Overview of Slovenian Legal Regulation for Possible Transformation of Public Institutions into Commercial Companies

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Abstract

In the present article, the author defines and analyses the legal framework of the transformation of public institutions into commercial companies with an emphasis on the procedures for transforming public institutions into limited liability companies (ltd.). The author first presents the Slovenian legal framework and the new legislation on public-private partnerships (PPP), which was adopted last year. In the second part of the article, the author analyses the new rules, which primarily refer to public companies. These rules apply, mutatis mutandis, to public institutions. The procedures for transforming public institutions into limited liability companies are particularly demanding, as not only the transitional provisions of public-private-partnership legislation regarding public companies apply mutatis mutandis, but also the procedures for the corporate transformation of public limited companies into limited liability companies. The author concludes the article with some open issues regarding such procedures in the Slovenian legal system and the consequences of such transformations for the founders and employees of such transformed public institutions.

Key words: public institution; public sector; public-private partnership; public service; limited liability Company; public limited company; law on public institutions;
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1. Introduction

The transformation of public institutions into commercial companies was envisaged by the Institutes Act (hereinafter IA) adopted in 1991 (last change 2006), which in Article 51 allows that the founder of an institution may decide that the institution or its organizational units are organized as a commercial company. A commercial company is a generic term, which derives from the former Yugoslav legislation on commercial companies. In Slovenia, the Companies Act (hereinafter CA) adopted in 1993 and last amended in 2007 translated this term into a modern, European concept. Later on, however, the legislation on public finance formally prevented the transformation of public institutions. The transformation of public institutions was only allowed under the condition that a special act which regulated the provision of a public service in a certain field, allowed such. Because such special acts did not exist after 2002, transformation procedures were frozen. With the adoption of Article 80j of the Public Finance Act (hereinafter PFA) in 2002, the possibility that public institutions were transformed into other legal entities was practically frozen. Not before the Public-Private Partnership Act (hereinafter PPPA; about PPP see also Grimsey, D. and Lewis M.K., 2005), which entered into force on 7 March 2007, was the transformation of public institutions again possible.

The legislature determined in Article 80j of the PFA that a legal entity may be transformed into a more appropriate organizational form in cases in which there is no longer a need that the state or a municipality provides a public service within the framework of a certain public institution and that the same quality of public service or public commercial service may be provided more effectively in some other manner. This is only allowed if the following two conditions are fulfilled:

- if a law which regulates the provision of a public service or public commercial service in a certain field allows such, and
- if the transformation is in accordance with a national program adopted by the National Assembly of the Republic of Slovenia in a certain field.

In view of the fact that special acts did not regulate this issue, nor were special national programs adopted in individual fields with the possibility of privatization in accordance with Article 80j of the PFA, the transformation of public institutions was consequently practically frozen until the PPPA was adopted.

In the transitional provision of Article 154. The PPPA annulled Article 80. j of the PFA. On the basis of the new regulation in Articles 141, 142, and 143 of the transitional provisions of the PPPA and by the annulment of Article 80j of the PFA, thus in accordance with Articles 144 and 153 of the PPPA, public institutions may be transformed into some other organizational forms, the obligations of which the founders are not personally liable for (PPPA, article 106), and so achieve greater efficiency and effectiveness in providing public service for the benefit of users and the public interest.

The transformation of public institutions into limited liability companies is at present regulated in the PPPA and in the special rules of corporate legislation. The 0 transformation of public institutions is carried out taking into consideration, mutatis mutandis, the rules on the transformation of public limited companies into limited liability companies in accordance with Article 666 of the CA, which is discussed in Chapter 3 of the present article.

2. The Transformation of Public Institutions into Limited Liability Companies in Accordance with the Legislation Regulating Public-Private Partnerships

The transformation of public institutions into limited liability companies was newly introduced into the Slovenian legal order by the adoption and implementation of the PPPA. Pursuant to the transitional provision of Article 144 of the PPPA, the provisions of this act relating to the transformation of public companies and the awarding of concessions to public companies that are transformed into commercial companies, also apply, mutatis mutandis, to the transformation of public institutions. From this perspective, the transformation of public institutions into other organizational forms is justified not only for certain public institutions but also from the perspective of users of their services and the employees in these public institutions in cases in which the public institutions gain most of their revenue from market activities.

