JESSICA Legal Study for Cyprus

Final Report

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1 Introduction and Purpose of the Study

1.1 Introductory Note

Following discussions between the Planning Bureau of the Government of the Republic of Cyprus and the European Investment Bank (EIB) the Planning Bureau (the Managing Authority) has expressed an interest in deploying the Joint European Support for Sustainable Investment in City Areas initiative in pursuit of Cyprus' urban agenda as this is set out in the National Strategic Reference Framework of 2007-2013 (NSRF 2007-2013).

At the request of Managing Authorities of various Member States the EIB has launched a more than 40 country or region specific evaluation studies towards the potential of deploying JESSICA in the following Member States: Belgium, Bulgaria, Cyprus, the Czech Republic, France, Germany, Greece, Italy, Lithuania, Luxembourg, Poland, Portugal, Slovakia, Spain, Sweden and the UK. These studies analyse the market gap for financial engineering instruments in support of sustainable urban development in the respective EU regions supported by EU grants in 2007-2013.

The EIB appointed Deloitte Limited, the Cyprus Deloitte member firm, in association with A.L.A Planning Partnership to produce the respective study for the JESSICA Initiative in Cyprus. The final version of this study was produced in July 2009. Amongst the main findings of this final report the agents concluded that:

"*Suitable projects that meet the objectives of national and EU economic development policy do exist; however, additional work is required to develop these into credible investment opportunities. Projects that do not display strong commercial returns suggest there is a crucial role to be played by JESSICA as it will provide the necessary risk mitigation through public sector involvement providing a stimulus for private sector investment.*

The current legal framework and UDF structure are two factors which will require further work than has been allowed for in the agreed Terms of Reference to this study. Indeed, a supplementary legal analysis is already underway. Needless to say both are factors of critical importance and will need to be addressed in further detail in order to iron out in advance issues that may arise during JESSICA implementation.

The structure proposed in this document sets out to address market failure and other imperfections related with investing in urban and infrastructure development projects and projects that display a long lead time in generating returns."[1]

Therefore as it is clear from the said study, the review of the current legal framework and the possible Urban Development Fund (UDF) structures associated with the implementation of the JESSICA Initiative in Cyprus was not within the mandate of the July 2009 report. Such a report on the legal framework covering the operation of the UDF(s) is deemed to be '*the most prominent point that should be raised*'[2]. The current study will build upon the findings of the first study in order to establish the legal framework under which the JESSICA Initiative could be deployed in Cyprus.

Recently, on July 30, 2009 the European Investment Bank and the Planning Bureau of the Republic of Cyprus have signed a Memorandum of Understanding to strengthen cooperation in financing integrated sustainable urban development in Cyprus. This certainly indicates the willingness of the Republic of Cyprus to proceed with the implementation of JESSICA.

1.2 The National Strategic Reference Framework

The current National Strategic Reference Framework for Cohesion Policy (NSRF), 2007-2013, which was approved by the Council of Ministers,[3] is a strategic programming document, which describes the development strategy in the framework of which the EU Structural and Cohesion Funds granted to Cyprus during the 2007-2013 programming period will be spent. The purpose of the NSRF, introduced for the first time during this programming period, is to establish a more strategic approach in the programming for the utilization of Cohesion Policy resources.

The NSRF, based on the provisions of the relevant EU Regulation[4], ensures that the assistance of EU funds is in line with the Community Strategic Guidelines for Cohesion and demonstrates their substantial contribution in achieving the objectives of the National Reform Program (NRP). To attain the targets of the NSRF two Operational Programs were prepared and approved by the Council of Ministers[5]. These are multi-annual development plans, which analyze the development strategy for utilizing the resources of Structural and Cohesion Funds of the EU to be granted to Cyprus during the 2007-2013 planning period.

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[1] At p. 4 of the JESSICA Evaluation Study for Cyprus July 2009
[2] At p. 9 of the JESSICA Evaluation Study for Cyprus July 2009
[3] Decision No. 64.705 29.11.2006
[4] Chapter II (Article 27) of Regulation 1083/2006
[5] Decision No. 65.106 28/2/2007

According to the NSRF for Cohesion Policy 2007-2013 programming document, the EU funds will be invested in five thematic priorities and two thematic priorities for ERDF and the Cohesion Fund Technical Support. The objectives of the NSRF are realised through two NSRF Operational Programmes:

1. "Sustainable Development and Competitiveness", which receives its funding from the European Regional Development Fund (ERDF) and the Cohesion Fund (CF).

2. "Employment, Human Capital, and Social Cohesion" which receives its funding from the European Social Fund (ESF).

The strategic objective of the first Operational Programme is "The improvement of the competitiveness of the Economy within Conditions of Sustainable development". The Operational Programme "Sustainable Development and Competitiveness" sets out seven Priority axes. The Strategic Objective of the second Operational Programme is "Full and quality employment, development of human capital and the strengthening of social cohesion and equal opportunities conditions". The Strategic Objective of the Programme aims at developing human capital and facing the structural weaknesses of the labour market, focusing on upgrading the skills of certain population groups and promoting them in employment. This operational programme sets out three Priority Axes.

According to the JESSICA Evaluation Study for Cyprus prepared by Deloitte, the two Operational Programmes contain a number of priorities the objectives of which are in alignment with the JESSICA concept. Consequently, any type of project envisaged under Priority Axes 1 to 5 of the "Sustainable Development and Competitiveness" Operational Programme and Priority Axes 1 and 2 of the "Employment, Human Capital, and Social Cohesion" Operational Programme could potentially be considered as candidates for implementation under JESSICA provided that the JESSICA general characteristics are satisfied.

1.3 The JESSICA Model

JESSICA is a policy initiative to exploit financial engineering mechanisms that support investment in sustainable urban development in the context of cohesion policy. It has been launched with a view of leveraging additional resources for public-private partnerships (PPPs) and, in general, for urban-renewal and development projects in the regions of the European Union (EU). It is designed to support the creation of Urban Development Funds (UDFs) which will select and support urban projects, providing them with loans, equity or guarantees. This will enable the Managing Authorities of Structural Funds to have greater access to funding for

the purpose of promoting urban development. Project promoters could be public, municipal, or private sector enterprises and it will also be possible for other private banks or investors to participate.

The diagram below sets out a generic structure for JESSICA. It is submitted that the key elements of any conceived JESSICA structure will normally be the following:

a. The Structural Funds: At present, there are four Structural Funds which allow the European Union to grant financial assistance to resolve structural economic and social problems. Two of these funds are the European Regional Development Fund (ERDF), whose principal objective is to promote economic and social cohesion within the European Union through the reduction of imbalances between regions or social groups and the European Social Fund (ESF), the main financial instrument allowing the Union to realise the strategic objectives of its employment policy.
b. The Managing Authority: According to Article 59 of Regulation 1083/2006 the Managing Authority is the national authority designated by the Member State to manage the operational programme.

c. The Holding Fund: This is an optional fund, the purpose of which, if decided to be utilized, is to act as a fund of funds, that receives initial ERDF cash from the Commission prior to it being placed with UDFs. The specific mandate, the powers and responsibilities, the managers of the holding fund and the method or receiving and making funding must be the subject of a funding agreement between the Managing Authority and the representatives of the Holding Fund.

d. UDF: at the core of the JESSICA initiative lies the Urban Development Fund. It is the intermediate entity that makes investments through equity, loan or guarantee products through the disbursement of funds into eligible projects. The funds allocated to the UDF may consist of structural funds and/or other resources of the public and/or private sector. The UDF may come as an independent legal entity or as a separate block of finance within a financial institution. The specific mandate, the powers and responsibilities, the managers of the Urban Development Fund and the method or receiving and granting funds must be the subject of a funding agreement. Depending on the utilisation of a Holding Fund, such Holding fund, or where no Holding Fund is used, then the Managing Authority directly, are obliged to conclude funding

agreements with the representatives of each UDF on the basis of the provisions of Regulation 1828/2006 as amended.

e. Public Private Partnerships or urban projects included in an integrated plan for sustainable urban development: these are the only eligible beneficiaries of investments carried on by UDFs. The limitation here is that eligible projects must be part of an integrated plan for sustainable development.

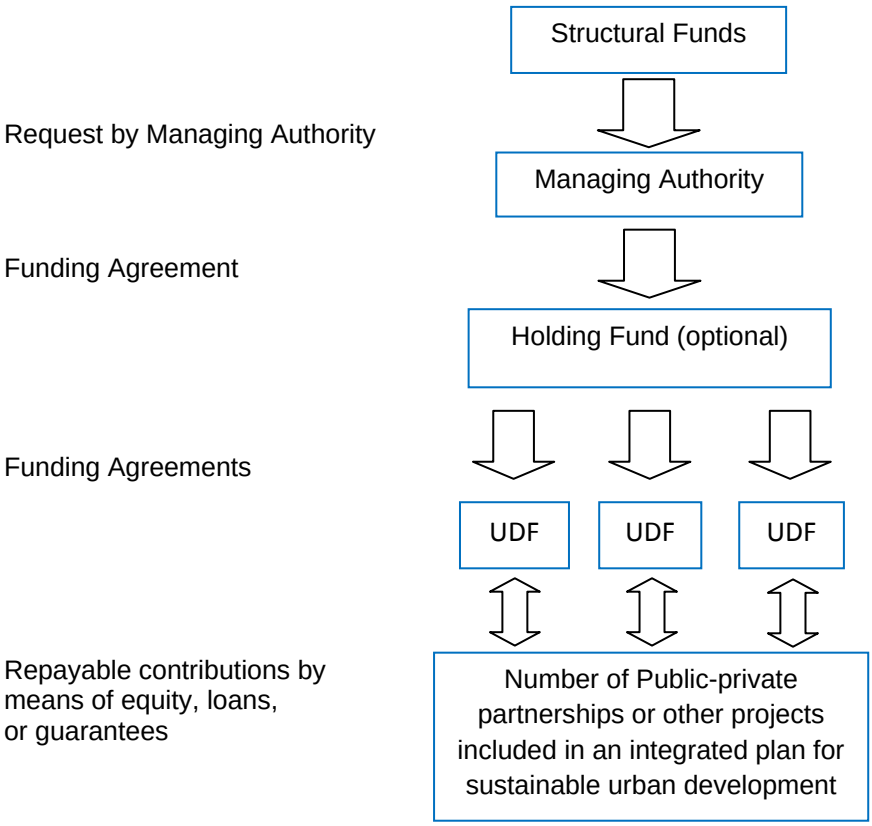

Diagram 1: Generic JESSICA structure

1.4 Purpose of the Study

LLPO Law firm has been commissioned by Deloitte to prepare, in association with Deloitte, a report assessing the legal framework in which JESSICA will be implemented. More specifically, the end product of the report will provide sufficient analysis of the following key issues:

1. Review and appraisal of the efficacy of the envisaged legal structure for JESSICA in Cyprus. (Comprising a Holding Fund, supporting a number of UDFs, with particular focus on the capacity of the proposed vehicle architecture to facilitate PPPs);

2. Review of the applicability of prevailing anticipated Cyprus legal instruments on the establishment and operation of PPPs;

3. Identification and analysis of possible legal structures that exist or could be created and might be used to establish UDFs, (taking into account that these must offer loans, provide guarantees or take equity);

4. Specification of the pros and cons of each of the defined structures (flexibility , tax, etc);

5. Review of the existing regulatory regime in relation to the reviewed legal structures and the regulatory role of possible supervising authorities; (Financial Commission, Central Bank) including evaluation of the ability to adapt existing entities such as banks, investment funds etc for use as UDFs;

6. Analysis of State Aid Control Issues associated with JESSICA deployment and provision of guidelines on addressing /minimizing State Aid Risk and / or ensuring compliance;

7. Appraise public administration law/regulations and public procurement law, their impact and effect on the implementation of a JESSICA Holding Fund and UDF(s);

8. Review and appraisal of the constraints of municipalities and other public agencies to make contributions, in kind and / or other equity contributions, either to UDFs or directly to Projects; and,

9. Propose changes to the legal and administrative framework to facilitate the implementation of JESSICA.

Unavoidably the report will have as a reference point the study prepared and the conclusions reached by our earlier study carried out in association with A.L.A Planning Partnership with regards to the market feasibility for implementing the JESSICA Initiative. Thus, the report will strictly adhere to its mandate namely the legal assessment of the abovementioned issues and tasks and will not engage into analysing the economic, technical or other non legal results from a potential implementation of the JESSICA Initiative.

1.5 Report Structure

The report is structured into eight chapters. The first part of the study deals with the underlying legislative and regulatory considerations pertinent to the implementation of the

JESSICA initiative. The second chapter presents an assumed JESSICA structure and identifies the major issues which are further examined in the Report. The third and forth chapters deal with the necessity of complying with public procurement, EU and domestic state aid control policies. In these chapters the need to ensure compliance with these policies and minimize exposure and risk of any potential illegal practices is identified and assessed.

Once these qualifying issues are dealt with, the study concentrates on its second part, which primarily deals with the actual set up and operation of the Holding Fund and the UDF(s). Under the Chapters in this part, possible existing and new structures are reviewed and assessed. The arguments in favour and against each structure are objectively examined. The Report ultimately proposes the most efficient, in our opinion, overall structure for the JESSICA deployment. Chapter 6 deals with the ability of municipalities to participate in the JESSICA deployment, whilst chapter 7 deals with the review of qualifying conditions of the eligible beneficiaries of JESSICA structure. In this chapter, the report also deals with the framework under which public-private partnerships operate. Within these chapters all issues of concern are addressed, objectively discussed and analysed thereby reaching clear and unambiguous conclusions.

2 The JESSICA Structure, the Holding Fund and the Urban Development Fund

2.1 Introductory Note

Article 44 of the Regulation (EC) No 1083/2006[6] provides that as part of an operational programme, the Structural Funds may finance expenditure in respect of an operation comprising contributions to support financial engineering instruments for urban development funds, that is, funds investing in public-private partnerships and other projects included in an integrated plan for sustainable urban development.

2.2 The Member State's Managing Authority

The Council of Ministers of the Government of the Republic of Cyprus, as the supreme executive power of the island has duly appointed and designated[7] the Planning Bureau as the Managing Authority in accordance with the said regulation. According to the said appointment the Planning Bureau has the overall responsibility to manage and apply the Operational Programmes and it enjoys all the competencies specified by Regulation (EC) No 1083/2006. The appointment of the Planning Bureau specifically enumerates the duties and competencies of the Planning Bureau in its capacity as a Managing Authority.

By reference to this appointment, the Planning Bureau may make any recommendation to commit ERDF through JESSICA, based on its own interpretation of operational requirements and the wider economic development agenda in the future. Nevertheless, the Managing Authority is not, currently at least, expressly authorized to proceed whenever it considers appropriate with committing funds to JESSICA or cooperate in the implementation of the JESSICA structure.

Any such attempt will require, for the purposes of compliance with the domestic Cyprus legal order, additional authorisation by means, again, of a Council of Ministers Decision. Such a decision will need to either assign the discretion as to the actual JESSICA implementation to the Managing Authority or alternatively approve a specific JESSICA implementing structure,

[6] Regulation (EC) No 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999, as amended by, Regulation (EC) No 284/2009 of 7 April 2009.
[7] Decision no 65.794, 4/7/2007

empowering the Planning Bureau, to merely sign the preselected structure and assume Managing Authority obligations in relation to JESSICA operation.

The fact that the outline of the JESSICA initiative is provided under primary EU legislation, coming in the form of Regulation having thus direct effect within the Republic, does not afford sufficient authority for the Managing Authority to proceed irrespective of domestic authorization with the implementation of this initiative. Indeed, all three relevant EU Regulations provide for a great extend of discretion to the Member States as regards the method and decision of implementation of the various Financial Engineering Instruments. That said any potential JESSICA implementation either through the utilization of a Holding Fund or through the direct setting up of UDF(s), will require the respective prior executive decision by the Council of Ministers.

2.3 Financial Engineering Instrument Through the Utilisation of a Holding Fund

According to Article 44 of Regulation (EC) No 1083/2006[8] where the Structural Funds finance expenditure in respect of an operation and when such operations are organised through holding funds, that is, funds set up to invest in urban development funds, the Member State or the managing authority shall implement them through one or more of the following forms:

a. the award of a public contract in accordance with applicable public procurement law;

b. when the agreement is not a public service contract within the meaning of applicable public procurement law, the award of a grant, defined for this purpose as a direct financial contribution by way of donation to a financial institution without a call for proposals, if this is in accordance with a national law compatible with the Treaty; and,

c. the award of a contract directly to the EIB.

The issue of public procurement procedures and the considerations as to the presence of State Aid are considered in the following chapters, therefore no further consideration as to the method of procuring shall be given in this chapter. For the purpose of this chapter the detailed rules concerning financial engineering instruments and the additional provisions applicable to

[8] Regulation (EC) No 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999, as amended by, Regulation (EC) No 284/2009 of 7 April 2009.

holding funds which are set out in Articles 43 to 46 of Commission Regulation (EC) No 1828/2006, are of primary concern.

2.3.1 Structure of the Holding Fund

According to the Article 43.3 of the Commission Implementing Regulation 1828/2006, financial engineering instruments, including holding funds, shall be set up in one of two forms. These can either be independent legal entities governed by agreements between the co-financing partners or shareholders or as a separate block of finance within a financial institution. These provisions are important when considering the available choices in the setting up of a Holding Fund.

With regards to the choice of independent legal entities, it is submitted that these may not take the form of unicorporate legal entities since these are not independent in their existence from their managers, promoters or otherwise proprietors. Thus only corporate legal entities can really be said to be independent in their nature. These entities must be able to enter into legal relations on their own right and incur liabilities against their name, independent from the abovementioned class of people associated with the entity.

A holding fund may be set up within a financial institution as a separate block of finance. The prescription here is that when the financial engineering instrument is established within a financial institution, it shall be set up as a separate block of finance, subject to specific implementation rules within the financial institution, stipulating, in particular, that separate accounts are kept which distinguish the new resources invested in the financial engineering instrument, including those contributed by the operational programme, from those initially available in the institution.

