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RESEARCH ARTICLE

DRAFT AMENDMENT TO THE POLISH ACT ON PUBLIC-PRIVATE PARTNERSHIP CONCERNING REVENUE BONDS AND ALLOCATING PUBLIC FUNDS IN INVESTMENT FUNDS. AMENDMENTS PROPOSED BY THE AUTHORS

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ABSTRACT

The purpose of this paper is to present current situation on PPP market, financial barriers to its development and suggested amendments in Polish law to enhance the development of PPP market concerning revenue bonds and possibility of allocating national funds in investment funds.

Key words:

public-private partnership,
revenue bonds, investment
funds

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INTRODUCTION

The purpose of this paper is to propose regulations, which encourage development of public-private partnership ("PPP") market in Poland. The authors based on the analysis of the domestic (Polish) law and the empirical data.

The Main Legal Regulation On The Ppp Market In Poland

Public-private-partnership is a relatively new form of investment in Poland. Not until 2009, when the Public-private-partnership Act was implemented, a single PPP projects has been noticed.

The Act of 19 December 2008 on public-private partnership ("PPP Act") contains basic definitions and principles of collaboration between the public entity and the private enterprise within the framework of the public-private partnership. According to this regulation, the subject of public-private partnership is joint implementation of a project based on a division of tasks and risks between the public entity and the private partner.

A public entity means in the Act

1. a public finance sector unit as defined by the provisions on public finance;
2. a legal person other than that specified under point 1 established for the special purpose of satisfying general needs that are not of industrial or commercial nature, if the entities specified in this provision and under point 1, individually or jointly, directly or indirectly through another entity:
 - finance it in over 50%, or
 - hold more than half of the shares, or
 - supervise its managing body, or
3. unions of entities specified under point 1 and 2.

According to the PPP Act, a private partner is an entrepreneur or a foreign entrepreneur.

A project means

1. construction or refurbishment of a building, or
2. provision of services, or
3. performance of a work, in particular equipping an asset with devices increasing its value and use, or

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- other service - combined with maintenance or management of the asset that is used for implementation of the public-private partnership project or related to it.

By the public-private partnership agreement, the private partner commits to implement the project at a remuneration and to cover in whole or in part the expenditure for project implementation or to have them covered by a third party, while the public entity commits to collaborate with the aim of achieving the project objective, in particular by making its own contribution.

The PPP Act regulates general issues of public-private partnership, such as:

- general provisions,
- selection of the private partner,
- public-private partnership agreement and implementation of public-private partnership,
- public-private partnership in the form of a company,
- provisions in the domain of public finance.

It contains neither economic nor financial instruments aimed at development of public-private-partnership. Moreover, these issues are also neglected in the other Polish acts of law.

Current Situation In The Ppp Market In Poland

Although the PPP Act improved functioning of PPP market in Poland, comparing to the situation from before its entry into force, present regulations did not result in dynamic development of PPP market in Poland. In 2009, the number of announcements for PPP projects amounted to 44 and 1 contract was signed. To the end of 2014, 82 contracts were signed and 342 PPP projects were announced.

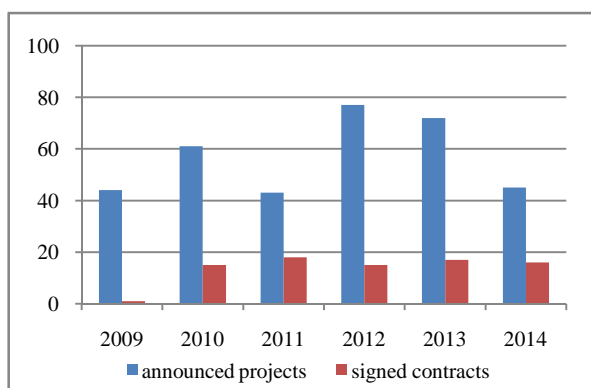


Chart 1 PPP market in Poland

Source: prepared by Authors based on *Raport na temat rynku PPP i koncesji w Polsce w 2014 r. na tle stanu obowi zuj cego w latach 2009-2013*, Polish Ministry of Economy, Warsaw 2015.