Primarily public institutions, which for several years have been earning more revenue in the market than the funds they receive from public financing, will be suitable for transformation. For such public institutions there exists a reason that in accordance with the PPPA they are transformed into limited liability companies, into public limited companies, into European public limited-liability companies (*societas europea*), and also into institutions which are awarded concessions for providing a public service and are 100% owned by the public founders.

In such a manner, the organizational form of public institutions can be legally and economically settled and services, which are provided as a public service newly, defined. Management supervision carried out by a founder can ensure greater efficiency and effectiveness in providing such services and (medicine) goods in the public interest. Furthermore, in accordance with Articles 142 and 143 of the PPPA, the transformed legal entities are awarded concessions for carrying out public services within one year following their transformation. The transformation also resolves the issue of additional bonuses for the employees from the market operations of the legal entity. In such a context, it is also important how the public service is funded (Korpič-Horvat, 2003; pp 15-30).

Table 1: The funding of public services in public institutions in Slovenia

PUBLIC SERVICE ACTIVITIES	Public Service Activities, which are financed from public funds.
	Public Service Activities by which IA in the market and are financed by payments from private and other non-public funds.
MARKET ACTIVITIES	Selling Goods And Services which are not part of the activities of the public service and are financed from private funds (also from other non-public funds).

A public service entails the legally regulated provision of services, which is defined by law and whose content is providing services and goods in the public interest, whereby its primary objective is not making a profit. A public service is thus a manner of carrying out a certain activity, which as a rule can be carried out in the market also as a normal activity not requiring such a special organizational form (Trpin, 2005; pp. 354-367). However, in cases in which such activities are carried out in the public interest, a special legal regulation applies. It must have a direct basis in a law. The special legal regulation of providing a public service is established in cases in which such is a responsibility and task of the state or a municipality and is dictated by the public interest.

The public interest is – similarly as a public service – a legally undefined term. This entails that the legislature does not define it formally but refers to it in terms of content. In terms of content, the public interest entails the legally protected *inclusive* will of a broader social community, which is provided for by the state through its – usually cogent – regulation. Inclusiveness is an essential element of the public interest and entails the availability of services and goods in the public interest to all under the same conditions without exclusion (Rus, 1990). On the other hand, the private interest is *exclusive*, which entails that by means of private regulation the state protects the interests and will of individuals who have a legitimate entitlement to legally exclude anyone (including the state) who interferes with their legally protected private interest against their will.

Prices at which public institutions provide services and goods in the public interest are not created freely in the market. They are set by a public "regulator" (i.e. the state, a municipality), which must thereby consider what share of the price will be covered by public funds.

Public funds for financing public services in public institutions are: (1) budgetary resources acquired from state or municipal budgets; (2) public funds deriving from the price paid for the public service which is provided by the state; (3) other *para-fiscal* resources which do not have the character of budgetary resources (e.g. obligatory subscription fees for financing a public service).

In addition, funds for financing public institutions are e.g. interest from investments, rents, grants, donations, subventions, gifts, and inheritances. These funds are not permanent and regular and therefore they fall into the category of other funds.

Market activities in public institutions are supplementary activities to the public service (Bohinc and Tičar, 2007). These are activities connected to public services; however, they do not fall into the statutorily determined scope of public services. An essential difference for distinguishing the non-public funding of public institutions and funding from supplementary – market – activities is in the determination of the prices for the services and goods, which such public institutions offer, to users.

The prices of services and goods with regard to supplementary activities may namely never include costs or part of the costs to the detriment of the public service. In such a case, the price would entail hidden subsidizing as well as unfair competition with the price of the same services and goods sold by other legal entities in the market. As regards the above-mentioned, the price for providing services and goods of a public service must be set by a regulation, whereas the price for selling services and goods as a supplementary activity may not be set by a regulation, in order to ensure free competition.

In cases in which public institutions create at least one half or more of revenue from privately funded activities, this indicates an inappropriate form of their organization. Thus, it would be reasonable from the viewpoint of founders that the provisions of the PPPA be applied and that they would approve of the transformation of the public institution into a more appropriate organizational form (Mužina, et al., 2007).

A further argument is that based on a general regulation contained in the IA, public institutions are namely legal entities without their own property. Institutions manage the property of their founders (i.e. the state or local communities), whereas they do not have their own property. However, all other entities of public law have their own property; including public companies (organized in the organizational form of a commercial company) which carry out commercial public services and which can be compared with institutions regarding the regime of providing public services.

