Sérvulo & Associados | Sociedade de Advogados, RL

European Investment Bank

JESSICA

JOINT EUROPEAN SUPPORT FOR SUSTAINABLE INVESTMENT IN CITY AREAS

Study on the Legal Implementation of JESSICA in Portugal

EVALUATION STUDY

July 2009

This document has been produced with the financial assistance of the European Union. The views expressed herein can in no way be taken to reflect the official opinion of the European Union.

Rua de Artilharia Um, n.º 79 - 5.º 1250-038 Lisboa - Portugal
Tel: (+351) 21 383 69 00 Fax: (+351) 21 383 69 01/02
www.servulo.com

Rua Mouzinho da Silveira, n.º 10 1250-167 Lisboa - Portugal
Tel: (+351) 21 030 31 90 Fax: (+351) 21 030 31 91/99
lisboa@servulo.com

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EXECUTIVE SUMMARY

JESSICA, the acronym of Joint European Support for Sustainable Investment in City Areas, is a joint initiative of the European Commission (EC) and the European Investment Bank (EIB) designed to promote and support investment in programs of urban development throughout Europe.

Under JESSICA, Member States (MS) of the European Union are given the possibility to use Structural Funds in projects included in an integrated plan for sustainable urban development. Structural Funds are used to finance investments into Urban Development Funds (UDFs). These UDFs are then invested in urban regeneration projects through the form of loans, bonds, guarantees and equity capital.

From a legal standpoint, JESSICA is a financing programme with innovative and specific features. The use of financial engineering techniques, the reimboursability of the funds invested and the possibility to serve, without any time limit, as a co-financing tool where private investors also participate altogether prove its value added as an additional financing tool for urban regeneration projects.

The Portuguese legal framework does not pose major obstacles as to the implementation of JESSICA in Portugal. Special attention has to be paid, however, to compliance with State aid limitations, as well as to public procurement impositions and banking law restrictions.

Due to the narrow time frame of application of the special regime for public procurement in areas such as urban rehabilitation (Decree-Law n. 34/2009), to expire by the end of 2010, and also to its limited impact, JESSICA's implementation will hardly benefit from such regime. Therefore, generally, the whole set of requirements deriving from the Public Procurement Code, transposing EU requirements into Portuguese law, will apply.

The public procurement impositions apply at different stages – i.e. at the moment of the choice of the holding fund (except if it is awarded to the EIB or EIF), at the moment of the selection of the UDF, at the level of the selection of projects, at the level of the selection of any supplier or services provider or at the level of selection of private partners in financial engineering instruments.

Although public procurement directives do not bind the EIB and despite the non-application of CCP, EIB is bound by the general principles set out in the EC Treaty and also by the specific provisions, regarding JESSICA, established in the applicable Regulations (namely Regulation (EC) 1828/2006). Concerning public procurement, the minimum requirements that the EIB must fulfil are, according to such provisions and principles: i) a

call for expression of interest duly addressed; and ii) the appraisal, selection and accreditation of UDFs under a transparent and objective atmosphere. This does not, obviously, interfere with the application and compliance with the EIB internal guidelines on procurement.

If the UDF adopts a public institutional form, any agreement it enters into is subject to national procurement rules and the choice of the specific procedure is subject to the applicable criteria foreseen in the CCP. In case it corresponds to what the Portuguese law describes as a "body governed to public law", its compliance with the CCP shall be subject to swifter terms and it may, in specific cases, be exempt of public procurement rules.

The presence of PPP's within JESSICA may be relevant in two different levels: i) constitution of the UDF; and ii) investment by the UDF through equity in private capital vehicles. Such operations may imply compliance with CCP rules, through the due launching the relevant procedure for the choice of the private partner, in case the contracting authority adopts the public institutional form. As mentioned, the legal framework will differ if the contracting party corresponds to a "body governed by public law".

It is advisable that the use of financial engineering tools is matched with a comfortable degree of transparency. In line with such interpretation, without prejudice of CCP provisions, UDF should, in any event, be subject to the same procurement principles that the EIB is bound to comply.

JESSICA funds allocated from the Operational Programme to the Holding Funds, from the Holding Funds to the UDFs or from any of the former to private undertakings, will not constitute State aid as long as the investment is commercially justifiable in the sense that a private investor in a similar position would adopt an equivalent measure. This assessment and the assessment of other state aid compliance elements involve a careful case-by-case analysis.