The vast majority of announced projects in the years 2009-2014 was issued by local governments. As a result, the PPP projects were investments in the local scale. PPP projects concerned such undertakings as for example: the building or the rebuilding of the local road infrastructure, the building or the rebuilding of the local sports facilities, the building of the thermal modernization of schools, the building of water-sewer network in the commune or the building of car parks. In

contrast with the Western European countries, such as for example France and Germany, projects in the nationwide scale were not implemented in Poland so far.

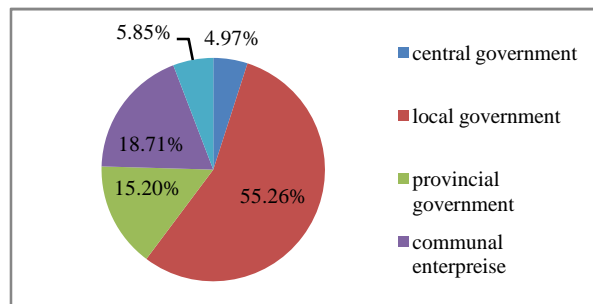


Chart 2 Public partners participation in announced PPP projects

Source prepared by Authors based on *Raport na temat rynku PPP i koncesji w Polsce w 2014 r. na tle stanu obowi zuj cego w latach 2009-2013*, the Polish Ministry of Economy, Warsaw, Poland 2015.

On account of local character of PPP projects, their average value was relatively low. The most PPP projects in the years 2009-2014 cost more than 1,25 mln and less than 12,5 mln EUR each one. Many projects had even a value lower than 1,25 mln EUR. According to the document prepared by the Polish Ministry of Economy titled “Results of the work of the Sub-assembly for manners of wider using the PPP instrument at the realization of large investment projects”, the Polish government aims to increase the number of large PPP projects. As a result, the average value of PPP projects in Poland is expected to rise in the future.

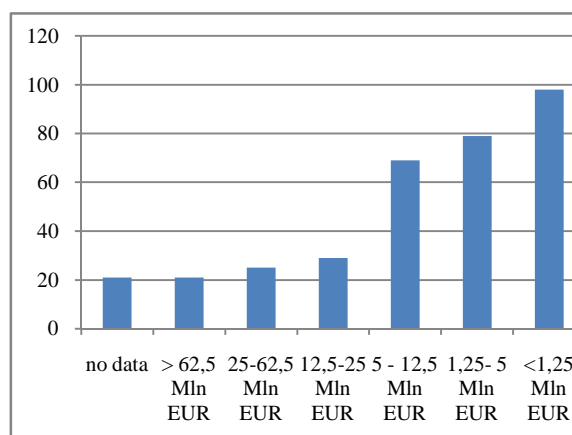


Chart 3 Value of announced PPP projects in Poland in the years 2009-2014 (number of projects)

Source: prepared by Authors based on *Raport na temat rynku PPP i koncesji w Polsce w 2014 r. na tle stanu obowi zuj cego w latach 2009-2013*, the Polish Ministry of Economy Warsaw, Poland 2015.

Financial Barriers To The Development Of Ppp Market In Poland

The difficulties in securing funding for projects (bankability) is one of the most important barriers to the development of PPP market in Poland.¹ The PPP projects are mostly the long term investments for about 20 years and require a long-term financial commitment. Both, public and private partners show

¹ *Ocena obecnego stanu i perspektyw finansowego zaangazowania sektora prywatnego i publicznego w rozwój PPP w Polsce*, the Polish Ministr of Economy, Warsaw, Poland 2013.

strong tendency to restrict their own financial commitment in such projects.