The transfer of public property to the ownership of public institutions pursues the goal of increased efficiency and effectiveness in using the funds needed for providing the public service. Such transfer of property is not privatization, as the property of institutions does not become private property, but rather remains public property, whereby such concept allows a better definition of the responsibilities for managing the property than the concept of direct public property does. Consequently, also the autonomy of the management increases as it can manage the property, however, still with the consent of the founders (Mužina, et al. 2007).

3. The Transformation of Public Institutions into Limited Liability Companies in Accordance with the Rules of the CA

In accordance with the rules of corporate legislation, public institutions may be transformed into limited liability companies by applying, mutatis mutandis, the rules on the transformation of public limited companies into limited liability companies. In accordance with Article 666 of the CA, entitled "The Transformation of Institutions into Commercial Companies", the legislature determined that the provisions laid down in the CA on the transformation of public limited companies into other types of companies apply, mutatis mutandis, for the transformation of institutions into commercial companies. In accordance with Articles 648 through 651 of the CA, public limited companies, which have fewer than 50 shareholders/founders, may be transformed into limited liability companies. The same applies to public institutions, which have less than 50 founders. A majority of at least 90% of the subscribed capital must adopt a decision on the transformation of a limited liability company into a public limited company. The amount of subscribed contributions in transformed limited liability companies may be less than is prescribed. The transformation of a public institution into a limited liability company must be declared for entry into the relevant court register by enclosing the list of the members and their subscribed contributions as well as the contract on the transformation. The transformed public institution acquires the legal status of a limited liability company upon registration in the court register (Juhart, 2007).

A legal basis for the transformation of the public institutions into limited liability companies is primarily the decision on the transformation; in the event that there are two or more founders, the contract on the transformation is also a legal basis. Mutatis mutandis interpretation of the rules on the transformation of the public limited companies into limited liability companies indicates that the competent authority of the institution must adopt a decision on the transformation of the public institution into the limited liability company in accordance with the articles of association by a majority of at least 90%.

The competent authority in public institutions is the board of the institution, which, however, is in practice not necessarily composed to be able to decide by a 90% majority vote of the members of the board. Thus, for example, in an institution in which there are fewer than 10 members on the board, the consensus of everyone is needed, as a vote of one-member amounts to more than 1/10.

Nevertheless, the consensus of the founders, i.e. as a general rule the state or a municipality, will have to be reached in the event that a public institution is transformed. Also for the founders, it applies, mutatis mutandis, that they must decide by a 90% majority vote. For the founders of a public institution who did not vote in favour of a decision on the transformation, Article 651 of the CA applies mutatis mutandis. This entails that any founder of a public institution who objects to the decision on the transformation of the public institution into a limited liability company may require that the new company take over his/her business share against payment of appropriate monetary compensation. A founder who did not decide on the transformation of the public institution if he/she was unlawfully prevented from attending the board meeting, if the institution board was not correctly convened, or if the subject put to a decision at the board meeting was not correctly published also enjoys this right.

The newly registered name and other elements of the company, as well as the entire content of the new memorandum of association must be stated in the decision on the transformation; in particular Article 474 of the CA requires the following information (Juhart, 2007, pp. 7): (1) the name, surname, and address or the registered name and registered office of each member; (2) the registered name, registered office, and activity of the company; (3) the amount of the share capital and of each subscribed contribution separately, and the members who invested each subscribed contribution and their stake; (4) the duration of the company if it is formed for a fixed period; (5) any obligations which the members have towards the company other than payment of the subscribed contribution and any of the obligations which a company has towards their members.

For the transformation of public institutions into limited liability companies, in practice not only the rules on the transformation of public limited companies into limited liability companies have to be applied mutatis mutandis, but also the rules on the transformation of sole proprietors into limited liability companies. Upon the transformation of a public institution into a limited liability company, the value of the company, which is transformed, will probably have to be defined and determined. Article 668 of the CA determines this.

Companies which are transformed into limited liability companies in accordance with corporate regulations are comprised of assets, as well as the rights and obligations related to the company Reference can be made to documents such as the annual balance sheet, the interim balance sheet, or appropriate accounting statements if their contents can be used as the basis for determining the value of the company subject to transfer. The submitted documents may not be older than three months on the day of the application of the transfer of the company into the register**.** If the value of the company exceeds 100,000 EUR an audit must be conducted upon the transfer of the company (Juhart, 2007).

