the purpose of redeeming the national debt or the debts of State-owned undertakings, or for servicing debts contracted as a result of the nationalisations, or for new investments in the share capital of the productive sector;
c) In the re-privatisation process, workers of re-privatised undertakings shall keep all their rights and duties;
d) Workers of re-privatised undertakings shall be given a preferential right to subscribe to a percentage of the share capital thereof;
e) Before re-privatisation, there shall be a valuation of the relevant means of production and of other assets undertaken by more than one independent body.

It is in this constitutional environment that the framework law on privatisations is adopted (Act no. 11/90 of 5 April still in force).

The Act just mentioned did not escape being reviewed by the Constitutional Court with regard to the consistency thereof with the Constitution.

In Judgment no. 195/92 (published in *Acórdãos do Tribunal Constitucional*, vol. 22, pp. 245 *et seq.*) the Court held that the provision which enables undertakings operating in basic sectors specified by law to have a private stake not exceeding 49% in their legal and economic capital (s.2) was not incompatible with the Constitution.

Considering that Article 87(3) of the Constitution provides that the law will determine the basic sectors where private companies and other entities of a similar nature shall not operate, the Constitutional Court ruled that there was no infringement of the provision at stake because such companies do not cease to be included in the public sector therefor, their activity not being thus pursued by private undertakings.

Furthermore, the Court decided that the said Act, by including the requirement (s. 5, sub-s. 1) that the assets to be reprivatised be evaluated previously by at least two independent entities chosen from among those whose applications were accepted as to their independence in a competitive tender opened for that purpose, with the safeguards arising therefrom, reinforces the general principle contained in Article 296 (e) mentioned above sufficiently; there is accordingly no need to specify the criteria for the selection and for securing the independence of the entities who will conduct the valuation.

The methods and procedure to carry out the reprivatisations are translated into privatising through competitive tendering, direct sale, capital reserved for employees, small shareholders and emigrants, share acquisition or subscription by small shareholders and emigrants.

Pursuant to Section 4, public enterprises to be reprivatised will be transformed by decree-law into public companies in accordance with this Act.

The said decree-law will approve the methods and procedure whereby each stage of the reprivatisation will be accomplished, including the grounds for the adoption of certain modes of negotiation, the special conditions for purchasing shares and the period during which shares will not be disposed of as far as those acquired, or subscribed to, by small shareholders and emigrants or by employees are concerned.

With regard to reprivatisations carried out by competitive tendering, flotation on the stock exchange or public subscription, no natural or legal person is allowed to acquire or subscribe to more than a certain percentage of the capital to privatise, or there will be a forced sale of the shares exceeding such

limit, forfeiture of the voting rights attaching to shares in excess or declaration of nullity, as may be determined.

The act on transformation may in addition set out a limit on the overall number of shares to be purchased or subscribed to by the foreign entities or by those where a great part of the capital is owned by foreign entities, and set out the maximum value of their stake in the share capital and specify the corresponding control arrangements, subject to forced sale of the shares exceeding such limits, forfeiture of the voting rights attaching to such shares, or declaration of nullity of such acquisitions and subscriptions, as may be determined.

Exceptionally, and where it is justified on grounds of national interest, the act which approves the articles of the company to be reprivatised may, in order to safeguard the public interest, make provision for the resolutions concerning certain matters to be ratified by a director appointed by the State.

Exceptionally too, and for the same reasons, the said act may provide for privileged shares designed to remain in the state-ownership, which, regardless of their number, will grant the right to veto any modification to the memorandum and any other decisions on certain matters which must be duly specified in the articles.

A Commission has been established for monitoring the reprivatisation process which has the duty to support the Government in technical matters and to supervise and control the stages in the disposal of shares or increase in the capital of public enterprises transformed into public companies where the majority of the capital is owned by the State.

Finally, the revenue of the State derived from the reprivatisations will be exclusively used, separately or jointly, for the purpose of:

a) Redeeming the national debt;
b) Sinking the debt of the State owned companies;
c) Servicing the debt arising out of the nationalisations;
d) New investments in the share capital of the public sector.

Lastly, a case, among many others, is worth mentioning.

As a mere example, and in the development of the legal rules set forth by Act no. 11/90, the Government, by publishing Decree-law no. 193-A/97 of 29 July, approved the two-stage reprivatisation of the whole share capital of *Setenave Estaleiros Navais de Setúbal*, a public enterprise created by Decree-law no. 182/76 of 9 March, after being nationalised.

At the first stage of the reprivatisation, 95% of the share capital was disposed of by direct sale, at the second stage 5% of the capital was disposed of through public offer reserved for the employees of the *Setenave* and small subscribers.

The shares corresponding to 51% of the capital which were acquired in the direct sale will, in any circumstance, not be disposed of before three years have lapsed from the date of publication of the Resolution of the Council of Ministers which identified the purchaser.

The Council of Ministers, by a Resolution, approved the relevant rules, including the conditions of the sale, justified by the reality of international markets and by the strategy defined for the sector.

It also set out the concrete conditions which would apply to the public offer of the shares.

As to the shares acquired by the employees and by small subscribers in the framework of the public offer, it was established that they would not be disposed of for three months.

Reprivatisations of many other enterprises are currently under way, some of them being at the third stage already; for each company a decree-law has been enacted making provision, *in concreto*, for the methods and conditions of the reprivatisation, but always within the framework of Act no. 11/90.