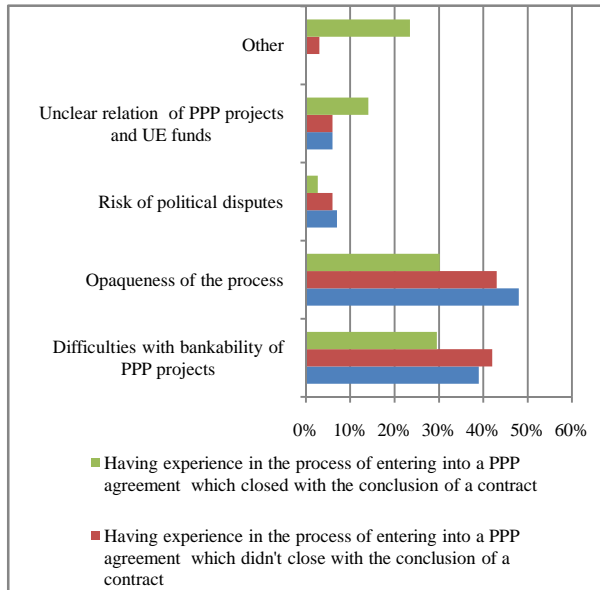


Chart 4 The reasons for the current low financial commitment by the private sector in PPP projects

Source: prepared by Authors based on *Ocena obecnego stanu i perspektyw finansowego zaangażowania sektora prywatnego i publicznego w rozwój PPP w Polsce*, the Polish Ministry of Economy, Warsaw, Poland 2013.

At the same time, the domestic financial market opportunities of obtaining long-term investment lending are currently relatively limited. The long-term credits are granted in Poland only by a few banks (for example the Bank Gospodarstwa Krajowego - the Polish state-owned development bank).

Taking into account, that currently difficulties with bankability appear by relatively low average value of the projects it is expected, that financial obstacles will become much more significant in the future, when larger projects with much higher financial commitment, will be prepared. Therefore, there is a strong need for development of opportunities for long-term investment lending.

Suggested Ammendements

The development of opportunities for long-term investment lending might be enhanced by implementation of revenue bonds or investment funds

Revenue bonds and investment funds

It is considered a significant disadvantage in relation to limiting the possibility of issuing revenue bonds in Article 25, item 1, point 4 and 5 of the Act on bonds, i.e. only reference to public sector entities which are local government units and the Treasury. In accordance with Article 9 of the Act of 27 August 2009 on public finance, the public finance sector is formed by:

1. public authorities, including government bodies, state control and law protection bodies as well as the courts and tribunals;
2. local government units and their associations;
3. budgetary units;

4. government budgetary establishments;
5. executive agencies;
6. budget economy institutions;
7. state earmarked funds;
8. The Social Insurance Institution (ZUS) and funds managed by it and the Agricultural Social Insurance Fund (KRUS) and the funds managed by the President of the Agricultural Social Insurance Fund (PKRUS);
9. National Health Fund (NFZ);
10. independent public health care (ZOZ);
11. public HEIs (Higher Education Institutes);
12. Polish Academy of Sciences and its organizational units;
13. State and local cultural institutions;
14. other state or local government legal entities established under separate acts for the execution of public tasks, with the exception of enterprises, research institutes, banks and commercial companies.

In addition, there are also entities beyond the public finance sector, which are formed in order to carry out public tasks. In this case, the definition of the act on public-private partnership can be used. However, it appears advisable to clarify the terms of the State Treasury and local governments by replacing them with the words "public entity". Such a concept is defined in Article 2, item 1 of the Act of 19 December 2008 relating to public-private partnerships [Lasecki, Skuza, 2015].

The adoption of this change would avoid doubts whether capital involvement in the company would be treated as an agreement with the State Treasury (e.g. public universities, state legal persons). It should also be noted that this change would not adversely affect the originator's approach to the concept of security issue of revenue bonds, and potential changes would apply only to the broadly understood public sector and public institutions.

Another drawback of the regulations concerning bonds is the failure to mention the issuing of project bonds, i.e. the revenue bonds guaranteed by public bodies in the directory of revenue bond issuers.