The above-mentioned rules are a supplementation to the mutatis mutandis application of the rules on the transformation of public limited companies into limited liability companies that apply to the transformation of public institutions. In view of the fact that they are not contrary to the regulation of the CA regarding the transformation of public limited companies into limited liability companies, we are of the opinion that they are also applicable to the transformation of public institutions into limited liability companies, also because there are no other rules. In practice, however, transformation procedures will have to be conducted in a manner such as that the registering court will be able to register transformed legal entities in the court register.

4. The Reasons and Consequences of the Transformation of Public Institutions into Limited Liability Companies for the Founders

In general, a fundamental defining element regarding public institutions is the public service provided. Therefore, it must be emphasized that the objective of public institutions is to achieve the maximum benefits and satisfaction of the users of the public service with the given, albeit limited, funds. Services provided by public institutions, as already mentioned above, can in general be categorized in three groups: (1) regular public services, (2) public service activities that public institutions sell in the market, (3) services which are not public services – i.e. market activities.

Public institutions on average receive 70-80% of funding from public finance for the purposes of providing public services. Pharmacies and social care services – primarily residences for the elderly – where market activities reach and exceed 50% of the funding of the public institutions deviate from the average (Zver, 2007).

Because public institutions gain part of their revenue in the market, the accounting legislation determines that they must provide separate - from providing the public service and from selling goods and services in the market - and combined statements of revenue and expenditure as well as statements of profit and loss (Trpin, 2004, pp. 1376-1382).

A general principle applies with reference to the statement of revenue, i.e. that revenue from providing the public service is the total revenue, which the public institution receives for the performed public service regardless of the fact whether such revenue comes from public or private funds. Thus, revenue from goods and services sold in the market entails only revenue, which the public institution earns by selling goods and services that are not defined as a public service. A prevailing activity of selling goods and market services also in the future entails a major part of the activities of the above-listed public institutions, whereas public services entails only a small part.

The problem of the demarcation of expenditure is namely connected with the monitoring of costs by cost centres, responsibility centres, and accounts, which is still not regulated in many public institutions. The question is how much expenditure in public institutions in fact arises from providing a regular public service, which is financed from public funds, how much from providing public service activities in the market, and how much from providing other activities in the market. Because of this problem, also the profit and loss statements of public institutions are questionable, especially when they are determined separately for public service activities and for market activities. On one hand, in the part, which refers to public service activities, public institutions as non-profit organizations should operate on a break-even basis, and on the other hand, they are allowed to maximize profit (a surplus of revenue over expenditure) from market activities, which is contrary to the non-profit character of public institutions. Due to the fact that the present legal regulation allows public institutions to assign a surplus of revenue over expenditure from market activities to funds intended for bonuses for additional work performance, loose accounting regulations may lead to the temptation that part of the expenditure which is created from market activities are stated as if they arise from providing the public service (Zver, 2007).

The transfer of fixed assets directly to a new – transformed legal entity – pursues the goal of increased efficiency and effectiveness in using the funds needed for providing the public service. Such transfer of the fixed assets directly to a new legal entity as a subscribed contribution is not privatization, as the property remains public property. Only the nature of the property changes. Such concept allows a better definition of the responsibilities for managing the property than the concept of direct municipal property does. Consequently, also the autonomy of the management of the transformed legal entity increases as it can more efficiently manage the property to the benefit of the quality of the public service provided.

Furthermore, one of the important reasons for the transformation of public institutions is the deficient and inappropriate regulation of the system of funding public institutions. A new normative public-finance and accounting regulation was adopted which requires the harmonization of this field with cogent provisions. In addition, the Transparency of Financial Relations and Maintenance of Separate Accounts further complicate the management of public institutions for Different Activities Act (2007).

Finally, the principle of funding in this field must be adapted to the strategic orientation of performing state and municipal tasks through the public institutions with an emphasis on the effectiveness of providing public services by means of measuring the results of their activities and their funding depending on their effectiveness in performing public functions. Within this framework the following issues must be regulated on a priority basis: ensuring funds for work by founders, the resources and manners of funding public institutions, the procedures for determining the scope of resources for providing public services, the procedures for formulating the prices of public services, the liability for the obligations of public institutions, the use of surplus revenue, and debt issues.