Article 43 (7) of Regulation (EC) 1828/2006 allows for uneven rights between investors in UDF - *inter alia*, between public and private parties. This does not raise any objection under Portuguese law, since loan contracts, equity capital and participation units in investment funds can attribute different rights to each category of investor. The constraints derived from the prohibition of State aid, however, must be strictly complied with.

EC Regulations allow for a considerable degree of flexibility in the concept of urban development "fund", and do not impose that such fund has legal personality nor prescribe a determined organisational form to be followed. The Holding Fund can namely enter into a contract with a financial intermediary to manage the fund, with no need to create a new separate legal entity. Moreover, the Portuguese legal system provides for a

wide number of alternatives in terms of the nature of the UDF. Therefore, the strategy to be pursued in terms of the choice of a legal vehicle to UDF's in Portugal should be adaptive and flexible, and not limitative.

Portuguese Banking Law imposes a significant restriction in the choice of UDF legal form, as it forces professional granting of loans and guarantees to be made through financial institutions. Such requirement can be derogated through a special legal intervention. It also does not apply to capital investment.

Among the various legal forms, the value-added that can be contributed by JESSICA deployment when compared to existing institutional solutions for promoting and funding urban regeneration, e.g. via Sociedades de Reabilitação Urbana (SRUs) is greater in private law forms or in public undertakings, as this accommodates the possibility of private investment, which does not occur in other Public law types of structure or in SRU's.

A legislative intervention to provide for an autonomous legislative text to deal with UDFs does not seem necessary. While the intention to prepare such piece of legislation has been announced by the Securities Law Commission, the existing rules already provide for a wide range of alternatives in terms of the concrete form to be observed by the Portuguese UDF. A legislative intervention would only have to be considered if the UDF were to grant credit or guarantees through non-financial forms.

The reference made in Regulation (EC) 1083/2006 to capital investment must be regarded in a functional sense and allowing UDFs investments with a high degree of risk. Therefore, that expression should be interpreted as to also include real estate investment funds, whose risk involved is mitigated, regardless of the nature of the fund (contractual or corporate form). Nevertheless, the current regime for investment funds implies certain limitations for open-ended Real Estate Regeneration Investment Funds. Still, closed-ended funds may seem to fit aptly in this context, as open-ended funds raise recurrent doubts in terms of liquidity in troubled or bear markets.

SUMÁRIO EXECUTIVO

O programa JESSICA, iniciais de *Joint European Support for Sustainable Investment in City Areas*, é uma iniciativa conjunta da Comissão Europeia e do Banco Europeu de Investimento vocacionado para a promoção e o apoio em programas de desenvolvimento urbano na Europa.

De acordo com o programa JESSICA, aos Estados-membros da União Europeia é concedida a possibilidade de utilizarem fundos estruturais em projectos de reabilitação urbana através de Fundos de Desenvolvimento Urbano (FDR ou *Urban Development Funds* (UDFs)). Estes Fundos são utilizados para investir em projectos de reabilitação urbana através de empréstimos, garantias ou investimentos de capital.

De um ponto de vista jurídico, o JESSICA é um programa de financiamento com características específicas e inovatórias. A utilização de mecanismos de engenharia financeira, o carácter reembolsável dos fundos investidos e a possibilidade de servir, sem horizonte temporal definido, de instrumento co-financidor, a par de participações financeiras asseguradas por entidades privadas, são em conjunto elementos distintivos que assinalam a mais-valia do JESSICA como mecanismo de financiamento adicional para projectos de regeneração e reabilitação urbana.

O sistema jurídico português não coloca obstáculos de maior à aplicação do programa JESSICA em Portugal. Ponto é que sejam cumpridas as exigências legais nomeadamente em matéria de proibição de auxílios estatais, contratação pública, Direito da concorrência e Direito bancário.

Mercê do curto prazo de vigência do regime especial de contratação pública para reabilitação urbana (DL n.º 34/2009), a vigorar até final de 2010, e em função do seu impacto limitado, é de estimar que a aplicação do JESSICA mal beneficie do seu regime. Assim, em geral, a disciplina constante do Código dos Contratos Públicos terá aplicação.