The proposal to implement project bonds appeared for the first time in the so-called Monti Report "A new strategy for the single market at the service of Europe's economy and society". Among the three options for financing infrastructure investments (grants and subsidies, regulatory incentives and financial instruments) considered by the European Commission, the proposal for the construction project bonds received the highest rating in terms of effectiveness, efficiency and impact on the parties concerned. The European Commission has assessed the option to use project bonds as the most preferred because [Marchewka-Bartkowiak, Wisniewski, 2014]:

1. It provides economic incentives for market participants to adjust their behavior without burdening their overall regulatory costs;
2. This option is considered to be the most effective, exerting the most positive impact on stakeholders and enables the introduction of the most significant

improvements in the scope of financing infrastructure projects.

Project bonds are a form of financial instrument to be used to finance commercially viable infrastructure projects. These are securities issued by a special purpose vehicle set up by the entities implementing a given project (e.g. in the framework of public-private partnership). Project bonds are inherently securities with long maturities intended for institutional investors.

The project bond instrument proposed by the European Commission takes the form of a hybrid instrument, which means that in order for it to be effectively used, it is necessary to apply additional financial support instruments to enable risk sharing in order to increase the credit assessment of the underlying instrument, in this case the guarantee of public bodies. Project bonds should be constructed as revenue bonds, i.e. the repayment of debt incurred to finance the project in question follows from revenues derived from its operation. Therefore, the project bond combines both features of traditional public bond structurally, as well as the revenue bonds [Marchewka-Bartkowiak, Wisniewski, 2014].

The use of the instrument of project bonds could lead to an increase in the public investment funding capability limited by the debt, because revenue bonds, public guarantees (at least partly) are not included in the limits of public debt especially debt of local government authorities due to the involvement of public-private partnerships. Furthermore, the introduction of such an instrument would cause institutional investors to increase interest in the concept of *project finance* and public-private partnerships due to the possibility of financing investments at a lower cost, thanks to guarantees of public entities [Marchewka-Bartkowiak, Wisniewski, 2014, Puszer, 2014].

Until recently, the European market for public-private partnership was largely dependent on project finance awarded by commercial banks or public financial institutions. From the onset of the financial crisis, securing financing from commercial banks has become more difficult, and lending conditions have deteriorated, which has contributed to the possibility of securing loans for projects of public-private partnerships in relation their price and quality. Financing the implementation of the necessary investments exclusively with public funds would not be possible even during the healthy condition of public finances in EU countries [Puszer, 2014]. Therefore, it would be appropriate to introduce solutions that all entities conducting public tasks, regardless of other criteria, maintain the right to issue revenue bonds, subject to guarantee or pledge of public bodies as defined in the act on public-private partnership for the commitments arising from such bonds.

The argument should be considered whether it is justifiable maintain a directory of issuers of revenue bonds. The recognition that revenue bonds represent securities with higher risk should be firmly opposed. The possibility of limitation of liability by the issuers of the bonds is matched by the issue of

separate accounts of the projects and the identification of assets acquired in the context of a particular project. It must also be remembered that the exclusion of liability is a faculty, not an obligation. In the case of a Special Purpose Vehicle ("SPV") having the right to a exclude liability revenue bonds, or the lack of it, practically does not pose a difference as the *de facto* company will have only the assets related to the financing of project using revenue bonds. To sum up, in the case of revenue bonds, the potential investor is obliged to evaluate the project and its credibility, not the entity issuing revenue bonds [Lasecki, Skuza, 2015].

The second instrument to facilitate the financing of PPP projects may be investing in mutual funds by public sector bodies. This trend can be observed in developed market economies whereby public tasks for collective investment institutions are carried out (infrastructure funds, funds created by international institutions such as the EIF and EFSA). For this reason, it is appropriate to consider the possibility of wider use of these institutions to raise funds for specific projects implemented in PPP. In the context of the Polish financial market, closed-end investment funds of private assets deserve special attention.