The choice to set up the Holding Fund with the EIB, as a separate block of finance within the EIB, seems to be the most efficient method of implementing the Holding Fund. This will afford Managing Authorities to immediately utilise the Holding Fund with no need for further legislative enactments, setting up a special body to receive the award of the grant. Furthermore, as it will be explained in more detail under the chapter discussing public procurement regulations, there will not be any need for preparing procurement proceedings thus saving time as to the utilization of the Funds.

2.3.2 The Funding Agreement between the Managing Authority and the Holding Fund

Among the latter rules, Article 44(1) of Regulation (EC) No 1828/2006 requires the interested Member State or Managing Authority to conclude a funding agreement with the holding fund, which shall, inter alia, set out the terms and conditions for contributions from the operational programme to the Holding Fund. The relevant Regulation provides that the funding agreement where appropriate, must take account of the urban development studies or evaluations and integrated urban development plans included in operational programmes.

In any case the funding agreement must, in particular, make provision for [9]:

a. the terms and conditions for contributions from the operational programme to the holding fund;

b. calls for expression of interest addressed to financial engineering instruments in accordance with applicable rules;

c. the appraisal and selection of financial engineering instruments by the holding fund;

d. the setting up and monitoring of the investment policy or the targeted urban development plans and actions;

e. reporting by the holding fund to Member States or managing authorities;

f. monitoring of the implementation of investments;

g. audit requirements;

h. an exit policy for the holding fund out of the financial engineering instruments;

i. the provisions for the winding-up of the holding fund, including the reutilisation of resources returned from investments made or left over after all guarantees have been honoured which are attributable to the contribution from the operational programme.

The investment policy referred to in point (d) shall comprise at least an indication of the targeted enterprises and the financial engineering products to be supported.

2.3.3 Holding Fund as Initial Repository or with Continual Existence

As indicated in Deloitte's Evaluation Report a Holding Fund is a "fund of funds" that receives initial ERDF cash from the Commission prior to it being placed with UDFs. A Holding Fund as proposed may be utilized to take two main forms:

[9] The provisions of Regulation 1828/2006 were amended on this aspect by the provisions of Regulation 846/2009 of 1 September 2009 O.J. L250/1 of 23/9/2009

- An initial repository for the ERDF monies while UDFs are set up. Once all monies have been deployed, the Holding Fund would disband and leave the UDFs to manage the reinvestment of recycled funds.

- A continual "fund of funds" to manage UDFs' monies.

As already argued, as a minimum requirement, the funding agreement should make a reference to the exit policy of the Holding Fund out of the Urban Development Funds. It is not clear if the said funding agreement may specifically make provision for the selection of a no exit policy. Arguably, the inability to choose not to withdraw funds from the UDFs, places the Holding Fund in the basis of a continuous existence rather than a mere initial repository of funds.

Depending on the political decision as to the character of the Holding Fund, it is submitted that the exit policy provided for in the said minimum requirements, as described above, may provide for an exit policy whereby funds are returned on a specified third party (a potential exiting public authority) rather than returning to the Holding Fund. Such a scenario secures the initial repository status of the Holding Fund.

Here it should be stressed that the matter of withdrawing contributions from Operational Programs by Managing Authorities out of the Holding Fund or UDFs has been the subject of specific mention by the Commission[10] as it entails certain technicalities. Indeed, the Commission notes that where the managing authority proceeds with a contribution from an operational programme to a holding fund or UDF, but does not declare this expenditure to the Commission and hence does not receive a corresponding interim payment from the Structural Funds, the Commission services consider that it would not be irregular for the managing authority to withdraw resources from the holding fund or UDFs.

However, where the contribution from an operational programme to a holding fund or UDF has been declared to the Commission and has been the subject of an interim payment from the Structural Funds, the Commission services would seriously discourage the contribution from the operational programme being withdrawn from the holding fund or UDFs save in exceptional and justified cases. This view is taken because there could be serious risks of irregularities in such circumstances.

More precisely, once the contribution has been paid from an operational programme to a holding fund or financial engineering instrument, and it has been included in a statement of

[10] Commissions Guidance note on Financial Engineering COCOF 08/0002/03-EN Final version of 22/12/2008

expenditure submitted to the Commission, it will be considered as “expenditure” within the meaning of Article 78 of Regulation (EC) No 1083/2006, and will be reimbursed by the Commission.

Where in such cases the contribution from an operational programme is later withdrawn from a holding fund or a financial engineering instrument, the Member State will have received an interim payment by the Commission for expenditure which has not been spent in enterprises or urban projects. This may constitute an irregularity, unless the statement of expenditure is subsequently modified to withdraw the ‘expenditure’ in question.

There is also a question of whether any such withdrawal would comply with the principle of sound financial management. In particular, there is a risk that such a practice would result in an improper circumvention of the provisions of Article 93 of Regulation (EC) No 1083/2006.

For these reasons, the Commission recommends that Member States or Managing Authorities instead proceed prudently, committing money from operational programmes to Holding Funds and financial engineering instruments in phases, with payment of contributions being dependent on effective investment in urban projects[11].

Once a decision on the necessity of a Holding Fund has been taken, then the utilised Holding Fund may take either form and it is indeed a matter of political decision. There is no underlying legal reason to reject either form, and no conflict arises if the Holding Fund is preserved to supervise the UDF provided always that such supervisory power is specifically agreed under the eventual Funding agreement concluded by the UDF and the Holding Fund.

2.3.4 Provisions on Selecting UDFs

As a minimum requirement the funding agreement must provide for the method of proceeding into a call for expression of interest addressed to UDFs, the appraisal, selection and accreditation of UDFs by the Holding Fund and for the setting up and monitoring of the investment policy or the targeted UDFs and actions. The importance of these provisions will be acknowledged fully once attention is given to the public procurement and state aid control implications, which according to the conclusions reached in the following chapters, are intrinsically inherent in the JESSICA actions.

It should be emphasised that the specific provision as to these activities but also the compliance with these provisions will provide to the JESSICA deployment the necessary state aid risk avoidance policy. Indeed, employing a transparent method of selecting UDFs is a responsibility, at any case, of the Member State, the Managing Authorities and the Holding

[11] Commissions Guidance note on Financial Engineering COCOF 08/0002/03-EN Final version of 22/12/2008

Fund. Again, the selection of the EIB as the Holding Fund Manager together with the utilisation of its own internal rules as to the procurement of UDFs will provide the necessary efficiency to the whole structure needed for the successful deployment of JESSICA.

2.3.5 Choice of Law and Forum

Despite not being within the minimum requirements, as mentioned above, key provisions in any agreement concluded and for whatever purpose, are the provisions concerning the Dispute Resolution, Choice of Jurisdiction and Choice of Law or better the applicable governing law of the agreement. Simply put, the law governing an agreement and the appropriate forum of bringing dispute resolution proceedings, unless specifically decided from beforehand, on the signing of the agreement, may be the subject of variable possible interpretations depending always on the authority interpreting the agreement, the circumstances behind its conclusion, performance and possibly its breach. This often leads to unnecessary uncertainties as to the precise nature and extend of the involved parties rights and liabilities and eventually any dispute resolution is time consuming.

To avoid any such uncertainties the parties to an agreement may determine expressly the legal principles under which the Agreement will be governed and the forum in which any dispute resolution will be brought. As such, it is recommended that the funding agreement specifically incorporates Cyprus law as the Applicable law of the contract especially where the Holding Fund Agreement is procured to a third party. This will secure that domestic familiar legal interpretations and proceedings will be upheld.

The same suggestion is not provided for, in the case where the EIB is to be selected as the Holding Fund Manager. In this case the governing law of the contract will not be the domestic law of a Member State, but the uniform (European) code of applicable law will be adopted. The reason behind this suggestion stems from the fact that both the EIB and JESSICA are both essentially EU entities.

The EU stature and the JESSICA framework have already been discussed. Similarly, the EIB was established under Article 9 of the Treaty Establishing the European Community, and is empowered to act within the limits of the powers conferred upon it by the Treaty and its Statute. Furthermore, the authority of EIB's legal personality is again dictated by the EC Treaty, Article 266. Bringing any agreement between the Member State and the EIB under the Member State's choice of law will effectively, deprive the uniform development of JESSICA for all Member States wishing to implement it. The risk here is that each Member State's law may interpret the rights and obligations under the Funding agreement according to its own principles, and this can lead to different interpretation depending on individual Member States law.

On the other hand employing a uniform code of principles governing the funding agreement will add value to JESSICA in the sense that the framework will have the opportunity to be interpreted in a uniform manner irrespective of any local aspects. This will provide certainty that ultimately is the predominant value in any contractual transaction. Such a uniform code could be the general principles of law common to the Member States as interpreted or to be interpreted by the Court of Justice of the European Communities.

With respect to the applicable legal body governing a potential agreement with the EIB it is submitted that this must be the Court of Justice, for the reasons mentioned above. Furthermore, under article 237 of the Treaty, it is specifically provided that as between disputes arising between Member States and the EIB, the Court of Justice of the European Communities shall have jurisdiction, the Member State may initiate proceedings in that forum. Therefore, according to the EC Treaty the Court of Justice is the natural forum of any such dispute.

2.4 Implementing the UDFs

As already mentioned, UDFs may be set up in one of two forms. These can either be independent legal entities governed by agreements between the co-financing partners / shareholders or as a separate block of finance within a financial institution. The limitations in terms of participation in either case are assessed in a subsequent chapter of this report. The implementation of the UDFs in the JESSICA Structure is independent from the decision on whether to utilise a Holding Fund or not. Depending on the political decision to utilise a Holding Fund, the reporting, monitoring, funding obligations under the funding agreement with the UDF will accordingly remain with the Managing Authority or be assigned or shared with the Holding Fund.

The same remarks made as to the implementing provisions that were made above for the Holding Fund apply in the case of UDFs. In the case of independent legal entities, it is submitted that these must be entities that can operate independent from their promoters, their stakeholders, their managers and beneficiaries. These entities must be able to enter into legal relations on their own right and incur liabilities against their name, independent from the abovementioned class of people associated with the entity. More particularly these entities must be able to invest in urban projects by means of equity, loans or by providing guarantees.

Alternatively, a UDF may be set up within a financial institution as a separate block of finance. When the financial engineering instrument is established within a financial institution, it shall be set up as a separate block of finance, subject to specific implementation rules within the financial institution, stipulating, in particular, that separate accounts are kept which distinguish the new resources invested in the financial engineering instrument, including those

contributed by the Operational Programme, from those initially available in the institution. The commonest form of implementing this choice would be the set up of a separate bank account (as a block of finance) within a banking institution, able to receive and distribute contributions to the UDF.

In either case, when it comes to the project level of JESSICA implementation, it is considered necessary to remember that the offering of loans and guarantees will require a transparent procurement procedure in place, so as to rule out the possibility of any State Aid risk in the form of arbitrary selections of beneficiaries. Similarly, as in the case of a Holding Fund, prior to any contribution of JESSICA funds into UDFs, a minimum set of preconditions need to be satisfied.

2.4.1 Minimum Conditions of Business Plan and Funding Agreements

The relevant regulations specifically provide that where operations comprising of UDFs are financed by Structural Funds, the business plan of a candidate UDF must be submitted and evaluated in accordance with Articles 43(2) and 44 of Regulation 1828/2006, either by the Managing Authority or by the Holding Fund.

Under Regulation 1828/2006 the business plan was supposed to specify at least the following:

a. the targeted market of urban projects and the criteria, terms and conditions for financing them;

b. the operational budget of the UDF;

c. the ownership of the UDF;

d. the co-financing partners or shareholders;

e. the by-laws of the UDF;

f. the provisions on professionalism, competence and independence of the management;

g. the justification for, and intended use of, the contribution from the Structural Funds;

h. the policy of the UDF concerning exit from investments in urban projects; and,

i. the winding-up provisions of the UDF, including the reutilisation of resources returned to the financial engineering instrument from

investments or left over after all guarantees have been honoured, attributable to the contribution from the operational programme.

The provisions of Regulation 1828/2006 were amended on this aspect by the provisions of Regulation 846/2009[12] whereby there is no specific list of minimum provisions. Therefore, the above list has no longer any effect. Nonetheless, these provisions have been included in the study simply for providing some guiding principles as to the minimum content that could be included in the funding agreement. The content of the actual agreement, once it is reached, should be examined in depth at that point and is not within the scope of the current study. The business plan shall be assessed and its implementation monitored as provided for under the respective Regulations. The assessment of the economic viability of the investment activities of the financial engineering instruments shall take into account all sources of income of the UDFs concerned.

The Managing Authority or the Holding Fund should then select UDFs and sign funding agreements with them. It should be stressed that the Commission states [13] that where possible, more than one financial engineering instrument should be selected, with a view to producing the best possible leverage effects for scarce public resources contributed by the Operational Programme, and in order to involve any available energy, resources and expertise of good quality from the private sector, and to achieve the investment and development objectives of the Operational Programme.

According to article 43(5) and 44(3) of the implementing Regulation[14], the terms and conditions for contributions to UDFs from the MA or the Holding Fund supported by Operational Programmes shall be set out in a funding agreement, to be concluded between the UDF, on one hand, and the Holding Fund, on the other.

The funding agreement shall include at least the elements of Article 43(6), namely [15]:

a. the investment strategy and planning;

b. provisions for monitoring and implementation;

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[12] The provisions of Regulation 1828/2006 were amended on this aspect by the provisions of Regulation 846/2009 of 1 September 2009 O.J. L250/1 of 23/9/2009

[13] The Note of the Commission 'Services on Financial Engineering in the 2007-2013 programming period' with reference number DOC COCOF/07/0018/01-EN FINAL of 16 July 2007

[14] Regulation (EC) No 1828/2006 of 8 December 2006 setting out rules for the implementation of Council Regulation (EC) No 1083/2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and of Regulation (EC) No 1080/2006 of the European Parliament and of the Council on the European Regional Development Fund.

[15] The provisions of Regulation 1828/2006 were amended on this aspect by the provisions of Regulation 846/2009 of 1 September 2009 O.J. L250/1 of 23/9/2009

c. an exit policy for the contribution from the operational programme out of the UDF; and,

d. the winding-up provisions of the financial engineering instrument, including the reutilisation of resources returned to the financial engineering instrument from investments or left over after all guarantees have been honoured that are attributable to the contribution from the operational programme.

2.4.2 Exit Policy

The funding agreement between the Managing Authority or the Holding Fund and the UDF must, further to Article 43.3 of Regulation (EC) No 1828/2006, include an exit policy for the contribution from the Operational Programme out of the Urban Development Fund.

The requirement set out by Article 43.3 of Regulation (EC) No 1828/2006 regarding the inclusion of an exit policy in the funding agreement signed between a Managing Authority or the Holding Fund and a selected UDF, concerns the definition of the precise conditions for returning to the Managing Authority, or to another designated competent pubic authority, resources attributable to the public expenditure from an Operational Programme contributed and invested in a UDF, including any return earned by it, after one or more full cycles of investment in urban projects have been made and completed by the financial engineering instrument.

2.4.3 Choice of Law and Forum

The precise conditions for withdrawing resources attributable to public expenditure contributed from operational programmes to financial engineering instruments in cases of conflict between the Managing Authority and the financial engineering instrument or the Holding Fund, or in case of incapacity of the financial engineering instrument to carry out investments, etc, should also be included in the funding agreement.

It is suggested that the dispute resolution provisions of the funding agreement at this level, concerning both the choice of law and forum, should be specifically agreed. Furthermore, since UDFs will be concerned with investments in the jurisdiction of Cyprus, it could be expected that the agreed terms could also provide for Cyprus Law as being the applicable law of the agreement. This will provide for the necessary certainty required in the JESSICA implementation at UDF and project level. However, this proposal is subject to the negotiations on the Operational Agreement between the parties concerned.

3 The issue of Public Procurement and Contributions to Financial Engineering Instruments

3.1 Preliminary Introduction to Cyprus Legislation on Public Procurement

Public procurement legislation becomes a central issue for JESSICA implementation for two main reasons. Firstly, if JESSICA is to be implemented, it will be done in a manner enabling the Managing Authority to hold a key position in the initial stage of the process. The Managing Authority itself is a public body obliged by law to observe the public procurement legislation and therefore the extent in which the provisions of this legislation apply needs to be assessed. Secondly, the Commission has repeatedly stressed the necessity to comply with any public procurement legislation in the implementation of Financial Engineering Instruments provided for by the respective EU Regulations.

Cyprus legislation incorporates a set of rules and procedures regulating the procurement of public contracts. Currently the applicable set of rules and procedures are provided for by the Coordination of Procedures for Public Contracts of Constructions, Supplies and Services and Relevant Issues Law 12(I)/2006 (hereafter called "Law 12(I)/2006") and the provisions of the Coordination of Procedure for Contracts of Public Construction, Supplies and Services in the Fields of Water, Energy, Carriage and Post Office Services and Relevant Issues Law 11(I)/2006 (hereinafter called "Law 11(I)/2006"). The provisions of these statutes were drafted to harmonise the Cyprus Public Procurement Legislation to the relevant EU Directives[16].

According to the said legislation two concepts are of cardinal importance for the purpose of our study, these are the concepts of Public Contracts and Contracting Authorities. Both of the concepts need to be examined before taking any decision on the applicability of the Cyprus public procurement legislation at any level of the JESSICA structure. Firstly, it should be understood that the subject matter of public procurement legislation is public contracts, which are defined as contracts for pecuniary interest concluded in writing between one or more economic operators and one or more contracting authorities and having as their object the

[16] Directive 2004 /17/EC of the European Parliament and of the Council of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors and Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts

execution of works, the supply of products or the provision of services within the meaning of the EU Directives.

Secondly, it is of the utmost importance to determine from beforehand whether or not the body (Holding Fund, Managing Authority or Fund Manager) purporting to select or contribute to another body (Holding Fund, UDF, Fund Manager of Project Manager) within the JESSICA Structure, comes under the definition of a Contracting Authority. Thus, a body will only be under an obligation to follow public procurement procedures if it can be said that it is a Contracting Authority within the meaning given to this expression by the Cyprus Legislation. If the selecting body cannot be said to qualify as a Contracting Authority then it may proceed with selections or contributions without the need to observe any public procurement procedures.