5. The Reasons for the Transformation of Public Institutions into Limited Liability Companies deriving from EU Legal Regulations

From the perspective of EU law, it can be concluded that the regulation of public institutions in terms of their organizational form cannot be found in the *acquis communatauire*. Thus, the transformation of public institutions into limited liability companies is consistent with Slovenian legislation and is not contrary to the *acquis communatauire.* Nevertheless, it must be emphasized that the transformation of public institutions will allow a greater transparency regarding the organizational form of such legal entities also within the context of Article 86 of the Treaty establishing the European Community (Official Gazette RS, No. 7/2004).

An essential difference for distinguishing the non-public funding of public institutions and funding from supplementary – market – activities is in the determination of the prices and in the transparency of the use of public funds. The prices of services and goods with regard to supplementary activities provided by public institutions may namely never include costs or part of the costs to the detriment of the public service. In such a case, the price would entail hidden subsidizing as well as unfair competition with the price of the same services and goods sold by other legal entities in the market. As regards the above-mentioned, the price for providing services and goods of a public service must be set by a regulation, whereas the price for selling services and goods as a supplementary activity may not be set by a regulation, in order to ensure free competition. In this context, Article 86 of the Treaty establishing the European Community must be taken into consideration, i.e. the issue of the community element of the market activities performed by public institutions. The competition rules of the European Community could indirectly be violated if the funds for public services spilled over into the price of services of supplementary (market) activities of public institutions (*i.e. cross subsidizing*). In the event that public institutions use public funds or public and non-public funds for providing public service and they use such to cover the costs of selling services and goods in the market, they must clearly count for such in the market price of services. Market prices cannot be created based on the above-mentioned components, as public institutions could compete in the market with prices based only on variable costs, whereas the fixed costs would be covered by the funds intended for providing the public service.

6. Conclusion

In the case of the transformation of public institutions into commercial companies, the transformed company remains 100% publicly owned. In accordance with Article 142 of the PPPA, it may be awarded a concessionary public service without a public tender being called by the founder. In such a case, however, the legal position of employees changes considerably. At present, the employees are civil servants, whereas in the future their position would be the same as the position of employees in the private sector.

Employees in public institutions are thus for the time being civil servants. Their position is regulated by the Civil Servants Act (hereinafter CSA) and by the present regulation of the Act Regulating Wage Rates in Public Institutions, State Bodies, and Local Community Bodies (hereinafter ARWRPISBLC). In addition, for directors, and in the future for all employees, the Salary System in the Public Sector Act (hereinafter SSPSA) also applies. In the meantime, the SSPSA replaced the ARWRPISBLC; however, the latter still applies for public institutions until the collective agreement for the public sector is adopted.

A civil servant is, as determined by the CSA, an individual employed in the public sector. In the CSA, a civil servant is not explicitly defined, but its definition follows from the definition of the public sector determined in the same act. The public sector comprises the state administration, state bodies, local communities, and public institutions, public funds, and public agencies. Public companies and commercial companies where the state or a municipality is a controlling shareholder are not a part of the public sector.

Employees in public institutions are civil servants; however, they are not state employees, as they do not perform state-administration tasks. For civil servants employed in public institutions, the first 21 articles of the CSA apply, but not also the remaining articles of the act. The most important provisions of the first 21 articles of the CSA, which apply for them, refer to fundamental principles. The legislation regulating the position of civil servants determines in detail the starting points on which the civil-servant system is built. Such starting points are determined as principles, which apply to all civil servants, whereas the principles, which apply only to officials, are determined separately.

A particularly important provision among the first 21 articles of the CSA is the third paragraph of Article 16, which determines that public institutions may not provide employees' rights largely than provided by law, executive regulations, or collective labour agreements if public budgeting is to be burdened therewith. In addition, the SSPSA in Article 3 contains a similar provision providing that public institutions may not provide employees different salaries than provided by this act. In the public sector, legal positions and salaries are namely precisely determined. In the transitional period until the entry into force of the SSPSA, the Act Regulating Wage Rates in Public Institutions, State Bodies, and Local Community Bodies with executive regulation applies. In the future, the legal basis will be the SSPSA, with new executive regulations and especially the collective agreement for the public sector, which has not yet been adopted, as well as branch collective agreements.

In cases of the transformation of the public institutions into limited liability companies with a concessionary public service, the rules, which apply in the public sector in accordance with the CSA and SSPSA no longer, apply. Employment relationships of employees are regulated in accordance with the general employment legislation. In addition to this, the salary system, which will apply in transformed public institutions, will no longer be the salary system of the public sector, but the salary system, which is regulated by the legislation on employment relationships (the Employment Relationships Act - ERA) and collective agreements.

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