In the present regulatory environment there is both a lack of legal barriers and counter indications as to the nature of the business to the above forms of investment for the private party of PPP projects. The provisions of the Public Finance Act are limited, however, to possible investment of public sector entities in financial instruments exclusively to purchase shares in companies, therefore under current legal conditions it is impossible for public finance bodies to participate in national or international collective investment institutions. Enabling such a commitment could contribute to the use of forms of financing investments based on market principles, supervised by the relevant authorities and very flexible forms of financing from various investors.

It is reasonable to point to the solution adopted in Article 117, item 3 of the Act of 27 May 2004 on investment funds. The solution provided for in the regulation introduces a minimum amount of one-time subscription for investment certificates issued by closed-end investment fund that is not a public closed-end investment fund, in the amount of 40,000 EUR. The aim of the above solution was to ensure that this type of investment fund was not directed to investors who are not professional investors since, as a rule, they do not have expertise and experience in the field of investment, and therefore require proper protection of their interests. The introduction of a minimum amount of subscription for investment certificates for the closed-end investment fund issuing only investment certificates which, in accordance with the statutes of the fund, will not be offered in a public offering or admitted to trading on a regulated market or introduced to the alternative trading system in the amount of 40,000 EUR, corresponding to solutions in relation to specialized investment funds using closed-end fund investment policy and non-standardized securitization funds already existing in the act. In addition, it should be noted that Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on

markets in financial instruments ("MiFID") provides that professional investor can be considered as a retail investor, who concluded transactions with a value of at least 50,000 EUR each or equivalent in PLN, on the relevant market at an average frequency of at least 10 transactions per quarter over the last four quarters [Lasecki, Skuza, 2015].

Given the scale of financial plans of individual public sector units, at least some of the public finance sector authorities are required by law equal status of professional investors (eg. The Minister of Finance, Minister of Treasury, Minister of Economy, Minister of Infrastructure and Development, the Polish Agency for Enterprise Development) thus, from the point of view of the market, they should be allowed to invest in investment certificates.

It should be noted that Article 49, item 1 of the Act on public finance under the law excludes the possibility of public sector units acquiring shares (with exceptions to entities including local government units and their associations), or stocks in companies and bonds issued by entities other than State Treasury or local government units, and shares in cooperatives, unless a separate law stipulates otherwise.

The provision of Article 49, item 1 of the Act on public finance cited above allows for the acquisition and possession by public sector entities, exclusively listed in that provision relating to types of instruments, i.e.:

1. shares;
2. stocks;
3. bonds.

Although the literal interpretation of this provision seems to refer only to the prohibition of the acquisition referred to in Article 49, item 1 of the Act on public finance relating to certain financial instruments and other property rights. However, the "pragmatic" interpretation seems to be expanding, i.e. interpreting this provision as the prohibition of other types of financial instruments and treating the possibilities for acquisition or purchase by the public finance sector entities as inadmissible.

In order to address all doubts, the possibility of creating public finance sector entities should be extended to a catalogue of instruments referred to in Article 49, item 1 by amending the Act on public finance. With the change of Article 49 item 1 of the public finance act, changes should also be made to Article 124, item 4, point 1 of the Act, which involves the addition to expenditure for the purchase and acquisition of shares indicated in this provision and making contributions to commercial law expenditure on the purchase of investment certificates.

The provisions of the Act on public finance appear to limit the possibility of capital investments in financial instruments on the public side from public funds exclusively to purchase stocks and shares. It appears advisable to allow such involvement to implement public projects. Consequently, it appears advisable to consider the proposed amendments to the public finance act by creating opportunities to invest public funds in investment funds. Although relying on a literal

interpretation, it may be presumed that there is no ban on such activities, but the change would seem to eliminate the risk of the use of teleological interpretation (with the objective of regulating the possibility of public sector entities having only shares in companies and bonds). The institution investment fund, in particular a closed one, enables ensuring stable long-term funding and would enable the acquisition of mixed public-private capital. It is necessary, for example, to draw attention to Article 14, item 1 and 2 of the Act on public-private partnership under which the contract of public-private partnership may provide that in order to perform, a public entity and a private partner will connect a capital company, limited partnership or limited - joint-stock company; the purpose and objects of the company may not extend beyond the scope of a contractual public-private partnership. In some cases, a closed-end investment fund could be a much more appropriate tool to combine public and private funds.