Having said that, Law 12(I)/2006 provides for the definition of Contracting Authorities as meaning the State, regional or local authorities (municipalities), bodies governed by public law, associations formed by one or several of such authorities or one or several of such bodies governed by public law. An indicative list of Contracting Authorities is provided for by the statute by way of an Annex on Law 12(I)/2006, even though no mention of any excluded authorities is found anywhere in the statute.

The legislation here follows the drafting of the respective EU Directives on Public Procurement. By statutory interpretation of the relevant provisions it is clear that apart from the Managing Authority - the Planning Bureau - and municipalities it is very difficult to conceive other bodies which may participate in JESSICA and which are at the same time specifically provided for in the Annex of the Act to enjoy the status of a Contracting Authority. That said Law 12(I)/2006 further defines what counts as bodies governed by public law, so that whenever a body falls within this prescription, then such a body is bound to follow the public procurement procedures. It is for this reason that the definition of “bodies governed by public law” becomes all the more interesting as it can potentially operate as a catch all provision for any other body, imposing on such body the obligation to observe public procurement legislation.

3.1.1 Bodies Governed by Public Law

As such the term “bodies governed by public law” deserves further interpretation for the purposes of our study. There is a great literature on this topic but a concise guide will be provided to avoid legal jargon. As already mentioned Law 12(I)/2006 itself provides for the definition of “bodies governed by public law”, meaning any body that is:

a. established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character;

b. having legal personality; and,

c. financed, for the most part, by the State, regional or local authorities, or other bodies governed by public law or subject to management supervision by those bodies or having an administrative, managerial or supervisory board, more than half of whose members are appointed by the State, regional or local authorities or by other bodies governed by public law.

Again a non-exhaustive indicative list of bodies and categories of bodies governed by public law which fulfil the criteria referred to above are set out in Annex III of the statute.

As such the provisions of the public procurement legislation need to be respected and observed by Contracting Authorities, even where these comprise of legal persons which do not belong to the public sector, but are under its direct or indirect control as this is specified under the Law. The provision referred to above emphasises two elements important for establishing the obligation to bodies governed by public law to apply the public procurement law. These are:

a. entity-related (particular influence of the public sector); and,

b. activity-related (meeting needs in the general interest, not having industrial or commercial character)[17].

The entity-related element can indeed be verified by reference to the influence of the public sector present in the structure and may be traced without particular problems. Yet the activity-related element is bound to cause more difficulties, as Law 12(I)/2006 does not contain a definition of “needs in the general interest, not having industrial or commercial character”. Neither do the respective EU Directives provide any similar provisions.

[17] Terminology adopted by the Report, Analysis of Legal Conditions for the Implementation of the JESSICA Initiative in Poland, Wierciński, Kwieciński, Baehr sp.k. law firmWARSAW, 8 SEPTEMBER 2008

The matter has been taken up by the European Court of Justice, which in referring in its judgments to the term "needs in the general interest, not having industrial or commercial character" points out the following[18]:

a. the content of this term covers the needs which a given body is obliged to meet even if they may be met by private enterprises;

b. which, for the reasons connected with general interests, the State chooses to meet on its own or upon which the State wants to have a decisive influence;

c. a body governed by public law meeting the needs in general interest, not having industrial or commercial character may have regard to other issues apart from those of economic nature and its activity does not aim at maximizing the profit;

d. a body which is managed according to the effectiveness, efficiency and profitability criteria and operates in a competitive environment is not a body governed by public law; and,

e. the term “body governed by public law” should be treated as a functional one, the important issue is the activity performed at a given moment by a given body - in this context, though all provisions, e.g. agreements or other types of founding acts of a given body may be significant for establishing the purpose for which the body was founded, the analysis of the currently performed activity should be of key importance.

It is submitted that in order to assess the obligation of any of the Financial Engineering instruments to apply the domestic Law 12(I)/2006 it is necessary to first assess whether the instrument selecting or contributing may qualify as a Contracting Authority, either directly by

[18] See, Joint cases C- 223/99 and 260/99 Agora SRL and Excelsior Snc di Petrotti Bruna v Ente Autonomo Fiera Internazionale di Milano and Ciftat Soc. Coop arl (Agora) [2001] ECR 3605, case C-373/00, Adolf Truley GmbH v Bestattung wien GmbH [2003] ECR I-1931, C-44/96 Mannesmann Anlagenbau Austria v Strohal Rotationsdrunk GmbH [1998] ECRI-73, Case C 470/99 Universale Bau AG Bietergemeinschaft v Entsorgungbetriebe Simmering GmbH (universale Bau) [2002] ECRI - 11617

reference to the Annex of the Act or indirectly by assessing is status as a body governed by Public Law, and furthermore whether the contract in question qualifies as a public contract.

3.2 Public Procurement Legislation at the Various Levels of JESSICA Implementation

It will be concluded from the following analysis that public procurement regulations become relevant in the following instances of implementing the JESSICA Initiative:

a. At the eventual appointment of a third party (not the EIB) as the Manager of the Holding Fund from the Managing Authority;

b. In the absence of a holding fund, at the selection of a UDF from the Managing Authority;

c. At the selection of a UDF from the EIB acting as a Manager of Holding Fund;

d. At the selection of a UDF from a third party acting as Holding Fund Manager;

e. At the selection of individual urban projects by the UDFs; and,

f. At the participation of private bodies into the UDF.

From the six above instances only the case where the EIB is acting as the Manager of the Holding Fund, may be distinguished since as it will be explained below the EIB may, and most probably will, choose to apply its internal procurement rules rather than Cyprus Legislation. In the rest of the instances referred to above, the selecting body, either this is the Managing Authority, or the third party acting as a Manager of the Holding Fund, or the UDF itself, will need observe the public procurement legislation as explained above.

3.2.1 Level 1: Selection of Holding Fund by the Managing Authority

According to Article 44 of the Regulation[19] where the Structural Funds finance expenditure in respect of an operation and when such operations are organised through holding funds, that

[19] Regulation (EC) No 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999, as amended by, Regulation (EC) No 284/2009 of 7 April 2009.

is, funds set up to invest in urban development funds, the Member State or the Managing Authority shall implement them through one or more of the following forms:

a. the award of a public contract in accordance with applicable public procurement law;

b. when the agreement is not a public service contract within the meaning of applicable public procurement law, the award of a grant, defined for this purpose as a direct financial contribution by way of donation to a financial institution without a call for proposals, if this is in accordance with a national law compatible with the Treaty; and,

c. the award of a contract directly to the EIB or the EIF.

The issues of compliance with applicable Public Procurement regulations are analysed by the European Commission[20] by following the lines of article 44 of Regulation 1083/2006. Accordingly, a distinction can be made between appointing as holder of the Holding Fund the EIB whereby "the mandate which the EIB …. may be given by Member States or managing authorities to act as a holder of holding funds under Article 44(b)(i) is not subject to public procurement rules" and on the other hand selecting as financial institution any other than the EIB.

3.2.2 Appointing the EIB as Holding Fund Manager

The European Commission clarified all public procurement issues that may arise in the option of appointing the EIB as Manager of the Holding Fund, by explaining that any such mandate is simply not subject to public procurement rules. The rational adopted for this conclusion is based on the relationship between the EIB and its members, i.e. the Member States, which is governed by primary law in an exclusive, self-contained and institutional manner. Thus, as a result in the present context, market related public procurement rules do not apply within this privileged relationship. If and when Member States and/or their designated Managing Authorities wish to request for an EIB loan, they may do so without having to observe the procedures set out in the Cyprus legislation or the respective EU Directives (note: the Republic of Cyprus is already a recipient of EIB loans, which are provided on the basis of EIB standard lending procedures).

[20] Commissions Guidance note on Financial Engineering COCOF 08/0002/03-EN Final version of 22/12/2008

3.2.3 Selecting a Third Party as the Holding Fund Manager

According to article 44 of the Regulation 1083/2006 a financial institution other than the EIB may be chosen as a Holding Fund Manager. This may be done either by way of public procurement, or when the agreement is not a public service contract within the meaning of applicable public procurement law, by way of award of a grant, defined for this purpose as a direct financial contribution, by way of donation to a financial institution without a call for proposals, if this is in accordance with a national law compatible with the Treaty, or by way of a grant without a call for proposal if this is pursuant to a national law compatible with the Treaty.

3.2.4 Selection of a Holding Fund Manager through the Award of a Public Contract in Accordance to Applicable Public Procurement Law

It must be remembered that the Planning Bureau of the Government of the Republic of Cyprus which is acting as the Managing Authority for the purposes of the JESSICA Initiative, according to the provisions of Law 12(I)/2006 is and qualifies as Contracting Authority.

Furthermore, according to the Commission Regulation (EC) No. 1828/2006, the Holding Fund will receive remuneration for managing the funds transferred to the Holding Fund from Operational Programmes, which, from the Managing Authority's perspective, will be the cost of managing. Therefore, a funding agreement concluded between the Managing Authority and the Holding Fund will be an agreement for pecuniary interest within the meaning of the said legislation. The remuneration of the Holding Fund will be covered by the Managing Authority with the funds of an operational programme.

It follows that any funding agreement concluded between the Managing Authority and the Holding Fund will constitute a public procurement contract within the meaning of the provisions of the Law 12(I)/2006. Consequently, in this scenario, the selection of the Manager of the Holding Fund, should take place in the form of a competitive procurement procedure.

3.2.5 Selecting a Holding Fund Manager by an Award of a Grant

It should be stressed from the outset that the possibility to select a Manager of the Holding Fund by an award of a grant is only present if the following preconditions are satisfied:

a. the grant (agreement) is not a public service contract within the meaning of applicable public procurement law; and,

b. this is in accordance with a national law compatible with the Treaty.

A grant, for the purposes of Article 44, is defined as a "direct financial contribution by way of donation". The term "donation" as used here therefore concerns the case of grant contributions from operational programmes to European or national financial institutions serving public policy objective. It is different from the purchase of services under public procurement provisions.

In addition, the grant from operational programmes to holding funds implies no loss of responsibility by the relevant authorities for those resources under the Structural Funds regulations. According to the Commission[21] such grants to holding funds, have no impact on the definition of the functions and exercise of responsibilities of the managing, certifying and audit authorities concerning investment in UDFs of contributions from operational programmes to holding funds, and the subsequent investment of such contributions in urban projects.

In this context attention is drawn by the Commission to the specific control and audit requirements set out by the Structural Funds regulations, with a view to ensuring the legality and regularity of expenditure, and sound use of public funds. Regarding national law compatible with the Treaty allowing the direct award of a grant for the purposes of Article 44 to a national (or regional as the case may be) financial institution, it is at least expected that the law will:

a. designate the financial institution in question;

b. present the public policy objectives justifying the direct award of a grant to it; and,

c. justify the existence within this financial institution of the expertise necessary for the successful accomplishment of the Holding Fund tasks.

Having said that a grant will in general have the following features:

a. a contribution is made either to an action or project carried out by a grantee which falls primarily within the scope of the grantee's activities or direct to the grantee because its activities contribute to policy aims of the grantor, such action or project of the grantee normally being in the interest of the grantor;

[21] The Note of the Commission 'Services on Financial Engineering in the 2007-2013 programming period' with reference number DOC COCOF/07/0018/01-EN FINAL of 16 July 2007

b. the application for financing originates with the grantee, who submits a proposal for support for activities it is carrying out or plans to carry out; its proposal sets out the specifications for the action to be performed, which may be within a pre-set legal or other framework laid down in advance by the grantor;

c. ownership normally remains with the grantee, although it is possible in some cases for the financial contribution to revert to the grantor at the end of an action;

d. the grant does not necessarily finance the total cost of the action;

e. the financial contribution of the grantor should not be in consideration of any product or service provided by the grantee to the grantor;

f. conditions can be attached to the grant awarded, but there is no direct and specific link between individual obligations on either side (grantor and grantee), although the grantor has the right to monitor technical implementation of the action and the use made of the funds granted;

g. the grant must not have the purpose or effect of producing a profit for the grantee; and,

h. the outcome of a grant award procedure is a grant agreement or a grant decision.

According to the Commission, national authorities will have to ascertain, on a case-by-case basis, whether the structure they are planning to implement is a grant or a public procurement and it is their responsibility to comply with any and all applicable laws[22].

3.2.6 Level 2: Selecting UDFs

At this stage the Managing Authority or the Holding Fund Manager will conclude funding agreements with particular UDFs, on the basis of which, UDFs will invest the funds at their disposal in projects included in an integrated plan of sustainable urban development. The investment forms stipulated by the EU provisions will comprise of capital contributions, loans or guarantees.

At this level the Managing Authority and the Holding Fund Manager, as the case may be, are the bodies responsible to assess whether their contribution from Operational Programmes to

[22] Guidance note on Financial Engineering COCOF 08/0002/03-EN Final version of 22/12/2008

specific UDFs is a public procurement of services governed by EC or national public procurement law and comply with any such applicable law. In this event, the Managing Authority or Holding Fund Manager should act in accordance with applicable Community and national rules.

3.2.7 Selection of UDFs Directly from the Managing Authority

Here it should be mentioned that the Commission pointed out that "Article 44 of Regulation 1083/2006 should not be read as meaning that where holding funds are not used to organize financial engineering instruments, there is no obligation to comply with applicable public procurement law"[23].

In this scenario, and as has already been explained, the Managing Authority is a Contracting Authority within the meaning of Law 12(I)/2006. If the Funding agreement with UDFs is to be concluded by the Managing Authority, the remuneration for managing the UDF operations will necessarily qualify the funding as a contract for pecuniary interest. As such the funding agreement will undoubtedly constitute a public procurement contract and thus the Managing Authority will have to follow the procedures of Law 12(I)/2006.

3.2.8 Selection of UDFs and Contributions by Holding Fund

In the case of financial engineering organised through holding fund, a funding agreement between the Managing Authority and the Holding Fund Manager should, pursuant to Article 44 of the implementing Regulation 1828/2006, make provision for the appraisal, selection and accreditation of financial engineering instruments by the Holding Fund. Where such funding agreements include specific provisions for the criteria applicable to the selection of operations, these criteria should be considered and approved by the monitoring committee.

Having said that it is submitted that the applicability of Law 12(I)/2006 at this level depends on the identity of the holder of the Holding Fund namely, on whether the Holding Fund may be considered as a purely private body or subject to the influence of the public sector in a way specified by Law 12(I)/2006. In the first case, where the holding fund is considered as private body, it can be said that the holding fund will not be Contracting Authority within the meaning of the Law, and, consequently will not be obliged to apply the particular procedures stipulated in the Law. Nevertheless, it will need to have in transparent procedures for the selection of UDFs as it will be explained under the State Aid Control regulations review.

However, in the case where the Holding Fund is influenced by the public sector then such Holding Fund would classify as a Contracting Authority, as this is defined in the Law. More

[23] The Note of the Commission 'Services on Financial Engineering in the 2007-2013 programming period' with reference number DOC COCOF/07/0018/01-EN FINAL of 16 July 2007

specifically, to qualify as a Contracting Authority the Holding Fund will need to be a legal person (i) established for the specific purpose of meeting needs in the general interest, not having industrial or commercial character and (ii) financed, for the most part, by the State, regional or local authorities, or other bodies governed by public law; or subject to management supervision by those bodies; or having an administrative, managerial or supervisory board, more than half of whose members are appointed by the State, regional or local authorities, or by other bodies governed by public law.

As concerns the requirement of being established for the specific purpose of meeting needs in the general interest, not having industrial or commercial character it is submitted that this is quite satisfied if one takes into account the following considerations.

a. The purpose of the Holding Fund will be to substitute the Managing Authority in managing the funds from operational programmes and in investing these funds in particular UDFs. Therefore, the Holding Fund takes over part of the tasks which belong to the duties of the Managing Authority;

b. Even though the Holding Fund will receive remuneration and it may generate profits, it is not the profit but the professional management of the funds from the operational programmes that will be the fundamental task of Holding Fund's activity;

c. Undoubtedly, the activity of the Holding Fund is of interest both for the State and for the local government bodies; and,

d. While investing in a particular UDF, the Holding Fund shall bear in mind also other factors, not only economic ones.

As far as the influence of the public sector is concerned, such a situation will arise where more than 50% of shares or stock of the Holding Fund operating in the form of a capital company is owned by the public sector. Therefore, it should be assumed that if the public sector has influence on the Holding Fund activity in a way specified in the Law 12(I)/2006, the Holding Fund will have the status of a Contracting Authority, referred to in the above provision. Consequently, while concluding contracts for pecuniary interest having as their objects services, supplies or construction works, Holding Fund with such a status will be obliged to apply the Legislative provisions.

As abovementioned and according to the Commission Regulation (EC) No. 1828/2006, the UDF shall receive remuneration for managing the funds transferred to it from operational programmes, which will constitute the cost of managing. Therefore, the funding agreement concluded with the UDF will be an agreement for pecuniary interest, within the meaning of the

Law. As such the funding agreement concluded between the Holding Fund and the UDF will be a public procurement contract for services within the meaning of Law 12(I)/2006, the procedures of which must be strictly observed.

3.2.9 Contributions when EIB is the Holding Fund Manager

In the case where the EIB is appointed as the Manager of the Holding Fund the situation is altered considerably. It is clear that the EIB is not subject to any national or other procurement legislation and, thus, not bound to observe such legislation.

Despite that, however at EU level the Commission pointed out that "*a transparent procedure for the selection of financial engineering instruments and for taking decisions on contributions from operational programmes to them, should be applied by the managing authority or the holding fund, as the case may be*"[24]. This selection procedure should be based on specific and appropriate selection criteria relating to the objectives of the Operational Programme, criteria which should be approved by the monitoring committee.

Therefore, where EIB acts as a Manager of the Holding Fund it is most likely and perhaps beneficial to the contracting parties that the funding agreement will provide specifically that the EIB's internal rules on UDF selection will be applicable in the selection of UDFs. This may be justified in a variety of reasons.

