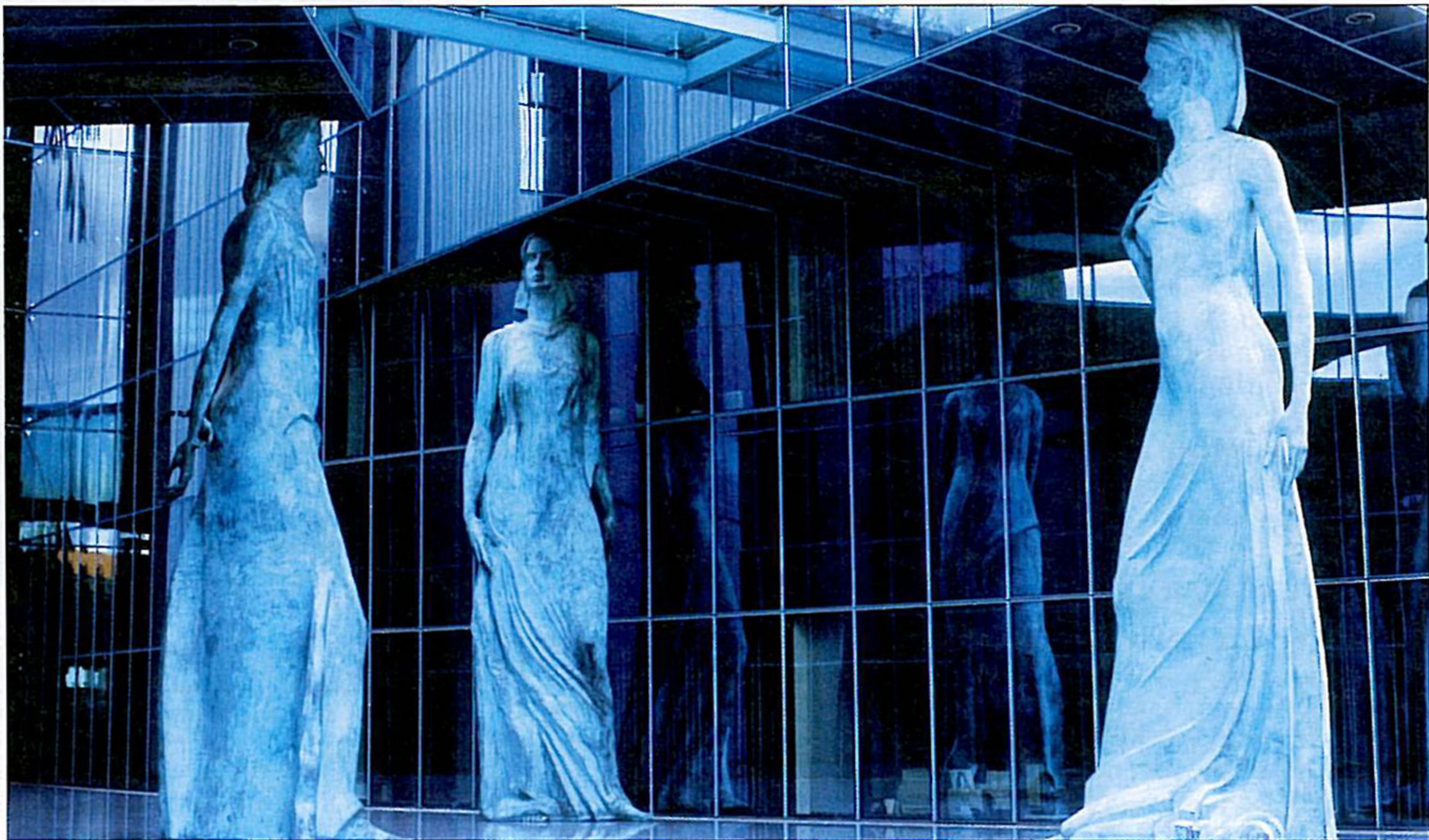


CENTRAL AND EASTERN EUROPE

Pole position

The implementation of EC legislation will make it easier for Polish companies to complete LBOs. It's a step in the right direction, says **Maciej Jamka**



Despite the considerable downfall in the securities market and the tightening of credit availability, the outlook for the private equity sector is optimistic.

Last year saw an unprecedented peak in both fundraising and investment in the Central and Eastern European region and 2008 has potential as well.

For example, Advent International just completed a fund of €1bn (£790m) – of which 20-40 per cent will be invested in Poland – and Bridgepoint is said to have invested €500m (£397.15m) in the region. Moreover, there is still a demand for shopping centres and acreage is predicted to double in the next 2-3 years with €3bn (£1.54bn) planned for this type of investment.

Currently, the Polish parliament is working on a set of amendments to the Commercial Companies Code that will implement EC legislation into the national regime. The idea behind the recent EC directive is to relax rules on the guarantee function of share capital and to make certain types of corporations across the European Economic Area more flexible and thus more attractive as investment vehicles.

There are two types of corporation in Poland: a limited liability company, which is a strictly private entity, and a joint-stock company, which can be either public or private.

Leveraged buyouts (LBOs) are currently not allowed with respect to joint-stock companies. The law also prohibits joint-stock companies from making loans or advance payments, establishing security interest or financing in any manner

whatsoever the purchase or taking up of its own shares.

Joint-stock companies are also not popular due to a number of issues relating to operation requirements, disclosure obligations and the like.

However, if an investor wants to take a company public or exit through an IPO, it must transform it into a joint-stock company. Consequently, in the private equity market the most popular vehicle is a limited liability company, which is also not subject to the financial assistance restriction and is thus fit for LBOs.

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The current situation makes private equity an attractive source of capital, and managerial skills and a trade sale seems an even more preferable exit for investors.

To make joint-stock companies more flexible vehicles, the amendments in Polish law will abolish the flat prohibition of financial assistance, with the company allowed to give financial assistance for the purchase of its own shares under certain conditions:

► The financing must be provided on 'fair market conditions', especially in relation to interest received by the company or security interest established in its favour. The financial condition of the debtor or any third

parties involved should also be duly verified.

► The shares must be purchased or taken up for a 'fair price'. Unfortunately, there is little guidance from the legislator on how to interpret this phrase.

► A prior establishment of reserve capital is required, pursuant to the provisions of Polish law.

► Financial assistance must require a prior resolution of the company's general meeting, which should lay down the terms of such assistance. A detailed written report of the company's management board should constitute the basis for the resolution. The report must be submitted to the registration court and published.

Without doubt, opening the door to a market that has been isolated from certain types of transactions is a good move. Not only could a whole group of companies benefit from it, but the Polish economy could too.

Nevertheless, it seems the move is a little too shy. The requirement of creating reserve capital from the company's net income undermines the essence of a classic LBO. EC law and legislative history make it clear that financial assistance should be allowed to the extent of the distributable reserves, which should provide for full cover of the risk associated with financial assistance.

Therefore, it is doubtful if this framework generates a whole new trend of transaction in the Polish market. Of course, one can always transform a joint-stock company into a limited liability company for the purpose of a LBO. But the law should make life easier, shouldn't it? ■

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