Summary

Considering the above proposal as a *de lege ferenda* one, there are two alternative solutions [Lasecki, Skuza, 2015]:

1. Removal of the catalogue of entities that may issue revenue bonds and limiting their involvement exclusively to institutional or professional investors.
2. Clarification of the revenue bond issuers directory.

Example 1

Article 25, item 1 of the Act of 15 January 2015 on bonds reads as follows

„Article 25. 1. Individuals can purchase revenue bonds referred to in Article 24, item 1, if they make a one-off subscription for these bonds with a value of not less than the equivalent of EUR 40,000 expressed in PLN. The PLN equivalent amount expressed in euros is determined using the average euro exchange rate announced by the National Polish Bank on the day of entry.”

Example 2

Article 25, item 1 of the Act of 15 January 2015 on bonds is as follows

Article 25. 1. Revenue bond issuers may be

1. local government units or an association of these units;
2. Bank Gospodarstwa Krajowego;
3. Krajowy Fundusz Kapitałowy SA, in order to achieve the business activity referred to in Article 5 of the Act of 4 March 2005 on the National Capital Fund (Journal of Laws No. 57, item 491, as amended);
4. joint-stock company or a limited liability company in which the public entity referred to in Article 2 item 1 of the Act of 19 December 2008 on public-private partnership, hereinafter referred to as "public entity", possesses stocks and shares solely or jointly with another public body or shares whereby the number of shares that gives them more than 50% of the total

number of votes at the general meeting of shareholders or partners, or state-owned enterprise, as long as the main business of the company or enterprise is to meet the needs of local communities or perform tasks related to the public general interest;

5. state-owned company or joint stock company or limited liability company, whose main activity is to perform tasks related to meeting the needs of local communities or public general interest under an agreement with a public entity, if the contract is for a period of at least equal to the period of maturity of bonds;
6. state-owned company, joint stock company or limited liability company which, under the authority of the law or on the basis of license or permission to perform tasks, will meet the needs of local communities or general interest or provide services in the field of transport and communication, and maintain and develop the communication infrastructure or transport at least for a period equal to the period of maturity of bonds;
7. joint-stock company with whom the contract for construction and operation or exclusive operation of a toll motorway referred to in Article 1a, item 2 of the Act of 27 October 1994 on toll motorways and the National Road Fund (Journal of Laws of 2012, item 931, as amended);
8. state-owned company or joint stock company or limited liability company, whose main activity is to perform tasks related to meeting the needs of local communities or the general interest, and the execution of monetary obligations arising from the bonds covered by warranty or guarantee of a public entity;
9. a social building society referred to in Article 23 of the Act of 26 October 1995 on certain forms of support for housing construction (Journal of Laws of 2013 item 255)."

In addition, it is also proposed to amend the law on public finance in order to allow public finance sector entities to invest in mutual funds.

The Act of 27 August 2009 on public finance (Journal of Laws of 2013 item 885, as amended) is amended as follows:

Article 49, item 1 is as follows

Public sector entities, with the exception of units, referred to in Article 9, item 2 may not have, or acquire shares in companies or acquire bonds and other financial instruments issued or

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offered by entities other than the State Treasury or local government units, and shares in cooperatives, unless a separate law provides otherwise, subject to item 2."

Article 124, item 4, the following point 1a is inserted after point

expenditure on the purchase or acquisition of units or investment fund certificates, referred to in Article 3, item 1 of the Act of 27 May 2004 on investment funds (Journal of Laws of 2014, item 157, as amended) in investment funds, whose object is to invest funds in specific securities, money market instruments and other property rights in order to carry out public tasks;".

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