Firstly, the EIB being an EU entity mandated as the long-term lending bank of the European Union and empowered to contribute towards the integration, balanced development and economic and social cohesion of the EU Member States, has a long tradition of observing EU public procurement law. It achieved that through the adoption of its internal rules on Public Procurement, which are tailored to match the public procurement principles as set by the relevant EU Directives.

Secondly, the eventual appointment of the EIB as the Holding Fund Manager, would be the direct result of the Managing Authority's decision to take advantage of the efficiency provided to the whole structure through the utilisation of EIB expertise as explained elsewhere in the report. It would be, unreasonable to fetter the EIB ability to manage the contributions from the Holding Fund by imposing any other set of rules or laws as concerns the procurement of public contracts. Thirdly, the EIBs internal rules on UDF selection do qualify as "*a transparent procedure for the selection of financial engineering instruments and for taking decisions on contributions from operational programmes to them".*

[24] The Note of the Commission 'Services on Financial Engineering in the 2007-2013 programming period' with reference number DOC COCOF/07/0018/01-EN FINAL of 16 July 2007

It is for these reasons that it is considered certain that once the EIB is appointed as the Manager of the Holding Fund, the funding agreement will also mention that the EIB is free to proceed with contributions to UDFs by making use of its own rules of procurement.

At this level it is deemed important to point out that the selection of private partners in financial engineering instruments, including Urban Development Funds, created on the initiative of public entities may correspond to the procurement of public services. The Managing Authority in any event must assess this, and comply with applicable legislation.

3.2.10 Level 3: Contribution at Project Level

Before considering issues of public procurement regulation, it should be remembered that pursuant to Article 43(1) of Regulation (EC) No 1828/2006, the provisions on financial engineering of that Regulation apply to "*financial engineering instruments in the form of actions which make repayable investments or provide guarantees for repayable investments*" for urban projects included in integrated plans for sustainable urban development. The intention of the legislator is clear, that resources returned should be re-used for the benefit of urban development projects or of enterprises. Having said that, it is clear that at this point that the UDF will invest in specific urban projects either by means of their capital contributions, grant loans or provide guarantees.

It is submitted that the applicability of Law 12(I)/2006 at this level depends on the status of the UDF, namely, whether the UDF may be considered as a purely private body or subject to the influence of the public sector in a way specified by Law 12(I)/2006. Again, in the first case, the UDF will not be the Contracting Authority within the meaning of the Law, and, consequently will not be obliged to apply the particular procedures stipulated in the Law.

However, in the case where the UDF is influenced by the public sector then such UDF would classify as a Contracting Authority as referred to in the Law. More precisely to qualify as a Contracting Authority the UDF will need to be a legal person (i) established for the specific purpose of meeting needs in the general interest, not having industrial or commercial character and (ii) be financed, for the most part, by the State, regional or local authorities, or other bodies governed by public law; or subject to management supervision by those bodies; or having an administrative, managerial or supervisory board, more than half of whose members are appointed by the State, regional or local authorities, or by other bodies governed by public law. With reference to the requirement of being established for the specific purpose of meeting needs in the general interest, not having industrial or commercial character it is submitted that this is acceptable if one takes into account the following considerations:

a. even though the UDF will receive a remuneration and may profit, it is not the profit, but the financial aid in carrying out the “urban projects” that will be the fundamental task of UDFs activity;

b. while investing in projects, by means of investing capital contributions or granting loans or guarantees, UDF will bear in mind also other factors, not only the economic one, i.e. social benefits;

c. the funds from national and regional operational programmes allow UDF to grant preferential loans and guarantees, which gives the UDF a privileged position in comparison to other entities offering the same type of products; and,

d. supporting the realisation of projects covered by an integrated plan of sustainable urban development is both in the interest of the State and the local government bodies.

It is submitted that if the public finance sector has influence on the UDF activity in a way specified by the Law, the UDF will have the Contracting Authority status referred to in the provisions of the Law. Consequently, while concluding contracts for pecuniary interest having as their objects services, supplies or construction works, the UDFs with such a status will be obliged to apply the provisions of Law 12(I)/2006. Thus, what remains to be determined in order to decide whether such a UDF will be obliged to observe the provisions of the Law, is whether or not the contracts that will be concluded by the UDF within the JESSICA initiative will qualify as public procurement contracts, namely contracts for a pecuniary interest.

It has already been highlighted that the UDF will invest in particular projects by means of capital contributions, loans or through the provision of guarantees. Where the UDF grants guarantees and provides loans then these activities do not come under the definition of a public contract since the UDF will not spend the funds, will not pay for provision of services or supplies and additionally will charge fees and interest on the granted loans and guarantees. Thus there is no identifiable abstract pecuniary interest in these activities.

The opinion is expressed that pecuniary interest does exist in these cases since loans are supposed to be provided with more preferential terms of finance (i.e. lower interest rates, reduced collateral requirements, longer maturity and grace periods) compared to the ones of standard market loans. Yet the fact in issue should not be the comparative advantage provided under the JESSICA funding method, but rather the pecuniary interest of the funding itself. As such the determining factor is that under the provision of loans method of JESSICA funding JESSICA funds are not spent but rather they are preserved with a margin of profit, as well.

As far as capital contributions are concerned, these will be interpreted in accordance to the method of investment. Assuming that these will be invested by means of the purchase of stock in the entities which deliver the urban projects, it is submitted that the provisions of Law 12(I)/2006 do not provide clear guidance as to its application over such arrangements. Still on the basis of the definition of a "public procurement contract for supplies" contained in the community directives it is assumed that this definition excludes the agreements having as their object the purchase of stock in commercial law companies from the application of the provision on public procurement contracts.

3.3 Brief Description of the Procedures Where Law 12(I)/ 2006 is Applicable

The right to take part in the contest for the award of Public contracts of any nature is afforded to those persons natural or legal or consortiums of natural or legal persons who according to the laws of the Member State in which they are established, have the right to take part in such contests. Especially in relation to consortiums of financial institutions, the contracting authorities are entitled to force the chosen consortium to take a certain legal form, if the contract is given to it, to the extent that this form is necessary for the correct execution of the contract.

Each Contracting Authority may proceed with the negotiation of public contracts by resorting to one of the following four procedures:

a. The open procedure which is the procedure in the context of which each economic operator can submit a tender.

b. The restricted procedure, whereby, the economic operator may request to participate, but only those that the contracting authority has invited to submit a tender may qualify.

c. The procedure of the competitive dialogue which is the procedure where each economic operator may request to participate. The contracting authority carries out a dialogue with the candidates that have been accepted in order to outline the requirements that need to be fulfilled. The contracting authority resorts to the procedure of the competitive dialogue in cases of complicated contracts where it cannot determine or specify the technical means that needed to satisfy its objectives or where it cannot determine the legal or economic preparation of a plan.

d. Through the use of negotiated procedure with or without the proclamation of a contest. Here, the contracting authorities negotiate

with one or more economic operators of their choice each term of the contract.

A contracting authority resorts in the negotiation procedure with the proclamation of contest in the following four cases:

a. In the case of irregular tenders or unacceptable tenders being submitted in response to an open or restrictive procedure or a competitive dialogue.

b. In the case where prior overall pricing is not possible.

c. In the case where the contract specifications cannot be established with sufficient precision.

d. In the case of works performed solely for purposes of research, testing or development.

The contracting authority may also resort to the negotiation procedure without the declaration of a contest in the following cases:

a. In the case of “lack” of tenders.

b. In the case where the contract may be awarded only to a particular economic operator.

c. In the case of “extreme urgency”.

d. In the case where the products involved are manufactured purely for the purposes of research, experiments, study or development.

e. In the case of additional deliveries by the original supplier.

f. In the case of supplies quoted and purchased on particularly advantageous terms.

g. In the case of contracts that follow a design contest.

h. In the case of additional works or services not included in the original contract.

i. In the case of new works and services consisting in the repetition of similar works or services of the original contract.

In any event, there is an obligation on the Contracting authority to proceed in publication of each contest except in cases where it chooses to proceed to a negotiation procedure without the declaration of a contest as mentioned above.

It is worth mentioning that the purpose of the evaluation procedure is to select the best among the tenders submitted prior to expiry of the submission deadline by tendering parties who are eligible to participate in the tender procedure and meet the participation requirements (qualitative selection criteria) specified in the tender documents.

4 State Aid Regulation and Primary Exceptions

4.1 European Union Regulations

According to the EC Treaty any aid granted by the state or through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods is, in so far as it affects trade between Member States, incompatible with the common market[25].

Firstly, it should be stressed from an early stage that not every state aid constitutes unlawful state aid. Following the wording of the general prohibition and the readings of the Commission, European Court of Justice, and the Cyprus legislation unlawful state aid or state aid incompatible with the common market exists wherever the following elements are present:

a. aid granted by a State or granted from state resources in any form whatsoever;

b. which distorts or threatens to distort competition;

c. has the effect of favouring certain undertakings or the production of certain goods, having thus a selecting character;

d. has the effect of granting to the aid recipient economic benefits upon conditions more favourable than market conditions; and,

e. it affects trade between Member States.

From the above analysis of Article 87(1) of the Treaty and the Staid Aid Control Act 30(I)/2001 it follows that any State aid that does not meet all five of the above elements cannot be qualified as incompatible with the common market.

Furthermore, certain exceptions to the general prohibition against State aid do exist. These may conveniently be divided between aid which is compatible with the common market and aid which may be considered as compatible with the common market. As exceptions their

[25] Treaty establishing the European Community, dealing with the State aid Control Policy are found in Part Three: Community policies, Title VI: Common rules on competition, taxation and approximation of laws, Chapter 1: Rules on competition, Section 2: Aids granted by States, Articles 87-89.

provision are relevant and may be considered once it is first established that a particular state aid is incompatible with the common market. These exceptions are designed to address specific circumstances so as to ensure a well-functioning and equitable economy.

A State aid which may be considered as compatible with the common Market, by way of exception and which is relevant for the purposes of this study concerns aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest. Under article 88 and 89 of the Treaty the Commission is vested with the powers to regularly review and comment on Member State practices and initiate proceedings of compatibility. At the heart of these powers lies the notification procedure whereby the Commission is supposed to be informed, in sufficient time to enable it to submit its comments, of any plans of a Member State to grant or alter aid. It is only after approval by the Commission, subject to an alternative procedure available to the Member States, that an aid measure can be implemented.

4.2 Cyprus Legislation and the State Aid Control Law 30(I)/2001 as Amended

It is submitted that the relevant European state aid control policy has been implemented within the Republic of Cyprus through the enactment of the State Aid Control Act 30(I)/2001. According to the Act state aid is defined as the financial aid which is granted in whatever form, directly or indirectly, from the Public Sector or through funds of the public sector, and which distorts or threatens to distort competition, having the effect of favouring certain undertakings or the production of certain goods by selective treatment and it includes grants, loan guarantees, or other guarantees, loans with preferential interest rates and the participation in the share capital of a business or the provision of capital under which are different from those which an ordinary private investor would agree in the provision of the same capital[26]. For the purposes of Cyprus legislation the public sector is defined as the State, municipalities and other self – governing communities that are not municipalities.

In any case however, under Cyprus State Aid Control legislation any aid which comes under the statutory definition of State Aid as it was abovementioned, unless it was communicated beforehand to the State Aid Commissioner of the Republic following the terms of the relevant legislation. Some of those state aids are automatically approved by the State Aid Commissioner and for others the State Aid Commissioner has discretionary powers to approve or to reject them.

Therefore according to the State Aid Control Act every Competent Authority which plans or intents to grant a new State aid communicates to the State Aid Commissioner the preliminary

[26] State Aid Control Act 30(I)/2001

plan of aid together with any available information. The Act defines Competent Authorities so as to include the Council of Ministers, the ministers, the managing boards of bodies regulated by public or private law, the Municipal Councils, other self - governing Community Councils, and any other public or private authority which decides alone or in the context of a public policies, the grant of State aid of whatever form.

Following the examination of the communicated proposed state aid the Commissioner decides whether the proposed state aid is compatible or not to the provisions of the State Aid legislation and issues a reasoned decision. If any Competent Authority acts in breach of the provisions of the State Aid Control Act then the Commissioner may demand the return of the aid for the beneficiary of the aid.

4.3 The Exception of the Private Investor Test

One other issue which is central in the State Aid Control Policy of the EU also incorporated within the Cypriot legal order is that of the private investor test, according to which the State or the public bodies may participate in regular trade on the same terms as private bodies: aiming to generate profits or, possibly, reduce losses. This is known as the private investor test and it will apply to aid provided to both public and private bodies.

This means that in order to determine whether State aid constitutes unlawful State aid, it will be necessary to find out whether a private body would act in the same way as a public body under the specific circumstances in which the aid was given. The private investor test can be utilised not only in case of investments, but also when public bodies provide financial support in the form of loans and guarantees, whereby the test will be adjusted accordingly, into private creditor/guarantor test etc). It is said that the criterion of regular market behaviour is of cardinal importance in the assessment of the private investor test. As such the private investor test is effective where the state aid was made on regular market conditions, meaning that the grantee would have obtained the aid on similar terms even from private bodies. In such a scenario the obtained aid is not unlawful State aid.

4.4 The Issue of State Aid Control within JESSICA

The application of the State Aid control policies and the relevance of the private investor test involve the assessment of real economic data and criteria in any given situation. This means that when assessing these policies the person mandated to conduct the examination will need to know the precise amount of intended aid on one hand, but will also need to enquire into the comparative market conditions existing at the moment of investigation. It is submitted that for the purposes of this study, the application of State Control Policies will be assessed on a theoretical level. It is stressed that any implementation of the JESSICA initiative will

necessitate the preparation of specific legal and economic analysis of the market conditions present at the moment of implementation.

The primary issue in assessing the lawfulness of State aid within JESSICA will be to verify whether there will be no preference of one body over another at subsequent stages of the JESSICA's implementation and operation, as such preferences could have an impact on trade exchange at Community scale, consequently leading to violation of competition. This premise is based on the assumption that the rest of the criteria that qualify an aid as State aid provided for by Article 87(1) of the EC Treaty and the Cyprus legislation are arguably present in the transmission of JESSICA funds.

As such it is considered as granted that JESSICA will be implemented through funds from operational programmes which are considered as public funds and perhaps through other contributions (from the public sector or municipalities) which also qualify as public funds, if the provisions of the State Aid Control Act 30(I)/2001 are acknowledged. Similarly, it is considered as granted that if an arbitrary selection of State Aid beneficiaries is adopted then all criteria of unlawful State Aid are present and any amount of aid may, potentially, have the effect of threatening to distort competition and affect trade between member states.

Having said that the state aid risk assessment will be focussed on the issues associated with the selection of Holding Fund and UDF, the relations built between Holding Fund and UDF, with the determination of Holding Fund and UDF remuneration, with support provided by UDF for specific projects, or the issues related to the public bodies' investments in UDF and Holding Fund. Here it is submitted that the issues relating to contributions made by Managing Authorities to Holding Funds and from Holding Funds to UDFs has been the subject of two communications by the Commission[27]. Both communications are important as they depict the interpretation that the Commission will give to the three main regulations as far as the deployment of financial engineering instruments is concerned.

According to the Commission[28] it has already made clear[29] that in general, an investment fund or an investment vehicle is an intermediary vehicle for the transfer of aid to investors and/or enterprises in which investment is made, rather than being a beneficiary of aid itself. On this interpretation, State aid to investment fund/investment vehicles is not present if the fund

[27] Note of the Commission 'Services on Financial Engineering in the 2007-2013 programming period with reference number DOC COCOF/07/0018/01-EN FINAL, and the Guidance note on Financial Engineering COCOF 08/0002/03-EN Final version of 22/12/2008

[28] Note of the Commission 'Services on Financial Engineering in the 2007-2013 programming period with reference number DOC COCOF/07/0018/01-EN FINAL, section 3. State Aid and Financial engineering, subsection 3.1

[29] Point 3.2 of the Community Guidelines on State Aid to promote Risk Capital investments in Small and Medium sized Enterprises (OJ C 194, 18.8.2006, p. 2)

managers or management companies, either at Holding Fund or UDF level, are chosen through an open and transparent public tender procedure or if they do not receive any other advantages granted by the State. However, measures involving direct transfers in favour of an investment vehicle or an existing fund with numerous and diverse investors with the character of an independent enterprise may constitute aid unless the investment is made on terms which would be acceptable to a normal economic operator in a market economy and therefore provide no advantage to the beneficiary.

4.5 Level 1: State Aid Control and Holding Fund

According to Article 44 of the Regulation[30] where the Structural Funds finance expenditure in respect of an operation and when such operations are organised through holding funds, that is, funds set up to invest in several venture capital funds, guarantee funds, loan funds and urban development funds, the Member State or the managing authority shall implement them through one or more of the following forms:

a. the award of a public contract in accordance with applicable public procurement law;

b. when the agreement is not a public service contract within the meaning of applicable public procurement law, the award of a grant, defined for this purpose as a direct financial contribution by way of donation to a financial institution without a call for proposals, if this is in accordance with a national law compatible with the Treaty; and,

c. the award of a contract directly to the EIB.

At this stage it can be said that in the setting up and operation of a Holding Fund, issues of State Aid will arise depending on the method of selecting the Holding fund. Indeed, as pointed out by the commission, measures involving direct transfers in favour of an investment vehicle or an existing fund with numerous and diverse investors with the character of an independent enterprise may constitute aid unless the investment is made on terms which would be acceptable to a normal economic operator in a market economy and therefore provide no advantage to the beneficiary.

[30] Regulation (EC) No 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999, as amended by, Regulation (EC) No 284/2009 of 7 April 2009.

At this level two distinct scenarios exist, first, selecting the EIB as Manager of the Holding Fund, selecting a third party other than the EIB as the Holding Fund Manager by procuring a public contract and third the awarding of a grant.

4.5.1 Selecting the EIB as Holding Fund Manager

In this scenario no issue of state aid arises for two reasons. The first reason is again based on the relationship between the EIB and its members, i.e. the Member States, which is governed by primary law in an exclusive, self-contained and institutional manner. Furthermore the status of the EIB is also relevant here, since EIB is established by the Treaty of Rome and mandated as the long-term lending bank of the European Union and empowered to contribute towards the integration, balanced development and economic and social cohesion of the EU Member States.