As exigências decorrentes do regime de contratação pública aplicam-se em diferentes fases – seja no momento da selecção do fundo de participação (salvo se a escolha recair sobre o BEI ou outra instituição financeira europeia), no momento de selecção do fundo de desenvolvimento urbano, seja ao nível da escolha dos projectos, seja ao nível da escolha de algum prestador de serviço ou fornecedor, seja por fim, na escolha do parceiro contratante em instrumentos de engenharia financeira.

Apesar de as Directivas sobre contratação pública não vincularem o BEI e pese embora a não aplicação do CCP, o BEI é vinculado aos princípios gerais fixados no Tratado e pelas disposições específicas referentes ao JESSICA, consagradas no regime correspondente (nomeadamente o Regulamento (CE) n.º 1828/2006). Em matéria de contratação pública, os

requisitos que o BEI deve observar são, pelo menos, segundo tais princípios e disposições, de dupla ordem: um convite para a manifestação de interesses devidamente endereçado e uma avaliação, selecção e acreditação de fundos de desenvolvimentos urbanos em ambiente transparente e objectivo. Tal não interfere, obviamente, com a aplicação e obediência aos procedimentos e regulamentos internos do BEI em matéria de contratação pública.

Se o fundo de desenvolvimento urbano adoptar uma forma jurídica pública, qualquer acordo que celebre está sujeito a regras de contratação pública e a escolha do procedimento específico está sujeito aos critérios fixados no CCP. Se corresponder ao que o Código qualifica como "entidade governado pelo Direito público", o seu cumprimento rege-se por normas mais flexíveis e pode, em certos casos, ser excepcionado da disciplina da contratação pública.

A presença de parcerias público-privadas no programa JESSICA pode ser relevante a dois níveis: na constituição de fundo de desenvolvimento urbano e no investimento do FDR através de participações de capital em veículos de Direito privado. Tais operações podem implicar a sujeição às regras do CCP, postulando o lançamento dos processos relevantes para a selecção de parceiros privados, se a entidade contratante adoptar uma forma institucional pública, e não se tratar de um "organismo governado pelo Direito público".

É aconselhável que a utilização de instrumentos de engenharia financeira seja acompanhado de um nível confortável de transparência. Assim, ainda que os fundos de desenvolvimento urbano estejam fora do âmbito do CCP, estes devem estar sujeitos às mesmas regras a que o EIB deve obeceder em matéria de contratação pública.

Os fundos JESSICA reafectados dos Programas Operacionais para os Fundos de Participação, destes para os fundos de desenvolvimento urbano ou de algum dos anteriores para empresas privadas, não constituirá auxilio estatal se o investimento for comercialmente justificável no sentido de que um investidor privado em posição semelhante adoptaria uma medida equivalente. Esta avaliação, bem como de outros elementos do regime proibitivo do auxílio de Estado, obriga a uma cuidadosa análise, a ensaiar caso a caso.

O Artigo 43 (7) do Regulamento (CE) n.º 1828/2006 admite direitos desiguais entre os investidores nos fundos de desenvolvimento urbano - *inter alia*, entre partes públicas e privadas. Tal não enfrenta objecção alguma à luz do Direito português, dado que os contratos de financiamento, as participações de capital e as unidades de participação em fundos de investimento podem implicar direitos diferentes consoante a categoria dos investidores. Todavia, as limitações decorrentes da proibição da prestação de auxílios estatais devem ser rigorosamente respeitadas.

O Direito comunitário não impõe nenhum conceito legal de fundo de desenvolvimento urbano, não exigindo sequer que este seja dotado de personalidade jurídica. O fundo pode, assim, ser um mero património autónomo gerido por um intermediário financeiro. O sistema jurídico português, aliás, faculta diversas alternativas quanto à natureza do fundo de desenvolvimento urbano. Nessa medida, a estratégia a prosseguir na selecção da forma jurídica do fundo deveria ser adaptada e flexível, e não limitativa.

Em Portugal, as regras de Direito bancário implicam restrições importantes na selecção da forma jurídica do fundo de desenvolvimento urbano, uma vez que obriga a que a concessão de crédito a título profissional seja realizada através de instituição financeira. Tal exigência pode, no entanto, ser derrogada através de alteração legislativa. Não se aplica, além disso, o investimento através de participações de capital.