Thus, as a result in the present context, market related state aid rules do not apply within this privileged relationship. The second reason is the fact that in any case the EIB in acting as the holder of the holding fund will act as an intermediary of aid rather than a beneficiary of aid itself. The only issue that arises concerns the matter of the management fees and their compliance with State Aid Control policies, which is elaborated further below.

4.5.2 Selection of a Third Party Other Than the EIB as Holding Fund Manager

As it is already mentioned when selecting a holding fund pursuant to the provisions of Article 44, the issue of State Aid should not arise since the Holding fund will normally operate as an intermediary of aid rather than a beneficiary of aid itself. Indeed, the Commission pointed out that where Member States or managing authorities implement an operation comprising of contributions to support financial engineering instruments through holding funds, the Holding Fund would be simply initiating investments and would be an intermediary vehicle and so would not be a beneficiary of aid[31].

Yet, when selecting the holder of the holding fund under an arbitrary procedure the Managing Authority could be charged with the granting of unlawful state aid, exactly because the arbitrary selection was not made on market criteria, thus benefiting a particular undertaking over another competitor. It is for this reason that it is suggested that public procurement procedures be followed strictly in accordance to the provisions of Article 44 and as explained under the Chapter of Public Procurement Legislation elsewhere in this study. Observing the public procurement regulations will secure that calls for proposals will be announced publicly

[31] The Note of the Commission 'Services on Financial Engineering in the 2007-2013 programming period' with reference number DOC COCOF/07/0018/01-EN FINAL of 16 July 2007

and each potential bidder will have the same access to the procedure information. As such the tender will be transparent and therefore, the risk of charge that the selection was not made on market terms will practically be eliminated.

4.6 Level 2: State Aid Control and Contibutions to UDFs

When contributions from operational programmes to financial engineering instruments are invested, loaned or committed for guarantees in urban projects, state aid may be present. State aid rules must again be respected by Member States and managing authorities, assisted by the holding fund where appropriate. Indeed, Article 43(7) of the Implementing Regulation (EC) No 1828/2006 as amended by Regulation (EC) 846/2009 requires managing authorities to "take precautions to minimise distortion of competition in the venture capital or lending markets and the private guarantee market".

Furthermore according to Recital 26 of the implementing Regulation 1828/2006 it is specified that contributions to financial engineering instruments from the operational programme and other public sources, as well as the investments made by financial engineering instruments in individual enterprises, are subject to the rules on State aid including the Community Guidelines on State aid to promote risk capital investments in small and medium sized enterprises.

It is submitted that in any case where a UDF will be selected either by the managing Authority or by the Managers of the Holding Fund then such a selection should observe a set of a transparent, clear procedure which should be based on the specific and appropriate criteria related to the objectives of a given operational program. In the case where the UDF is selected by either the Managing Authority of a third party other than the EIB acting as the holder of the holding funds then this procedure may follow the domestic Cyprus Public procurement Legislation.

Where the UDF is selected by the EIB acting as the holder of the holding fund then the selection criteria can follow the EIB internal rules on UDF selection.

4.7 Level 3: Contributions to Individual Projects

4.7.1 Operating in the Market as an Investor, Through Capital Contributions or Loans

It has been explained above that if a body administering public funds, operates in the market, invests, extends loans, gives guarantees etc, like any other private investor, then its activities will be qualified as market operations, not associated with the risk of unlawful State aid.

The ability of any such body to operate on the market without offending against State aid control policies will depend on the private investor test. The cases of interest for the present study are those where the body administering public funds is participating in other bodies either through capital contributions or loans. State aid will be present if such investments are made on terms and circumstances where no private investor would decide to carry out the same.

The Commission had the opportunity to clarify its position[32] with regard to public authorities' holdings in share capital. The Commission stressed that due to the principle of equity between public and private bodies its action may neither penalize nor favour public authorities which provide companies with capital contributions. Nor should the Commission comment on the choices made as to the forms of financing equity or loan.

The Commission distinguishes four types of situation in which public authorities may have occasion to acquire a holding in the capital of companies:

a. the setting up of a company;

b. partial or total transfer of ownership from the private to the public sector;

c. in an existing public enterprise, injection of fresh capital or conversion of endowment funds into capital; and,

d. in an existing private sector company, participation in an increase in share capital.

On this basis, the Commission distinguishes the following cases when the existence of state aid is assessed, whereby:

a. Straightforward partial or total acquisition of a holding in the capital of an existing company, without any injection of fresh capital, does not constitute aid to the company;

b. State aid is also not involved where fresh capital is contributed in circumstances that would be acceptable to a private investor operating under normal market economy conditions. This can be taken to apply:

    i. where a new company is set up with the public authorities holding the entire capital or a majority or minority interest, provided the

[32] EC Bulletin 9-1984

authorities apply the same criteria as provider of capital under normal market economy conditions;

ii. where fresh capital is injected into a public enterprise, provided this fresh capital corresponds to new investment needs and to costs directly linked to them, that the industry in which the enterprise operates does not suffer from structural overcapacity in the common market, and that the enterprise's financial position is sound;

iii. where the public holding in a company is to be increased, provided the capital injected is proportionate to the number of shares held by the authorities and goes together with the injection of capital by a private shareholder; the private investors holding must have real economic significance;

iv. where the strategic character of the investment in terms of markets or supplies is such that acquisition of a shareholding could be regarded as the normal behaviour of a provider of capital, although profitability is delayed; and,

v. where the recipient company's development potential, reflected in innovative capacity from investment of all kinds, is such that the operation may be regarded as an investment involving a special risk but likely to pay off ultimately.

However, there is State Aid where fresh capital is contributed in circumstances that would not be acceptable to a private investor operating under normal market economy conditions. This is the case:

a. where the financial position of the company, and particularly the structure and volume of its debt, is such that a normal return (in dividends or capital gains) cannot be expected within a reasonable time from the capital invested;

b. where, because of its inadequate cash flow if for no other reason, the company would be unable to raise the funds needed for an investment programme on the capital market;

c. where the holding is a short-term one, with duration and selling price fixed in advance, so that the return to the provider of capital is considerably less than he could have expected from a capital market investment for a similar period;

d. where the public authorities' holding involves the taking over or the continuation of all or part of the non-viable operations of an ailing company through the formation of a new legal entity;

e. where the injection of capital into companies whose capital is divided between private and public shareholders makes the public holding reach a significantly higher level than originally and the relative disengagement of private shareholders is largely due to the companies' poor profit outlook; and,

f. where the amount of the holding exceeds the real value (net assets plus value of any goodwill or know-how) of the company.

The Commission stressed that even if the holding is acquired in the manner described in one of the last two cases, if it is a stake in a SME which, due to its size, is not able to secure appropriate collaterals on the private financial market, but whose outlooks seem to justify public participation in excess of its net assets or private investments, it will not constitute state aid[33].

Furthermore, the Commission clearly emphasizes where (under the guidelines contained in the 1984 Position), public authorities, contribute capital to a company by acquiring its shares, and are not simply providing capital contributions under normal conditions of market economy, then such a case should be examined in the light of Article 87 of the EC Treaty.

Having said that it is necessary to comment on whether or not in such situation a shareholder to or a body co-financing the UDF should be considered as the beneficiary of unlawful state aid. To determine any such this it is necessary to examine whether or not such shareholder or body will be privileged over its competitors due to its participation in the fund, in which a body administering public funds is also capitally involved.

It is submitted that this enquiry can be analysed into two further stages, namely the stage where the UDF is operating/investing and the stage where the shareholder or co-financing body will receive a return from the investment. As concerns the first stage and given that the shareholders will not receive any direct benefits from JESSICA's operation at the funds' operation stage, then admittedly they will not receive any public funds. Any contribution in the funds as such will not involve their obtaining of unlawful State Aid.

On the other hand, as concerns the returns received by shareholders from the UDF investment, the matter is more complicated and an investigation may be necessary as to

[33] EC Bulletin 9-1984

whether at the return-on investment stage the UDFs shareholder does not receive unlawful State aid. The investigation becomes necessary because the terms under which a shareholder will agree to participate in the UDF and the terms as to the rates of returns on which he agrees to participate may vary depending on the circumstances of each particular shareholder/ co-financing body.

What can be said at this point of the study is that the risk of unlawful State Aid may be mitigated by introducing an appropriate competitive procedure for selecting the UDFs shareholders. Depending on the structure to be adopted, the competitive procedure requirement may be satisfied either through the Public Procurement legislation or the EIB internal rules. Indeed, the Commission itself expressed the view that at this level it is considered interesting to point out that the selection of private partners in financial engineering instruments, including UDFs, created on the initiative of public entities may correspond to the procurement of public services. The Managing Authority or the Holding Fund in any event must assess this, and comply with applicable legislation or procedures.

4.7.2 Granting Guarantees

In the case of a guarantee granted from public resources, the aid beneficiary is usually the borrower. The State guarantee enables the borrower to obtain better financial terms for a loan than those normally available on the financial markets. Typically, with the benefit of the State guarantee, the borrower can obtain lower rates and/or offer less security. In some cases, the borrower would not, without a State guarantee, find a financial institution prepared to lend on any terms. State guarantees may thus facilitate the creation of new businesses and enable certain undertakings to raise money in order to pursue new activities or simply remain active instead of being eliminated or restructured, thereby creating distortions of competition. State guarantees thus generally fall within the scope of Article 87(1), if trade between Member States is affected and no market premium is paid. Additionally State guarantees come within the State Aid Control Act 30(I)/2001, definition of State Aid.

The benefit of a State guarantee is that the risk associated with the guarantee is carried by the State. This carrying of a risk by the State should normally be remunerated by an appropriate premium. Where the State forgoes such a premium, there is both a benefit for the undertaking and a drain on the resources of the State. Thus, even if no payments are ever made by the State under a guarantee, there may nevertheless be a State aid under Article 87(1). The aid is considered as granted at the moment when the guarantee is given the aid, not the moment at which the guarantee is invoked or the moment at which payments are made under the terms of the guarantee. Whether or not a guarantee constitutes State aid, and, if so, what the amount of that State aid may be must be assessed at the moment the guarantee is given.

The above conclusions are acknowledged by the Commission which again dealt with the matter of State guarantees as a form of state aid and its results are incorporated in the Notice on the application of Articles 87 and 88 of the EC Treaty to state aid in the form of guarantees. The Commission lists the criteria the fulfilment of which ensures that an individual State guarantee does not constitute the unlawful State aid under Article 87(1) of the EC Treaty, These are the following:

a. the borrower must not be in financial difficulty;

b. the borrower would in principle be able to obtain a loan on market conditions from the financial markets without any intervention by the State;

c. the guarantee must be linked to a specific transaction, for a fixed maximum amount, and must not cover more than 80% of the outstanding loan or other financial obligation, not applicable for bonds and derivative instruments, and must not be open-ended; and,

d. the market price for the guarantee must have been paid, something which reflects, amongst others, the amount and duration of the guarantee, the security given by the borrower, the borrower's financial situation, the sector of activity and the prospects for its development, the rates of default and other economic conditions.

Equally, a State guarantee scheme shall not constitute unlawful State aid when:

a. the scheme does not allow guarantees to be granted to borrowers who are in financial difficulty;

b. the borrowers would in principle be able to obtain a loan on market conditions from the financial markets without any intervention by the State;

c. the guarantees are linked to a specific financial transaction, are for a fixed maximum amount, do not cover more than 80% of each outstanding loan or other financial obligation and are not open-ended;

d. the terms of the scheme are based on a realistic assessment of the risk so that the premiums paid by the beneficiary enterprises are sufficient to make it self-financing;

e. the scheme provides for the terms on which future guarantees are granted and the overall financing of the scheme to be reviewed at least once a year; and,

f. the premiums cover both the normal risks associated with granting the guarantee and the administrative costs of the scheme, including, where the State has provided the initial capital for the start-up of the scheme, a normal return on that capital.

The Commission stresses that failure to comply with any one of the above conditions does not mean that such guarantee or guarantee scheme are automatically regarded as unlawful State aid. If there is any doubt, an individual guarantee or a guarantee scheme should be notified to the Commission. The Commission shall examine whether aid in the form of guarantees is compatible with the common market, taking into account the rules and guidelines concerning horizontal, regional and by sector aid[34]. As concerns the Cyprus legal order such uncertain scheme must be communicated to the State Aid Commissioner who will proceed with the aforementioned examination.

The Commission has also established that where Member States do not observe the obligation of prior notification of their intent to grant aid and suspension, the aid element of the guarantee is to be qualified as unlawful under Council Regulation No. 659/1999[35]. The Commission clearly stresses that if a guarantee is deemed unlawful, it may be recovered from its beneficiary, even if it means the declaration of bankruptcy of the enterprise. The same principles apply equally under the State aid Control Act 30(I) / 2001.

4.8 Recycling of Contributions

Article 78(7) of Regulation (EC) No 1083/2006 expressly provides that "resources returned to the operation from investments undertaken by funds as defined in Article 44 or left over after all guarantees have been honoured shall be reused by the competent authorities of the Member State concerned for the benefit of urban development projects or of small and medium sized enterprises". For loan and venture capital funds, the resources returned include interest and loan repayments and capital gains.

It is clear that private contribution to an operation or a financial engineering instrument should be returned to the private entity that contributed it, and not to the competent public authority of the Member State. Indeed, Article 43(7) of Regulation (EC) No 1828/2006 provides that

[34] Commission Notice on the application of Article 87 and 88 of the EC Treaty to State Aid in the form of guarantees.
[35] Laying down detailed rules for the application of Article 93 of the EC Treaty of 22 March 1999

"returns from equity investments and loans, less a pro rata share of the management costs and performance incentives, may be allocated preferentially to investors operating under the market economy investor principle … and they shall then be allocated proportionally among all co-financed partners or shareholders."

The Commission recommends[36] that returned resources be re-used in the region covered by the operational programme and that re-use should be through financial engineering instruments, with a view to ensuring further leverage and recycling of public money.

4.9 State Aid Control and Management Fees

According to the communications from the Commission it can be held that Aid to the fund's managers or the management company will be considered to be present if their remuneration does not fully reflect the current market remuneration in comparable situations[37]. The Commission holds that the ceilings for the management costs, capped at a yearly average of 2% for holding funds and 3% for UDFs, in accordance with Article 43(4) of Regulation 1828/2006[38], reflect current market remuneration. Provided these ceilings continue to reflect market remuneration, payment of management costs to holding funds should not constitute State aid to them.

The Commission specifically mentioned[39] that the rates referred to in the said Regulation to calculate the ceilings of management costs are applicable to contributions from operational programmes to holding funds or to other financial engineering instruments, including UDFs. The term 'contributions from the operational programme' should be understood as referring to the EC and national public funds, as well to private funds that are set out as originating from the operational programme in the funding agreement provided for by Articles 43(5), 44(1), and 44(3) of Regulation 1828/2006.

If the Holding Fund or UDFs is chosen through a public procurement procedure, it is up to the parties to fix the rate and regard does not need to be had to precise and detailed management costs. The Commission considers the following categories of costs of UDFs or holding funds as eligible management costs compatible with the principles of sound and efficient management, in the past:

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[36] Commissions Guidance note on Financial Engineering COCOF 08/0002/03-EN Final version of 22/12/2008

[37] Community Guidelines on state aid to promote risk capital investments in small and medium-sized enterprises

[38] Regulation (EC) No 1828/2006 of 8 December 2006 setting out rules for the implementation of Council Regulation (EC) No 1083/2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and of Regulation (EC) No 1080/2006 of the European Parliament and of the Council on the European Regional Development Fund.

[39] The Note of the Commission 'Services on Financial Engineering in the 2007-2013 programming period' with reference number DOC COCOF/07/0018/01-EN FINAL of 16 July 2007

a. Staff costs, including travel and subsistence expenses, the cost of offices, equipment, IT systems, consumables and supplies, directly linked to the management and investment of contributions from operational programmes to financial engineering instruments and holding funds; such costs being incurred in carrying out activities such as selection and tendering procedures, controls, monitoring and reporting, consultancy, information and publicity.

b. Overheads of the financial institution acting as a financial engineering instrument or holding fund in the management and investment of the contribution from the operational programme(s).

In any case, appropriate evidence should be kept by holding funds or UDFs, allowing them to demonstrate that management costs paid by operational programmes of the Structural Funds, effectively correspond to sound and efficient management principles.

Furthermore, the funding agreement may envisage front-loaded payment of management costs which exceeds the limits set out by Article 43(4) of Regulation 1828/2006 for one or more years, such as for example the first years of the programming period. This payment structure might be justified by the fact that holding funds or fund managers may incur significant costs before investments, loans or guarantees in enterprises effectively take place.

However, the eligible management costs for the Structural Funds, at the partial or final closure of operational programmes, should not exceed, averaged on a yearly basis over that part of the programming period for which the holding fund or financial engineering instrument effectively manages an operation, the threshold fixed in Article 43(4) of Regulation 1828/2006.

It should be stressed that the rates for management costs in Article 43(4) of Regulation 1828/2006 are maximum rates, unless an open competitive procedure reveals that higher rates are necessary. The Commission expects the managing authority or holding fund to negotiate management costs in accordance with the principles of sound financial management. Furthermore, the Commission specifically recommends[40] that the funding agreements link the remuneration to the amounts which will finally be actually invested in, or loaned out or committed as guarantees to, enterprises. Actual expenditure is a condition of the eligibility at closure of the expenditure other than management costs, under Article 78(6) of Regulation 1083/2006. Linking eligible management costs to the volume of finance contributed from operational programmes and finally disbursed to or committed for

[40] The Note of the Commission 'Services on Financial Engineering in the 2007-2013 programming period' with reference number DOC COCOF/07/0018/01-EN FINAL of 16 July 2007, page 5

guarantees to enterprises, would create an incentive for holding funds and financial engineering instruments to be active in promoting development and expansion of enterprises and in particular SMEs.

4.10 The Consequences of Unlawful State Aid within JESSICA

Detailed rules as to the recovery of unlawful aid have been set forth in Council Regulation (EC) No. 659/1999[41]. It should be emphasized that in any case the recovery proceedings shall be conducted against the Member State and not directly against the body granting the aid or the beneficiary. As such the State will be the subject of the proceedings and not the Holding fund or the UDFs.