Entre as diversas formas jurídicas, a mais valia que pode ser retirada da aplicação do JESSICA, quando comparada com outras soluções para promover e financiar a reabilitação urbana, nomeadamente através de Sociedades de Reabilitação Urbana (SRUs) é maior em formas de Direito privado ou em empresas públicas, dado que tal acomoda a possibilidade de investimento privado, o que não ocorre nas demais formas de Direito público nem nas SRU's.

Afigura-se desnecessária uma intervenção legislativa para proporcionar um tratamento autónomo aos fundos de desenvolvimento urbano. Apesar de a Comissão do Mercado de Valores Mobiliários ter anunciado a intenção de preparar um projecto legislativo com tal finalidade, o certo é que as regras em vigor já facultam diversas alternativas quanto à forma jurídica a observar pelos fundos de desenvolvimento urbano a constituir em Portugal. Uma tal intervenção legislativa apenas se revela necessária se for contemplada a adopção de um fundo de desenvolvimento urbano que pretenda conceder crédito ou prestar garantias através de uma forma jurídica com personalidade jurídica sem revestir a natureza de instituição financeira.

A referência feita no Regulamento (CE) n.º 1083/2006 a instrumentos de capital deve ser analisada no prisma funcional, ao permitir investimentos com elevado grau de risco. Assim, essa expressão deve ser interpretada em sentido funcional, quanto a permitir igualmente a inclusão de investimento através de fundos de investimento, cujo risco é mitigado, independentemente da natureza do fundo (contratual ou societária). Reconhece-se que o regime actual dos fundos de investimento implica limitações aos fundos abertos de investimento imobiliário em reabilitação urbana. Porém, os fundos imobiliários fechados parecem mais aptos a servir

neste contexto, dado que os fundos imobiliários abertos suscitam dúvidas recorrentes em termos de liquidez, em conjunturas bolsistas depressivas ou ocorrendo turbulência dos mercados.

ABBREVIATIONS

CCP.....	Portuguese Public Procurement Code, approved by Decree-Law n. 14/2008, 29 January
CIT…….	Corporate Income Tax
EIB or BEI…….	European Investment Bank/ Banco Europeu de Investimento
JESSICA….....	Joint European Support for Sustainable Investment in City Areas
QREN.....	National Strategic Reference Framework, approved by Decree-Law n. 312/2007, 17 September
Sérvulo……...	Sérvulo & Associados – Sociedade de Advogados RL
SRU……...	Urban Rehabilitation Companies (Sociedades de Reabilitação Urbana)
UDF……...	Urban Development Fund
VAT……...	Value Added Tax

I. INTRODUCTION

1. Context

1.1 Legal sources of JESSICA under EU Law

The JOINT EUROPEAN SUPPORT FOR SUSTAINABLE INVESTMENT IN CITY AREAS (herein referred to as JESSICA) is an initiative jointly promoted by the European Commission and the European Investment Bank, aimed at extending the use of financial engineering in integrated programs of urban development. Under JESSICA, urban regeneration projects included in an integrated plan for sustainable urban development can be financed namely through loans, bonds, guarantees and equity capital[1].

The European Investment Bank (EIB) has appointed Sérvulo & Associados – Sociedade de Advogados RL to undertake a Legal Study aimed at identifying legal challenges and opportunities for implementing JESSICA in Portugal and, where JESSICA deployment might be constrained and/or compromised, to suggest possible mitigation measures.

The founding documents of JESSICA's implementation in Portugal are the Memorandum of Understanding signed between the Portuguese Authorities and the European Investment Bank in November 2008 and the Funding Agreement signed between the same parties in July 2009.

JESSICA's legal regime is anchored in Articles 36, 44, 45 and 78 of Regulation (EC) n. 1083/2006 of 11 July 2006, in Articles 7 and 8 of Regulation (EC) n. 1080/2006 of 5 July 2006 and in Articles 43, 44, 46, 47 and 51 of Regulation (EC) 1828/2006 of 8 December 2006.

The interpretation of such sources has been facilitated through Guidance Notes provided by the Commission services[2].

In spite of the relevance of these sources, this Study is not intended to elaborate in their in-depth interpretation, as its scope is mainly placed in the analysis of Portuguese Law and the articulation between EU Law and Portuguese internal Law.