Where the Commission is informed of alleged unlawful aid, it examines such information and after giving the Member State concerned the opportunity to submit its comments, the Commission may adopt a decision requiring the Member State to:

a. suspend any unlawful aid until the Commission has taken a decision on the compatibility of the aid with the common market ("suspension injunction"); and,

b. provisionally, recover any unlawful aid until the Commission has taken a decision on the compatibility of the aid with the common market ("recovery injunction"), if specific criteria are fulfilled.

Where negative decisions are taken in cases of unlawful aid, the Commission shall decide that the Member State concerned shall take all necessary measures to recover the aid from the beneficiary ("recovery decision"). Recovery shall be affected without delay and in accordance with the procedures under the national law of the Member State concerned, provided that they allow the immediate and effective execution of the Commission's decision.

The limitation period shall be 10 years and begin on the day on which the unlawful aid is awarded to the beneficiary. Any action taken by the Commission or by a Member State, acting at the request of the Commission, with regard to the unlawful aid, shall interrupt the limitation period.

Domestic procedures of recovering unlawful state aid were enacted and incorporated in the State Aid Control Act 10(I)/2001, whereby the Competent Authorities are afforded with administrative powers to reclaim unlawful State Aid from the beneficiary of such aid.

[41] Of March 22, 1999 laying down detailed rules for the application of Article 93 of the EC Treaty

5 Identification and Analysis of Possible Legal Structures to Assume the Role of UDFs

5.1 Prescriptions as to the Structure of the Holding Fund and UDFs

Article 43(2) of the relevant Implementing Regulation[42] as amended by Regulation (EC) 846/2009 specifies that financial engineering instruments, including holding funds, shall be independent legal entities governed by agreements between the co-financing partners or shareholders or as a separate block of finance within a financial institution. In such structures the Commission may not become a co-financing partner or shareholder in financial engineering instruments.

5.2 Financial Engineering Instruments Established Within a Financial Institution

Article 43(2) of the Implementing Regulation[43] as amended by Regulation (EC) 846/2009 further specifies, that where the financial engineering instrument is established within a financial institution, it shall be set up as a separate block of finance, subject to specific implementation rules within the financial institution, stipulating, in particular, that separate accounts are kept which distinguish the new resources invested in the financial engineering instrument, including those contributed by the operational programme, from those initially available in the institution.

According to this second option the need for an underlying independent legal entity is waived provided at least that, the financial engineering instrument will be established within a financial institution and as such, it shall be set up as a separate block of finance, subject to

[42] Regulation (EC) No 1828/2006 of 8 December 2006 setting out rules for the implementation of Council Regulation (EC) No 1083/2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and of Regulation (EC) No 1080/2006 of the European Parliament and of the Council on the European Regional Development Fund.

[43] Regulation (EC) No 1828/2006 of 8 December 2006 setting out rules for the implementation of Council Regulation (EC) No 1083/2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and of Regulation (EC) No 1080/2006 of the European Parliament and of the Council on the European Regional Development Fund.

specific implementation rules within the financial institution. No further guidance is offered as to the meaning of the financial institution or the separate block of finance.

Here there is no matter for further inquiry as regards the possible structures that may be utilized under this option of establishing the Financial Engineering Institution. The regulation simply provides for this structure, specifying this to be a separate block of finance within a Financial Institution. The terms of operation of this block of finance will be the subject of the Underlying Funding Agreement.

5.3 Financial Engineering Instrument Established as Independent Legal Entities

No particular stipulation is made with regard to the specific structure of a Financial Engineering Instrument established as an independent legal entity. As no specific guidance is given with regard to the first choice of establishing the Financial Engineering Instruments, enquiry should be made at the national - domestic legislation. Here three preliminary points must be stressed.

Firstly, it is necessary to point out that any national or domestic legislation from any of the Member States may qualify as to the appropriate independent legal entity to be adopted for the implementation of JESSICA. Any such attempt of course will require further competent legal advice from the Member State whose legislative provisions are considered. It is not the subject of his study to embark on any analysis of any foreign independent legal entities that may be utilized for the implementation of JESSICA.

Secondly, it should be remembered that according to the implementing Regulation[44] urban development funds shall invest by means of equity, loans and guarantees. Therefore, the possible structures examined below must at least be able to invest by means of equity loans or guarantees. Any structure that fails to correspond in any of the three activities is arguably inadequate for our purposes.

Thirdly, the following examination will assess the ability of the various identified structures to meet the underlying objects of the UDFs. Whilst the flexibility of the structure to adopt any funding arrangements will be a key element in the following assessment, the particular funding arrangements behind the structure constitute a totally different aspect that it will be examined further below.

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[44] Regulation (EC) No 1828/2006 of 8 December 2006 setting out rules for the implementation of Council Regulation (EC) No 1083/2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and of Regulation (EC) No 1080/2006 of the European Parliament and of the Council on the European Regional Development Fund.

Having said that, it is submitted that within the jurisdiction of the Republic of Cyprus and according to Cyprus legislation, an independent legal entity is one which possess legal personality, distinct and independent from the legal personality of the person(s) behind its formation, or the person(s) administering the entity's affairs, its debtors or creditors. Within the Cypriot legal order such entities come in the form of:

a. private limited liability companies, by shares or guarantee;

b. public limited liability companies;

c. cooperative Companies;

d. companies formed under the specific provisions of an Act of Parliament;

e. associations; and,

f. foundations.

Given that the relevant EU Regulations prescribe for the necessity of independence of the legal entity it is not correct to include in the qualifying list of entities, structures such as partnerships, joint – ventures, trust agreements or other contractual or semi - contractual arrangements. Nevertheless, such arrangements may still be utilized under the second option where the Financial Engineering Instrument is set up as a separate block of finance examined further below.

5.3.1 The Cyprus Limited Liability Company

Under the Companies Act Cap 113, as amended, there are two main types of limited liability companies, public and private limited liability companies. Private companies are by far the most popular form of incorporation both for local and international investors basically due to their less onerous disclosure, simplicity regarding its registration and administration and dissolution.

According to Cyprus legislation a private company is one which by its articles the liability of its members is limited up to the amount unpaid for their subscribed shares. To qualify as a private company the number of the shareholders must not exceed fifty (50), with the exception of those who are serving the company as employees. A private company with more than fifty shareholders is considered for all the purposes of the relevant legislation as a public company and all mandatory provisions applicable to public companies must be observed. A Cyprus private company may be formed for all legally acceptable purposes and there are generally no limitations on the object that the company will chose to follow. Certain activities

require specific license to operate such as security companies[45], banking services companies[46], insurance companies[47] and investment services companies[48].

Private companies can be formed by even one shareholder as subscriber. The shareholders can take the form of a legal entity or an individual. If there is more than one shareholder, then these may be either legal or individual entities or both. The company is a distinct person from its shareholders in all respects and it is administered through the resolutions of its directors or the Board of Directors as the case may be. In practice however, the control of the Board of Directors is exercised by the Shareholders' General Assembly thus effectively the General Assembly controls the company.

The minimum number of directors is one and there is no maximum limit. Directors may be local or foreign. As mentioned above, the appointment and removal of directors is made by the Shareholders' General Assembly. Cyprus companies must have at least one local director except where the company's secretary is a local Cypriot resident. A company may be structured so as to operate through the decisions and resolutions of the shareholder's General Assembly and the Board of Directors. The constitution and operation of the company will normally be defined by the constitutional documents of the company namely the Memorandum and Articles of association.

Indeed, the company must have a Memorandum and Articles of Association. The Memorandum of the company amongst other things provides for the main objects for which the company is formed, the amount of the authorized and paid up capital which must be of a minimum Euro 1,000.00, the names, addresses and description of the subscribers together with the number of shares for which they subscribe. According to the provisions of the memorandum the shares of a private company may be divided, according to the wishes of its shareholders in registered shares of par value, preference shares, redeemable preference shares and shares with no voting rights. Bearer shares are not available.

Similarly, the Articles of Association consist of the maters regulating, the internal management of the company, provisions as to dividends, debentures, accounts and audit, voting rights, general meetings of the company, appointment-removal of directors, powers and general meetings of directors, winding up of the company. It should be stressed that as concerns the private limited liability companies any invitation to the public to subscribe for shares must be regulated.
Every company must prepare a full set of financial statements in accordance with

[45] Private Firms for the provision of Security Services 125(I)/2007
[46] Banking Services Act 66(I)/1997 as amended, Central Bank of Cyprus 138(I)/2002
[47] Practicing Insurance Services and other relevant matters Act 35(I)/2002
[48] Enterprises of Provision of Investment Services Act 148(I) / 2002

International Financial Reporting Standards and must complete an annual return within a period of 42 days from the date of its Annual General Meeting and must file immediately with the Registrar of Companies, a copy of the annual return, signed by a director and the company secretary. The annual return filed with the Registrar of Companies must be accompanied by the full set of financial statements. The Company's bank accounts of any kind may be opened, in any currency, either in Cyprus or abroad. Auditing obligations apply whereby only Cyprus licensed auditors my audit company accounts.

Limited liability companies acquire legal personality, upon registration at the register of companies maintained within the Registrar of Companies, and may commence trading and general activities by acquiring rights and incurring liabilities in their own name. They may take equity, provide loans and guarantees.

The Companies Act Ch 113 does not specify what is a public company and this is left to be extracted from an interpretation of the said Act. Therefore, it could be said that a public company is a non - private company, whereby at least seven shareholders need to subscribe to its memorandum. There must be at least two directors and it may be dissolved if the annual directors' report is not delivered or the annual meeting is not convened or even if the number of the shareholders falls below 7 and a declaration of incapacity to replace the missing shareholders' positions is filed in. In almost all other respects the procedures and operations of the companies are governed by the same set of provision of the Companies Act Ch 113.

A Cyprus limited liability company can be dissolved in two ways, either through a court order following the petition of the company or the creditors or the Attorney General or the official receiver, or any of them. Alternatively, a Cyprus company may be voluntarily dissolved following a resolution of voluntary dissolution or a resolution stating that because of its liabilities the company may not is unable to continue with its operations and that it is advisable to be dissolved.

It is submitted that the Cyprus limited liability company can be utilized for the implementation of JESSICA with no need for any further legislative enactments or amendments. Indeed the memorandum and articles of association of the limited liability company may be so drafted so as to meet all capital participation and management control concerns shared by interested parties, public, municipal and private. As such any funding arrangements may be adopted within the regulations of the company with expedient and swift procedures. Furthermore, the procedures with respect to the set up or the acquisition of a company's shares are simple and time-efficient affording the JESSICA initiative the attribute of swift implementation.

5.3.2 Independent Legal Entity Established by Act of Parliament

The parliament is the supreme legislative body within the jurisdiction of Cyprus and following the motion of the government or one of the Members of the Parliament may vote and approve any legislation which it considers appropriate. Such legislation may, provide for establishing entities of whatever formation, which according to the Parliaments wish is endowed with legal personality. Such legal creatures should not be confused with corporations as these are defined by the Companies Act Ch. 113, since they are essentially different in nature.

Indeed, the objects, organization and structure of a corporation under the Companies Act 113 are decided by the promoters/original shareholders of the company and they take effect on the subscription and issuing of a registration certificate by the Cyprus Registrar of Companies. On the other hand the objects, organization and structure of the legal entity is decided by the Parliament and take effect from the day that the Parliament so decides.

Furthermore, the mode of the management participation in the statutory legal entity as well as the method of dissolution of this entity again will rest on the decision making powers of the Parliament. The Parliament may either decide beforehand the exact method of management participation in the entity or may empower certain officials to determine the mode of such participation. Similarly the parliament may either specifically provide for the method and procedures of dissolution of the entity or alternatively may decide the dissolution by simply repealing the Act.

Amongst the various provisions of any such legislative initiative, the Parliament may make specific mention as to the establishment of a fund, from which monies can be used for the benefit of the legal entity's object or as otherwise the legal entity considers it appropriate (including the taking of equity, offering loans and guarantees). It must be said that the practice of enacting legislation thereby establishing independent legal entities has been tried on many occasions in the past.

Similar entities endowed with a distinct legal personality, can be found in the Cyprus Theatrical Organisation Act 71(I)/1970, the Cyprus Sports Organisation 41(I)/1969, the State's Exhibitions Authority Act, 93(I)/1968, as amended, the Human Resource Development Authority Act / Fund 125(I)/1999, as amended, the Special Fund for the Professional Rehabilitation of Persons Suffering from Incapacity Act 103(I)/2000, the Termination of Employment Act and provisions for Redundancy Fund Act 24(I)/1967, the Provident Fund Act 44(I)/1981 and the Agricultural Funding Organisation Act 64(1)/2003

It is submitted that an independent legal entity established by an act of Parliament, presents various problems if seen in the wider JESSICA context. First of all, such a decision would require launching a proper legislative initiative involving much more difficult and complex steps than setting up a company or other concluding any other private understanding.

Secondly, it is arguably difficult to estimate the number of UDFs that would need to be established through an act of law. It would be necessary either to establish, at a central level, the number of UDFs which should be created based on one act, or to adopt separate acts for creating each one of the UDFs.

Third, one should stress that a legal entity established by an act of Parliament does not have the nature of a corporation, hence other bodies, in particular local self-government units or private investors, will not be able to take up holdings in such fund. One way around this problem would be to suggest empowering the central management to conclude investment agreements with possible investors, yet again specific regulations will need to be enacted as to the selection etc of such investors. Forth, the legal entity's format will unavoidably be inflexible when it comes to an intended liquidation of the entity; any potential liquidation of the UDF operating as a special purpose fund would depend on the decision of the Parliament, the same would be true of the possible return of the monies remaining in the fund to the governing institution. These conclusions are discouraging if not negative when if third party investment is sought from the free market.

5.3.3 Possibility of Cooperatives in the JESSICA Structures

According to the Cooperatives Companies Act 22(I) /1985, as amended a cooperative is a voluntary association of an unlimited number of persons with variable composition and variable share fund, which runs joint business activity in the interest of its members, in the form of an independent legal entity. Therefore, a cooperative is not a public body and the property of a cooperative is a private property of its members who, on a voluntary basis and for the purpose of achieving their own objectives, establish a new cooperative or join an already existent one.

Unfortunately, Cyprus cooperatives legislation does not avail itself for the implementation of JESSICA structures since as a minimum precondition members/shareholders of any cooperative must be natural persons or registered cooperative companies, the membership of which in turn must consists of natural persons.

5.3.4 Clubs Associations and Foundations

When considering available structures that may be utilized to implement JESSICA, it is considered at least necessary to refer to the provisions of the Associations and Foundations Act 57(I) / 1972 as amended. The said legislation provides for the requirements for establishing two distinct in their nature structures.

5.3.4.1 Associations

It is submitted from the outset that Associations are not considered as a structure that may be utilised for the advancement of the JESSICA structure. Associations also translated as 'clubs' but a distinct legal form the legal structure of 'clubs' as defined in the Clubs (Registration) Law 1930, are indeed a popular structure within the Republic conferring distinct legal personality. The law defines an association as "the organised union of at least twenty persons for the purpose of accomplishing a specific non profit making purpose". Members of an association may include corporations as well as individuals, although it is unclear how this happens in practice.

Associations must register with the Ministry of the Interior. An association registered in accordance with the Associations and Foundations Law will obtain legal personality. The Associations and Foundations Law requires founders or administrators to submit the act of incorporation, names and addresses of members, the signed and dated memorandum of association, the club's emblem and a description of its assets. There is a fee for applications.

Associations applying for registration will face a considerable degree of scrutiny of their internal administration. Section 8 of the Associations and Foundations Law sets out certain requirements which must be included in the memorandum of association. Registration may be withheld or refused if officials are dissatisfied with an association's administrative provisions. In addition officials at their own discretion may comment on other aspects of internal administration.

Registering associations are required to produce a list of at least twenty (20) resident members. In principle, corporate members (legal persons) are counted individually, even if they are themselves membership organisations with many members. The registration process is slow. In theory registration may take six to eight months in average, but in practice cases may take between one and two years. If there is a problem with the application, officials will highlight them to applicants and suggest changes.

Associations do not submit financial statements to the Ministry of Finance. The assessment could not confirm whether this is because associations do not come under the scope of the Tax Code or because they are deemed essentially exempt based on certain clauses of the Tax Code. Some respondents indeed stated that associations must submit an annual return to the Ministry of the Interior. It is not clear if this requirement is enforced, or if there is any scrutiny of information submitted. There are no clear audit rules, other than that the members appoint auditors unless stated otherwise in the memorandum.

The Associations and Foundations Law states that the highest organ in an association is the assembly of members. Unless stated otherwise, the assembly shall elect, supervise and (if

necessary) remove members of the council of administration, oversee membership, expel members (if necessary), appoint auditors, and approve the association's balance sheet, amendments to the memorandum and dissolution. Decisions are made by an absolute majority of those present (understood to mean that a majority of all members present must support a measure, including abstentions). There is no prescribed quorum for members' meetings, except for dissolution votes (half plus one members) and votes to amend the purposes (three-quarters of members). Invalid or unlawful decisions of the assembly may be overturned by the courts if an action is filed by an interested party within six months.

Associations are to be "administered" by one or more members and with simple majority voting (unless the memorandum states otherwise). These persons shall be in charge of the affairs of the association and shall have such powers as prescribed by the memorandum. They shall represent the association in and out of court.

Associations can be dissolved by the members, if the membership becomes less than twenty or by court order. Rules for dissolution by members should be set out in the memorandum. The rules must include a restriction on the distribution of any remaining property amongst members. Unless stated otherwise, a members' meeting with half plus one members present must approve dissolution. Associations should inform the Ministry of their dissolution so that the register can be updated. In practice, few associations inform the Ministry of their dissolution.

As abovementioned Associations are not considered as structures that may be utilized for the purposes of implementing JESSICA. The requirement of 20 people, initial and ongoing membership, the requirement that it may not distribute profits and the reality of facing administrative scrutiny in their registration will present as obstacles to the implementation of JESSICA.

5.3.4.2 Foundations

As with associations, foundations are established under the Associations and Foundations Law of 1972. The alternative translation of 'institutions' is also being used. In addition, the term 'trust' may be used, although there is specific separate legislation relating to trusts. A foundation is defined in the Law as "the total set of property committed to servicing a certain purpose." A foundation is established through an act of incorporation, either by legal action or *ex vivo* as an act of last will. It achieves legal personality through registration of its act of incorporation under the Associations and Foundations Law.

Funds are normally transferred by the founder on incorporation unless otherwise requested by the founder. A foundation may be established by one or more founders. No minimum

amount of funds is specified in laws and regulations, but in practice officials will assess whether they believe the funds are large enough to meet the stated objectives.

The purposes for which a foundation can be established are not clear. All that is stated by the Associations and Foundations Law is that it must be for "a certain purpose". Section 42, which relates to changes to a foundation's purposes, states that any new purpose must not be contrary to "the provisions concerning the public benefit or general interest purpose". This implies that foundations must have public benefit or general interest purposes but this is not explicitly stated in the law. In practice the Ministry of Interior will not register the establishment of a new foundation if it is not established for the public benefit.

Foundations, like associations, must register with the Ministry of the Interior, and again, foundations applying for registration will face a considerable degree of scrutiny of their internal administration. The process is slow. In theory, registration takes six to eight months on the average, but in practice cases took between one and two years.

Unlike associations, there is a clear monitoring regime for foundations. All foundations must keep "precise and detailed" books of accounts, complete accounts for each calendar year and submit them to the Ministry within one month of completion. As well as all transactions, the accounts should detail the amounts held at the beginning of the year, the amounts collected during the year and any outstanding amounts owed. The accounts must be audited by a certified auditor. In addition, the Courts can order the auditing of a foundation's accounts by an appointed auditor at the foundation's expense. The Attorney General has the power to dissolve a foundation which does not comply. This happens very rarely – once every three-five years on average according to the registrar.

Foundations are to be "administered" by one or more persons with simple majority voting (unless the act of incorporation states otherwise). These persons shall be in charge of the affairs of the foundation and shall have such powers as prescribed by the act of incorporation. They shall represent the foundation in and out of court. If there is any doubt as to the extent of the administrator(s)' powers in any given case it shall be assumed that their powers extend to every relevant act.

Amendments to the foundation may be made by the courts. This includes amendments to the purposes if they are no longer capable of being achieved, in which case new public benefit or general interest purposes should be created in line with the founder's most probable wish. If that is not possible, the court may authorise the transfer of property to a related purpose. A court approval for an amendment is still required even when the founder is still alive.

Following an application by the administrators the courts may authorise amendments even against the founder's will if it is deemed necessary in the achievement of the foundation's

purposes. The courts may also appoint temporary administrators if the necessary members for administering the foundation are absent.

A foundation shall cease to exist according to the rules set out in the act of incorporation, or if dissolved by the court. Dissolution by the courts shall occur if a foundation's purpose has been achieved or is incapable of being achieved, or if the foundation is engaged in unlawful activities. Any remaining funds will be used in accordance with the act of incorporation or, failing that, transferred to the government to distribute for the same or similar purpose.

It can be argued that the structure of Foundation if compared to that of an Association, it does not incorporate any prohibition as to the profit making use of the fund. Indeed, the founder(s) may specifically provide for the distribution of the fund at dissolution. Furthermore, no minimum number of participation is required. Yet, despite obvious advantage over Associations it is submitted that the structure of a Foundation does not correspond to the needs of JESSICA and its Financial engineering Instruments. This position is held due to the prevailing ambiguity as to the accepted purposes of such Foundation and the statutory interpretation that officials choose to make use of namely that such foundation be in the public benefit or general interest purpose. This coupled with the delay in the public administration and more precisely with the delays in the examination and assessment of an application are elements that place the structures of Foundations in less advantageous position over normal corporate structures such as the limited liability company.

Furthermore, the structure of foundation rests upon the initial act of the founder(s), and there are no provisions as to the method of further investment or participation. Arguably for every new investment or additional participation, a new founders act will need to be submitted something that will trigger afresh the procedures of examination and assessment as abovementioned. This event will prove disastrous for the efficient implementation of JESSICA financial engineering instruments.

5.4 Ability to Appoint Existing Banks as UDFs

It is within the mandate of the present study to evaluate the ability to appoint existing Banking Institutions as UDFs (note: always respecting the "separate block of finance" principle). Banking Services are the subject of considerable regulation and control within the jurisdiction of the Republic of Cyprus. The main legislative instruments in the field of Banking Services are the Banking Services Act 66(I)/1997, as amended and the Central Bank of Cyprus 138(I)/2002, as amended.

Before considering the limitations and prohibitions as concerns the services of a Bank it is necessary to identify which institutions may qualify as banking institutions by reference to Cyprus legislation. As such a banking institution can be any legal person established either

under the provision of the Companies Act Ch 113, as amended or any other Cyprus or respective foreign legislation, which has been specifically licensed by the Central Bank of Cyprus to provide banking services as these are defined by the Banking Services Act 66(I)/1997. It needs to be clarified that the Central Bank of Cyprus may withdraw any license provided for the benefit of any institution if the terms upon which the licence was granted are not complied with by the institution.

Banks are under strict limitations and prohibitions as concerns their banking activities. According to the said legislation a bank is precluded from engaging in the provision of certain services and transactions. For instance a bank may not permit the total value of its financial openings towards a particular person or in general, to exceed certain percentages calculated on its own capital base. In the event where the prefixed thresholds are broken banks are in statutory breach and under reporting obligations to the Central Bank. Yet, this is a theoretical and probably non – operative for our purposes restriction. Indeed, whether this proviso is of relevance will depend on the actual figures of the funding agreement with the banking institution which will need to be contrasted to the banks' capital base.

Similarly, a bank may not appropriate any interest over an immovable property for equity purposes (for loan and guarantee purposes the limitation does not apply). If a bank acting as a UDF may not enter into a transaction and thereby advance funds in return of shares in a project which involves immovable property, then arguably, this limitation will affect the performance of the UDF since it will deprive such UDF of an important investment method and opportunity. Furthermore, in the case where a bank is utilised as a UDF then an issue as regards the additional participation by other public or private investors and control at management level arises. Of course such issues can be dealt with, through appropriate agreements and it is submitted that this should not cause any serious problem.

Finally, a bank may not enter into commercial activity or business, for its own account or on commission basis, except where such activity of business is exercised in the ordinary course of banking services or for the purposes of repaying debts towards the bank. Yet, according to the Banking Services Act 66(I)/ 1997 a bank is not considered as prohibited from being active in offering loans or guaranties or taking equity (subject to the aforementioned limitations) even if these activities are undertaken as part of a commercial activity.

Subject to these comments there are generally no other legislative provisions precluding a Cyprus licensed bank from being utilised as a UDF. In any event however and given that any eventual appointment of a bank to operate as a UDF will be made on the basis of a specific funding agreement, it is suggested that before the appointment takes place a specific communication be addressed to the Central Bank of Cyprus, which as a supervising / controlling authority will be in the best position to comment on the initiative. More precisely the communication will request confirmation that no irregularity is present in the appointment of a

Cyprus Bank as a UDF. The communication will need to mention the proposed amount of funds to be contributed to the proposed UDF. This should in any event provide for the necessary risk management in any such appointment.

5.5 Ability to Appoint Existing Enterprises Providing Investment Services (EPIS) as UDFs

It is within the mandate of the present study to evaluate the ability to appoint existing Enterprises Providing Investment Services (hereinafter called EPIS) as UDFs. Similarly, to Banking Services, Investment Services are the subject of considerable regulation and control within the jurisdiction of the Republic of Cyprus. The main legislative instruments in the field of Investment Services are the Enterprises Providing Investment Services Act 148(I)/ 2002 and the Cyprus Security and Exchange Commission Act 70(I)/2009.

According to the Enterprises Providing Investment Services Act 148(I)/ 2002, Investment Services may only be provided by Cyprus Enterprises Providing Investment Services regulated under Cyprus Legislation, Foreign EPIS regulated in accordance with foreign and Cyprus EPIS legislation, Banks regulated in accordance with the provisions of the Enterprises Providing Investment Services Act 148(I)/ 2002 and the provisions of the Central Bank of Cyprus Act. As such no Cyprus Company, the objects of which are specified to be the provision of professional investment services, may be registered without first obtaining a specific professional investment services license from the Cyprus Security and Exchange Commission.

EPIS are again under strict regulation and control. A shareholder wishing to transfer shares in a CEPIS and the interested transferee of that share must specifically communicate their intended transaction to the Cyprus Security and Exchange Commission, which may approve or decline the transfer. Furthermore CEPIS are under strict organisational and administrational supervision by the Cyprus Security and Exchange Commission.

The relevant EPIS legislation specifically provides what counts as investment services and in relation to what instruments such investment services are regulated. As such investment services comprise of the following:

1. (a) Reception and transmission, on behalf of investors, of orders in relation to one or more of the instruments (specified below).

   (b) Execution of such orders other than for own account.

2. Dealing in any of the instruments for own account.

3. Managing portfolios of investments in accordance with mandates given by investors on a discriminatory, client-by-client basis where such portfolios include one or more of the instruments listed below.

4. Underwriting in respect of issues of any of the instruments listed below and/or the placing of such issues.

The instruments for which investment services are regulated are as follows:

1. (a) Transferable securities.

   (b) Units in collective investment undertakings.

2. Money-market instruments.

3. Financial-futures contracts, including equivalent cash-settled instruments.

4. Forward interest-rate agreements (FRAs).

5. Interest-rate, currency and equity swaps.

6. Options to acquire or dispose of any instruments falling within the abovementioned, including equivalent cash-settled instruments. This category includes in particular options on currency and on interest rates.

The following are also considered as regulated services even that these are considered as derivative non-core services:

1. Safekeeping and administration in relation to one or more of the instruments listed above.

2. Safe custody services.

3. Granting credits or loans to an investor to allow him to carry out a transaction in one or more of the above listed instruments, where the firm granting the credit or loan is involved in the transaction.

4. Advice to undertakings on capital structure, industrial strategy and related matters and advice and service relating to mergers and the purchase of undertakings.

5. Services related to underwriting.

6. Investment advice concerning one or more of the instruments listed above.

7. Foreign-exchange service where these are connected with the provision of investment services.

Having said all the above, it is submitted that the said legislation regulates the professional provisions of investment services in relation to the instruments and services specified in the Act. The legislation does not affect the minimum investment opportunities and activities that are carried through company own funds in any other areas not listed within the above. Therefore, the simple provision of loans, and guarantee and the taking equity as these are the investment options of the UDF are not the subject-matter of an EPIS business. It is submitted that choosing to utilise EPIS as a UDF will involve the unnecessary submission to strict regulatory supervision.

Indeed, any such decision will be unfortunate since it will entail the utilising of a corporate structured vehicle, the structure of which was set to facilitate investment schemes that are irrelevant to those of a UDF. Why not simply use a normal corporate structure with no reporting obligations and supervisory controls.

5.6 Concluding Remarks

It is submitted that from the structures examined above the best available structure as concerns the independent legal entity form of setting up UDFs is that of limited liability private or public company. The participation in the company is open for further analysis but in general it can be said that it is under no restriction as to number or orient of the participating shareholders. Thus the shareholders of the company can be the public sector, the municipal councils (provided investments will be carried forward within the municipality's area of competence) and other private investors. The holding in the company may be decided by the participating members and in principle it will be proportional to the contributions of each participant. This can be modified in the interests of achieving private investor's participation.

It should be remembered that independently of the method of selecting the UDF, namely either under a competitive tender under Cyprus Public Procurement Legislation or by following the EIB internal UDF guidelines for selecting and appointing UDFs, once a company has been established and once it has been selected as a UDF and received funds accordingly, then as a risk management safeguard any additional private participant shareholders in this company must be selected through a competitive tender following the provisions of the Cyprus public procurement legislation.

The management of the company namely the board of directors can comprise of any number of participants so as to satisfy the concerns of all interested investing parties. It should be remembered that the Board of Directors is merely the statutory board of management and that this board may according to their decision appoint or out - source specialized services to specialized experts, who would still have to report to the collective Board meetings. The Company's Articles of association together with the memorandum of incorporation can be so

drafted and amended following majority resolutions so as to enable the Company to adapt to any changing need relating to the participation and management of the company.

6 Local Government (Municipal) Participation and JESSICA

6.1 Participation of Municipalities and Other Public Agencies in JESSICA

It has already been examined what are the possible legal structures for the implementation of the JESSICA initiative within Cyprus. In accordance with Article 43(2) of Commission Regulation (EC) No. 1828/2006, financial engineering instruments, including holding funds, shall be set up as either independent legal entities governed by agreements between the co-financing partners or shareholders or as a separate block of finance within a financing institution.

As concerns the option of independent legal entities we have already concluded that the Cyprus company structure is the most appropriate structure for the set up of UDFs. In this present chapter the possible participation of a municipality shall be examined both at the UDF level and at the entities in charge of individual projects. The participation shall be assessed under the scenarios where municipalities make cash (capital) or non-cash (in-kind) contribution to the above legal entity in exchange for the status of a partner or shareholder.

Equally our examination will also consider the participation in the second option, namely of a financial engineering instrument functioning as a separate block of finance within an existing financial institution or where a given project is executed in co-operation with a private partner pursuant to an agreement.

6.2 Municipalities and Communities as Public Authorities

It is safe to assert that in terms of local self government administration two concepts arise, those of Municipalities and those of Communities. Communities are organized as local self government bodies in all areas where no municipality is established[49]. Communities are outside the purposes of our study since by definition urban development is only relevant in Cyprus at least to the areas where a municipality has effective local self government control. Communities are more relevant to the concept of rural areas. As such it is considered unnecessary to deal in any further length to the provision of the relevant communities' legislation for the purposes of the present study.

[49] Section 5 of the Communities Act 86(I)/99

Indeed, urban development is closely associated to the concept of municipalities in the Republic of Cyprus. A municipality is established by following the provisions of the Municipalities Act 111(I)/1985, as amended and according to its implementing regulations. Municipalities have a population of more than 4,000 people and falling below the threshold of 4,000 is a reason for which a municipality may be re structured into a community.

According to this legislation each municipality is endowed with independent legal personality. The affairs of the Municipality are dealt with the Municipal Council chaired by the municipal Mayor. The municipal council is elected on a 5 year term and all its decision are binding on each successive differently constituted Municipal Council. Similarly with public sector bodies, municipalities submit yearly proposed budgets to the Council of Ministers, the approved result of which is binding upon the municipality. Permissible expenditure is only that for which the Municipality is competent to incur under the provisions of and their provisions of the respective municipal budget.

In general municipalities maintain a municipal fund which may be used for any necessary and lawful municipal expenditure in accordance to the provisions of the relevant legislation. Furthermore, municipalities own movable and immovable property and municipal councils are empowered to improve and utilise in whatever way any movable or immovable property which is owned or held by a Municipality.

Municipalities are able to decide through their Municipal Councils for the sale or exchange of any movable municipal property. As far as immovable property is concerned they may decide for the sale or exchange of such property but any such decision is subject to the approval of the Councils of Ministers. Similarly upon the approval of the Council of Ministers the Municipal Council may decide the renting / leasing or placing of encumbrances on any immovable property for a period not exceeding ten years.

Furthermore Municipal Councils may establish ‘public businesses’ something however that unfortunately is not defined elsewhere in the relevant statute. The Municipal council may enter into contractual relationships, but for any contract the period of which exceeds that of 5 years, an approval by the Minister of Internal Affairs is necessary. Municipal councils may also lease any movable or immovable property and may enter into loan agreements on whatever terms.

As it was aforesaid municipalities may incur expenditure in order to secure any of their competences as provided for by the Law. Amongst other competences, the municipalities are the competent authorities for the maintenance, repairs and construction of public roads, streets, bridges, squares and the construction, maintenance operation of the municipal infrastructure, maintenance of water piping systems, water supply, municipal sewage system, garbage dumps and municipal waste management, cleanliness and sanitary equipment,

municipal transport, environment protection, social and administrative utility facilities and municipal public order.

6.3 Participation in JESSICA

It is submitted that the ability of the Municipalities to participate within the JESSICA initiative are governed by the Municipalities Act 111(I)/1985 and the provisions of the respective municipal budget. Having said that and according to the Municipality's budgetary provisions its funds may be used for the purposes of JESSICA participation contributions, capital investment, provision of loans and guarantees, provided that these correspond also to one or more of the Municipality's competences. It is submitted that because of the wide nature of municipal competences their participation in JESSICA will not be barred for lack of competence.

On the other hand, it is submitted that the Municipalities Act does not expressly provide for the ability of Municipal Councils to set up or take holdings in a limited liability company. Indeed, this has been and still is the subject of parliamentary deliberations for the legislative amendment of the Municipalities Act so as to expressly provide for the Municipalities ability to set up or participate in limited liability companies. Under the draft bill of law 'Statute amending the Municipalities Act' No 58[50], the amongst various other proposals, the bill expressly provided that the Municipal Council would be empowered to establish or participate in limited liability companies or foundations for the execution of projects of public interests, the provision of services ;or the development and management of cultural and social activities and the provision of relevant services, after the joint approval of the Minister of Interior and the Minister of Finance.

Eventually the said draft bill was withdrawn and therefore, the said amendments never materialised. Nevertheless, despite the in existence of specific statutory provisions, it could be argued that the powers of setting up or participating into corporate structures are impliedly afforded to the Municipal Councils, provided always that any such participation into the share capital of a company is undertaken for the attainment of a purpose that is expressly within the competencies of the Municipality. Authority for this conclusion maybe drawn from the general powers and rights of the Municipal Council as discussed above.

It could be further argued that the participation in a limited liability company can be effected either through cash or non cash contribution to achieve participation. Again, the general powers of a Municipal Council's in the management of the municipal property as

[50] Official Gazette of the Republic, App VI No 4094 October 2008, p 712

abovementioned, concerning the utilization in whatever way of any property owned or held by the Municipality, may afford sufficient authority for this conclusion.