1.2 Legal sources affecting JESSICA under Portuguese Law

[1] See article 44 Regulation (EC) n. 1083/2006, 11 July 2006. For general information, see JESSICA's website at http://ec.europa.eu/regional_policy/funds/2007/jjj/jessica_en.htm.

[2] See, v.g., the following Guidance Notes: COCOF note COCOF/07/0018/01, of 16 July 2007; COCOF note COCOF/08/0002/03, of 22 December 2008.

Under Portuguese law, the implementation of JESSICA is at a crossroad of several areas of law: Financial and Company law, Public law, Real Estate law, Tax law and Competition law. Therefore, an interdisciplinary approach must be adopted, in order to adequately respond to the objectives of this Study.

The choice for the structure of UDFs, a key element of the programme, forces a review of the main components of Portuguese Financial and Company Law. Different forms must be compared, in order to assess the best possible solutions.

As the Financial law analysis is paramount to the study, so is the Public law assessment, as it will address urban planning legal structure that strongly determines urban regeneration projects. Attention will be given to the regime on PPP's that derives from the Public Contracts Code and other adjacent legislation.

Finally, EU and Portuguese Competition Law have to be taken into account, namely in respect to compliance with Competition Law rules and State Aid prohibitions.

The present Study is not aimed at making a survey of tax implications deriving from the execution of JESSICA. Portuguese tax law is solely considered at the level of the choice of the legal form to be adopted by and UDF[3]. Also, this Study does not attempt at reviewing other areas of law, such as real estate law or real estate lease law, which may directly or indirectly impact JESSICA.

1.3 Intersection with the Evaluation study

Parallel to this Study, Deloitte and Parque Expo have prepared an Evaluation Report on the basis of which JESSICA is to be implemented in Portugal[4]. The scope of each document is different, as this Study is exclusively concerned with legal aspects of JESSICA's implementation. While the responsibility of this Legal study lies exclusively with Sérvulo, we are grateful for preliminary comments received from Deloitte and Parque Expo.

2. A changing legal environment

[3] See *infra*, 6.1.

[4] See DELOITTE/ PARQUEXPO, *Jessica Evaluation Study. Final Report,* (June 2009).

The Portuguese Government approved on April 9 2009 a Proposed Amendment to the Legal Framework on Urban Regeneration[5]. This legislative text was then subsequently sent to Parliament, where it was approved on July 3 2009. The document has already been sent to the Government for final approval. Therefore, the legislative process is expected to be concluded this year.

When finally adopted, this legislative text may play an important part in the implementation of JESSICA, as one of the innovative components it touches upon is the financing of urban renewal. However, as the correspondent legislative process in still in progress, this Report does not examine its possible implications to the implementation of JESSICA.

3. Structure of the Study

This Study is structured into four main parts. Following this introduction (I), the Study will address Legal Constraints affecting the Architecture of UDFs (II) and Benefits regarding the Legal Architecture of UDFs (III). The Study equally presents a set of Recommendations, Proposals and Conclusions (IV).

[5] See Legislative Proposal (Proposta de Lei) n. 266/X, available at http://www.parlamento.pt/ActividadeParlamentar/Paginas/DetalheIniciativa.aspx?BID=34489 .

II. LEGAL CONSTRAINTS AFFECTING THE ARCHITECTURE OF URBAN DEVELOPMENT FUNDS

4. The Freedom of Choice of UDF Legal Form according to EU Law

*4.1. A flexible concept of "fund" (*Article 44 (2) of Regulation (EC) n. 1083/2006*)*

JESSICA envisages channelling Structural Funds to finance investments into Urban Development Funds (UDFs). These UDFs are then invested in urban regeneration projects through the form of loans, bonds, guarantees and equity capital.

Thus, at the core of JESSICA lies the concept of urban development fund. The definition of these funds included in Article 44 (2) of Regulation (EC) n. 1083/2006 of 11 July 2006 is very broad, as it encompasses "funds investing in PPP and other projects included in an integrated plan for sustainable urban development".