Therefore, in the case of UDFs operating as independent legal persons running business activity in the form of granting loans, guarantees and investing its capital contributions, the municipalities will be able to participate in the UDF structure. As far as the variant in which UDF is a financial body separated within a financial institution is concerned, the possibility of transferring the means to the fund by municipalities on the basis of an agreement concluded with the financial institution mentioned may as well be considered. Yet, in this latter scenario it should be remembered that it is the financial institution the one to decide which body and from which area should receive support, and such support may be also granted to an alternative municipal area and, therefore funding and support will automatically be outside the jurisdictional competences of the Municipal Council.

Here it is interesting to point out that each Municipal Council which intends to either:

a. execute a project of public interest which at the Council's discretion, residents of other local government authority may also benefit from such project (in addition to the benefit of residents of the deciding Municipality), or

b. in relation to the provision of services, which up to that point were provided by each Municipalities separately,

may conclude a contract with such municipality or other local government authority, for the joint execution of the project or the joint provision of services. Minimum statutory requirements as to the term and content of any such agreement apply. For the purposes of the Municipalities Act a project of public interest is defined as including the construction of parks, theatres, swimming pools, recreational places, cultural centres and the creation waste management infrastructure. The Council of ministers may approve additional projects of public interest.

Similarly services are defined as including waste management services, roads construction and maintenance, the approval of planning and building permits and any other services the Municipalities may jointly determine at their joint discretion. Arguably this method of enabling Municipalities to engage into common ventures facilitates their common participation in a single UDF structure or alternatively their coordination in the project level of JESSICA.

Having said that, further than their participation into UDFs, municipalities may also participate in the JESSICA implementation by cooperation at the project stage with a private partner pursuant to an agreement whereby it will co-finance or otherwise contribute to the said project again on a cash and on a non–cash basis. Similarly, according to the general powers of

Municipalities, participation through a public private partnership can also be conceived, provided that the objects of the PPP are within the Municipalities competences.

In all the above instances, it should be remembered that both public procurement legislation and the provisions of the State Aid Control Legislation apply for municipalities and that these provisions must be respected at all times.

7 Urban Projects: The Eligible Beneficiaries

7.1 Introductory Note

Article 47 of the implementing Regulation[51] provides that where Structural Funds finance UDFs, those funds shall invest in public-private partnerships or other projects included in an integrated plan for sustainable urban development. Such public-private partnerships or other projects shall not include the creation and development of financial instruments such as venture capital, loan and guarantee funds. UDFs shall invest by means of equity, loans and guarantees. Urban projects receiving grant assistance from an operational programme may also be supported by UDFs. In any case where Structural Funds finance urban development funds, the funds concerned shall not re-finance acquisitions or participations in projects already completed.

7.2 PPPs, Past Experience

Despite the presence of specific legislation dealing with the aspects of public procurement, throughout the years the Republic of Cyprus identified the need to distance itself from the traditional way of investing into the public infrastructure, namely by solely using public funds, and move towards an alternative method to the public infrastructure investment, and namely engage into initiatives which involve the private sector in the operation of public services.

From as early as May 1999 the Government of the Republic of Cyprus deliberates on the formation of a framework for undertaking public private partnerships. These deliberations led to the creation of a Ministerial Committee under the Chairmanship of the Minister of Finance and a Central Service Committee under the chairmanship of the Permanent Secretary of the Planning Bureau.

Furthermore, by considering the composite character of the PPPs, the Council of Ministers in March 2001 approved the creation of a Central Unit within the Planning Bureau that will consider policy issues related to public private partnerships under the Directorate of

[51] Regulation (EC) No 1828/2006 of 8 December 2006 setting out rules for the implementation of Council Regulation (EC) No 1083/2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and of Regulation (EC) No 1080/2006 of the European Parliament and of the Council on the European Regional Development Fund.

Sustainable Development. The Council approved the creation of guidance committees in some Ministries to promote the implementation of specific projects through the DBFO method and has determined the role and competence of the Project Managers and Technical Committees.

These preparatory measures helped the conclusion of a number of projects on PPP basis. In February 1999 a contract of build-own-operate-transfer (BOOT) was awarded for the daily supply of 40,000 m^3 of desalinated water by the Water Development Department of the Ministry of Agriculture, Cyprus. When the contract period expires in 2011 the plant will become the property of the Cypriot government, who also have the option to purchase ahead of this date, exercisable at six-month notice.

In a more advanced scheme planning, the public services proceeded with the projects of development of the Larnaca and Paphos Airports using the Build-Operate-Transfer method. Under this model, the private sector will design and build a facility. With the completion of the facility the title of the facility will be transferred to the public sector while the private sector will remain responsible for its operations for a specified period of time. The signing of the final Concession Agreement with the private contractor took place in May 2006, signalling the launching of the redevelopment of the two airports, using the PPP method. In the meantime, as from 2006 the selected consortium took over the operation of the two existing airports, whereas the construction works for the redevelopment of the two airports started in June 2006.

Another recent project can be traced in the agreement for the redevelopment of the Larnaca port and marina into a mainly passenger port on a PPP basis. Construction is expected to start within 2009. Furthermore, on September 2008 the negotiations with the selected bidder commenced for the construction via the PPP method, of the Paphos-Polis Chrysochous main road.

Given that all these projects were undertaken under no specific PPP legislative framework, a Services Provision Agreement between the Planning Bureau and an international Contractor was signed on February 2009. The contractor has extensive experience as regards the Public Private Partnerships frameworks and it shall provide its services over the period up to and including March 2011 that will culminate in an overall assessment of the current PPP practice and proposals for a more efficient administration.

The said study is expected to cover among others the following activities:

a. development of an initial diagnosis of existing institutional and governance arrangements;

b. procedures for the administration and quality control of PPP projects, from the definition of project need, up to the execution of the project contract;

c. development of the institutional architecture;

d. roles/responsibilities/governance of the government departments/services that may be required to ensure the delivery and management of PPP projects;

e. control, administration and information procedures in relation to any fiscal issues that may arise through PPPs; and,

f. high level support from the Planning Bureau.

7.3 PPPs and the Deployment of JESSICA in Cyprus

In the report prepared by ourselves and A.L.A Planning Partnership it is pointed out that, JESSICA 'has been launched with the view to leveraging additional resources for public-private partnerships (PPPs) for urban renewal and development projects in the regions of the EU.'[52]

Similarly, the study provides as an argument for the adoption of JESSICA the macro-economic factor which is illustrated in the report as: "Providing a new financing tool alongside grants will encourage the development of a more sophisticated approach to PPP and other financial instruments in Cyprus. An option for consideration by the Planning Bureau is the way it wishes to use external support if it wishes to develop this option. One approach could be to set up an overarching Holding Fund and utilise the skills and experience of the EIB as Holding Fund Manager, bringing its expertise from across Europe. Alternatively, Cyprus has an established and competent financial services sector that could be engaged in delivering the resources needed for a UDF structure."[53]

On the other hand, the report also points out that 'Regeneration project delivery has historically been instigated by the public sector, with the private sector playing a "contractor" role in the delivery. As such the public-private relationship appears in its infancy and it is opportune to develop new mechanisms. Building on the above, there are no obvious PPPs in place for regeneration delivery in Cyprus at present. A review of existing delivery suggests the role of joint ventures (and similar mechanisms) are not typically utilised and therefore risk transfer and co-financing are not engrained in the public-private relationship'[54].

[52] At p. 8 of the JESSICA Evaluation Study for Cyprus July 2009
[53] At p. 30 of the JESSICA Evaluation Study for Cyprus July 2009
[54] At p. 34 of the JESSICA Evaluation Study for Cyprus July 2009

Indeed, in Cyprus, a few projects have been undertaken in the form of PPPs without the existence of a proper regulatory framework concerning the operation, administration and control of PPPs. So far construction projects as abovementioned are the most popular area for PPP treatment. Eight projects have already been identified as suitable for PPPs and a Steering Committee has been set up to examine each one.

The above brief discussion of the various projects that were concluded on the PPP basis aimed mainly to highlight the fact that despite the inexistence of a proper regulatory framework of PPPs, still there is ample of precedent as to the conclusion of those agreements between the public and private sector. The precedent at least shows that PPP method of venture forms a possible method of performing projects for which the execution is assigned in the hands of the private sector together with a management contract over the project for a specified period in return, whilst the public sector retains the title over the project.

On the other hand, all the above planning schemes concern commercial uses and as such are expected to be and indeed are more appealing to the private sector than regeneration delivery projects and reconstruction of deprived areas projects. It is for these reasons that the combined effect of the absence of a PPP regulatory framework and the intended use of JESSICA, poses a prima facie problematic area that calls for further examination. Whilst there is no doubt that the provision of this new financing engineering instrument alongside grants will encourage the development of a more sophisticated approach to PPPs still it is the case that such an approach is at the moment unknown both to the public and private sector.

7.4 The Cypriot Practice in the Conclusion of PPPs

All PPP agreements concluded so far were commenced on the basis of a competitive public procurement procedure in accordance to the Public Procurement Legislation as described in the relevant Chapter of the present Study. The inexistence of a regulatory PPP framework leaves no other choice for Competent Authorities than to present themselves as Contracting Authorities within the meaning of the Coordination of Procedures for Public Contracts of Constructions, Supplies and Services and Relevant Issues Law 12(I)/2006 (henceforth called "Law 12(I)/2006") and the provisions of the Coordination of Procedure for Contracts of Public Construction, Supplies and Services in the Fields of Water, Energy, Carriage and Post Office Services and Relevant Issues Law 11(I)/2006 (hereinafter called "Law 11(I)/2006").

Through the status of Contracting Authorities[55] the intended PPP is offered as a public contract under a competitive call for tenders. In order to avoid unnecessary repetition a brief

[55] Who may be a contracting authority is discussed in detail in the preceding chapters

note on the procedure is also provided for under Chapter 3. Once the appropriate contractor(s) is selected then the PPP agreement is signed as this is provided for under the relevant legislation. The concluded agreement regulates the relation, rights and liabilities of the various contracting parties.

That said, it is submitted that it is needless to examine in any greater length, the implementation of JESSICA under the concept of PPPs. In essence PPPs constitute nothing more, in the legal sense and under the Cypriot legal order, than a specific public contract procured under the usual public procurement procedures and under the same Contracting Authorities. Nothing special exists in the Cyprus PPP market that is different from that which is the norm, namely public bodies, procuring public contracts through a public procurement procedure. The provisions as discussed under the Chapter of Public Procurement Procedures apply mutatis mutandis, namely, the same principles, with the necessary adjustments as to the context.

What deserves to be highlighted for the purposes of our examinations is that PPPs can be concluded once a contracting authority procures a public contract / project and the PPP will in fact be the pubic private partnership for the execution of that project. Therefore, it must be understood that the UDF proposing to invest in a PPP must be ready to finalise its offer of investment at the stage in which the tender of the Public Private Partnership closes. This is important since the UDF investment in the partnership will need to be assessed together with the rest of the tender documents of the applicant Private entity. The scenario where a PPP is established with the view to proceed for some projects, arguably, will not be a compatible method of forming PPPs under the Public Procurement Legislation. No contracting authority can procure a public contract the object of which will be the future development of projects. Such procurement will be vague and ambiguous.

7.5 Projects Within an Integrated Urban Development Plan

Article 47 of Regulation (EC) No 1828/2006[56], which is the implementing regulations as concerns the various financial engineering instruments specifically provides that where Structural Funds will finance UDFs, those funds shall invest in public-private partnerships or other projects included in an integrated plan for sustainable urban development. The Structural Funds regulations for the period 2007-2013 do not include a definition of, or specific requirements for, an “integrated plan for sustainable urban development”.

[56] Regulation (EC) No 1828/2006 of 8 December 2006 setting out rules for the implementation of Council Regulation (EC) No 1083/2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and of Regulation (EC) No 1080/2006 of the European Parliament and of the Council on the European Regional Development Fund.

Consequently, and according to the views expressed by the Commission the requirements behind the integrated plan for sustainable urban development should be defined by Member States and managing authorities, taking account of Article 8 of Regulation (EC) No 1080/2006 on sustainable urban development and the specific urban, administrative and legal context of each region.

It should be stated that Section 2.1 of the Community Strategic Guidelines on Cohesion 2007-132 is helpful in this respect. It specifies that:

> "the preparation of a medium- to long-term development plan for sustainable urban development is generally a precondition for success as it ensures the coherence of investments and of their environmental quality. This will also help to secure the commitment and participation of the private sector in urban renewal. In general, a multidisciplinary or integrated approach is needed. For area-based actions, for example, to promote social inclusion, this requires that actions seeking to improve the quality of life (including the environment and housing) or the level of services to citizens are combined with actions to promote the development of new activities and job creation in order to secure the long-term future of the areas concerned.
>
> The new JESSICA initiative is designed to promote and facilitate the development of financial engineering products to support projects included in integrated urban development plans. In general, integrated support services and programmes should have a focus on those groups which are most in need, such as immigrants, young people and women. All citizens should be encouraged to participate in both the planning and delivery of services."

As it was also the conclusion of the JESSICA Evaluation Study for Cyprus prepared by Deloitte, urban development in Cyprus is programmed and controlled through the implementation of the Local Plans of the major urban areas. Although the Local Plans of the four major urban areas in Cyprus contain an integrated planning approach, they do not clearly identify or give any priority to sustainable development, environmental, social and cultural operational programmes and projects which are necessary for the enhancement of the urban areas and which could also meet the funding criteria of the EU Operational Programme “Sustainable Development and Competitiveness 2007-2013”.

In order to fill this gap and prepare projects which would be coherent with the above mentioned Operational Programme, the Department of Town Planning and Housing and the Planning Bureau, prepared the four Local Operational Plans for the four major urban areas of Cyprus. These Local Operational Plans contain proposals for specific and targeted action programmes and projects which are based on the general policies of the Local Plans and arguably comply with the main goals of the EU Operational Programme “Sustainable

Development and Competitiveness 2007-2013", and with Priority Axis number 5 of this Operational Programme that refers to the revitalisation of urban and rural areas.

For all intends and purposes the four Local Operational Plans comprise the domestic integrated urban development plan, and their conclusion was based on an analysis of the existing demographic, socio-economic, planning and physical environment of each urban area. Following an examination of these Local Operational Plans, Deloitte formulated in its proposal an Urban Regeneration Agenda and the Infrastructure Enhancement Agenda of the urban areas of Cyprus. These two Agendas were then "translated" in urban development and infrastructure projects which are linked with the Local Operational Plans, and which in turn could form the basis for the implementation of the JESSICA initiative in Cyprus.

8 Concluding Remarks

The above legal study addressed all mandated issues of inquiry as to the evaluation of possible JESSICA implementation for Cyprus. It was attempted to structure the report in a way as to present in a comprehensive manner the mandated issues against the background of the gradual implementation of JESSICA. As such the report approached JESSICA in a generic potential structure comprising of a Holding Fund, supporting a number of UDFs, investing in PPPs and urban projects.

The report commenced by identifying issues within funding agreements that need to be clarified to avoid future uncertainties, as such the mandated authority of the Managing Authority needs to be altered for the conclusion of any funding agreement, allocating funds to JESSICA. Furthermore, the minimum content of such agreement was presented together with additional clauses that will safeguard the efficiency of JESSICA actions.

Moreover, the various inherent issues of public procurement were examined again in detail and on a stage by stage basis so as to present the different underlying needs in upholding public procurement procedures. It should be noted that despite the limited number of Contracting Authorities enumerated in the relevant legislation, the number of bodies that may qualify as Contracting Authorities multiply when the status of “bodies governed by public law”, is assessed. The same strategy was followed during the examination of potential State Aid, which is again inherent in the JESSICA implementation. State aid control policies were explained in detail. Furthermore, risk management procedures were suggested, such as the securing of a transparent procurement of the various services, as a method of stepping out of the definition of common state aid.

Having reviewed the legislative limitations in the operations of JESSICA the study concentrated in the possible legal structures available for the implementation of UDFs. The conclusions here are that a limited liability public or private company is the best available method of implementing the UDF, when the method of independent legal entities is concerned. Alternatively UDFs can be established as separate blocks of finance within existing financial institutions. Arguably, what is important in either case is the co-financiers or shareholders agreement as to their respective participation in the common fund. Yet it is submitted that at the UDF level, the Cyprus limited liability company provides for the necessary safeguards which should concern the participators and promoters of JESSICA.

The role of Municipalities was examined also in the background of their respective competences. Indeed, when considering the role of municipalities in the JESSICA structure one concludes that this is at a great extent limited to their geographical jurisdiction and as such their ability to participate in the level of a UDF depends at a great extent in the areas in which such UDF will invest. In any case it is submitted that the role of municipalities when considering the JESSICA mechanisms fits better at the project stage rather than at the UDF participation.

Finally, the beneficiaries of UDF investment were clearly identified. Unfortunately, no legislative framework exists that could lead to the development of more efficient PPPs. Despite the fact that projects have been delivered in Cyprus under PPP structures, especially in construction commercial projects. Thus, PPPs cannot be ruled out when evaluating any possible JESSICA deployment. Still, even if the vehicle of PPPs is not utilised, JESSICA can be deployed with investments made directly to projects. Indeed, an integrated urban development plan is in place and it is ready to form the selection basis for JESSICA eligible projects.

All the above were prepared as a first evaluation on the possible deployment of the JESSICA initiative in Cyprus. Indeed, the subject matter of this study is not the actual implementation of JESSICA, but instead the examination of the legal framework affecting the possible deployment of JESSICA. As far as the initial steps of the deployment are concerned, namely the funding agreement with the Holding fund and the structure and operations of the holding fund, it is submitted that the present study provides an exhaustive analysis of every possible alternative, Yet as the deployment moves towards the more subjective part of deploying UDFs, defining their operation, participation and investment the present study provides merely a presentation of the applicable legal principles and their effect. It is certainly suggested that if and when a political decision is taken as to the implementation of JESSICA, specific legal evaluations should be reassigned by the interested parties so as to review in depth the specific structure under which UDFs are proposed to be implemented. Such specific evaluations are considered necessary for securing the lawful implementation of JESSICA.