It is worth underlining the degree of flexibility herein implied in the concept of "fund". Namely, Regulation (EC) n. 1083/2006 does not impose that such fund has legal personality nor does it prescribe a determined organisational form to be followed. Moreover, Regulation (EC) n. 1828/2006 foresees in article 43 (3) that "financial engineering instruments, including holding funds, shall be set up as independent legal entities governed by agreements between the co-financing partners or shareholders or as a separate block of finance within a financial institution". Therefore, UDFs can be used either to use exclusive funding coming from the Holding Fund or to share investments with other co-financing entities. These co-financing parties can alternatively invest at the level of each project.

In this context, it is a matter of Portuguese law, to determine the possible forms of UDF's. This will be dealt with later in this Report[6].

4.2 A dual approach: legal compliance and legal optimizing

The subsequent sections present an analysis of legal constraints affecting the structure of UDFs. Such analysis is divided in two major parts. On the one hand, attention is given to compliance issues, i.e. topics that effectively entail limitations to the setting up process and to the overall the activity of UDF's (Section 5.). A separate treatment is dedicated to optimizing JESSICA according to the existing legal framework (Section 6.),

[6] See *infra*, 6.1.

as a central component of the legal engineering that must match the financial engineering underlying JESSICA.

5. Addressing compliance issues: Legal Constraints regarding the Choice of UDF Legal Form

5.1 Limitations concerning the national strategic reference framework

In line with Regulation (EC) n. 1083/2006, Portugal approved the national strategic reference framework (QREN) establishing the main directives for the national use of the structural community funds for the period 2007-2013 – Decree-Law n. 312/2007, of 17 September.

The decree-law referred to above also sets out the organic structure regarding the exercise of monitoring functions, auditing and control, certification, management functions, strategic advising and assessment functions, as established in the applicable community regulations.

According to this legal instrument, there is a very deep public control on the use of the funds occurring *before* such use, *during* the application of the funds and *after* its investment, which has to be considered, taken into account and respected on the process of defining JESSICA structure for Portugal.

The governance of QREN and the Operational Programmes is made through two different levels: (i) the Government level, regarding the ministerial coordination and political direction and (ii) the technical level, concerning the strategic and financial coordination and monitoring, the auditing and control, the strategic advice and assessment.

Hence, there is a wide range of bodies with responsibilities in the context of QREN and Operational Programmes, which vary according to the different types of functions they develop (including but not limited to political direction bodies, auditing bodies, technical and financial coordination bodies, strategic advice bodies, certification bodies).

Considering that JESSICA's financial engineering instruments are built within one operational programme[7], the Operational Programme's governance maintains its relevance within JESSICA and is also composed of several bodies with different competences also varying depending on the

[7] See article 44 of Council Regulation n. 1083/2006.

origin of the funds in each Operational Programme (European Regional Development Fund, European Social Fund and Cohesion Fund).

It is worth mentioning, in the context of the many existing competences and entities, that the technical, administrative and financial orientations regarding each sort of investment are established by the managing authorities of each Operational Programme (mentioned in articles 59 and 60 of Regulation (EC) 1083/2006) and that, with special relevance for JESSICA, the selection criteria for investments supported by Operational Programmes shall be approved by the relevant monitoring committee.

5.2 Public Procurement Law requirements

5.2.1 Introduction to Portuguese Public Procurement Law

Portuguese Public Procurement provisions are contained in "Public Procurement Code" (CCP), approved by Decree-Law n. 18/2008, of January 29th, which transposed Directives 2004/18/CE and 2004/17/CE, of European Parliament and Council, of March 31st.

On February 6th, an exceptional and transitory regime for public procurement, derogating some of the provisions set out in CCP, was published (Decree-Law n. 34/2009) covering some axis that are considering as priority for the economical development of the country: renewable energy, energy efficiency and transport grid, schools modernisation, modernisation of the technological infra-structure and urban rehabilitation. Concerning urban rehabilitation, this new and exceptional regime does only stipulate, in more favourable terms than those foreseen in CCP, swifter terms for the negotiation procedures and restrictive procedures. Due to the narrow time frame of application of this special regime for public procurement in areas such as urban rehabilitation (Decree-Law n. 34/2009), to expire by the end of 2010, and also to its limited impact, JESSICA's implementation will hardly benefit from such regime. Therefore, generally, the whole set of requirements deriving from the CCP, transposing EU requirements into Portuguese law, will apply.

(i) Contracting authorities

Under the regime imposed by the CCP, the range of entities subject to its provisions – and therefore called "contracting authorities" – are the State, regional or local authorities, public institutes, public foundations[8] and

[8] Exception made to the ones governed by Law n. 62/2007, of September 10th.

associations, associations formed by one or several of such authorities and also any "body governed by public law".

According to the CCP and also European directives, bodies governed by public law means any body:

(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[9].

(ii) Public contracts

Noteworthy is the fact that the CCP has a much broader perspective about public contracts subject to its provisions compared to the one held by European directives. In fact, under the light of CCP, public contracts means any contract that contracting authorities sign, independent of its designation or nature, which contractual renderings are not or may not be subject to market competition, deriving from its nature or from its features, as well as from the relative position of the parties on the contract or on the context of its generation.

Therefore, most of the contracts that are entered into by contracting authorities, in the sense of the CCP, assume the quality of public contracts, even though its execution is governed by private law.

(iii) The applicable procedures

In awarding their public contracts, contracting authorities shall apply the national procedures adjusted for the purposes of this Directive.

The main procedures foreseen in CCP are:

a) Negotiated procedure without a notice, which begins by an invitation addressed by the contracting authority to the economic operator to submit a tender;

[9] The elements that constitute the concept of "body governed by public law" have not been yet developed or materialised by Portuguese jurisprudence, but they shall be interpreted according to the very relevant and broad jurisprudence issued by the European Court of Justice on such concept.

b) Public tender, which is an open procedure meaning that any interested economic operator may submit a tender;
c) Restrictive procedure, in which any economic operator may request to participate and whereby only those economic operators invited by the contracting authority may submit a tender;
d) Negotiated procedures, which begin as restrictive procedures but include then a period of negotiation;
e) Competitive dialogue, in which any economic operator may request to participate and whereby the contracting authority conducts a dialogue with the candidates admitted to that procedure, with the aim of developing one or more suitable alternatives capable of meeting its requirements, and on the basis of which the candidates chosen are invited to tender[10].

The choice of any of the above mentioned procedures depend either on the value of the agreement that will be entered into (value criteria) or on other material and exceptional circumstances that, once verified, allow the choice of some of the procedures to be independent of the contract's amount (material criteria).

The amount which is relevant for the value criteria varies according to the type of the contracting authority (on one side, State, regional or local authorities, public institutes, public foundations and associations, and on the other authorities governed by public law) and to the nature of the contract that will be entered into.

5.2.2 Contracting authorities and public contracts within JESSICA

The concept of contracting authority is very important on the subsequent analysis of public procurement in JESSICA, since such rules apply only when there is a contracting authority in the sense of CCP. Thus, the approach to JESSICA, regarding public procurement requirements, shall begin with such analysis.

(i) Selection of the Holding Fund

Regarding JESSICA's design, as mentioned above, it is easy to understand that the first moment in which the public procurement Law could be required to intervene is exactly *the moment of the choice of the Holding Fund*. This means that, in principle, once a decision is taken upon the

[10] Portuguese Law completely follows Directive 2004/18 in respect to this specific procedure.

existence of a Holding Fund, it would be necessary to verify whether the use of the Holding Fund is subject to any public procurement procedure imposed either by Portuguese national law or by European provisions, either the EC Treaty or directives.

According to article 44 of Regulation 1083/2006, the selection of the Holding Fund may be implemented through:

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

b) The award of a grant defined as a direct financial contribution by way of a donation, either to the EIB or EIF or to a financial institution without a call for proposals, if this is pursuant to a national law compatible with the Treaty.

If the holding fund is the EIB or the EIF, and although either the State or the managing authority are contracting authorities under the light of CCP, there is no need to launch any public procurement procedure for the choice of the holding fund, as Regulation 1083/2006 allows, in article 44, for it to be directly awarded to the EIB or EIF.

Since the Portuguese Authorities and the EIB signed the funding agreement on 20th July, where the EIB was designated as "holding fund" for JESSICA purposes, there is no need to analyse the public procurement requirements for a financial institution to play the role in the Holding Fund.

(ii) Selection of the urban development funds (UDF's)

Hence, there is another relevant moment to which the public procurement rules shall be applied – which is during the selection or the setting up process of a UDF.

Concerning such aspect, Commission Regulation (EC) n. 1828/2006 of 8 December, that sets out the rules for the implementation of Council regulation (EC) n. 1083/2006, establishes in article 44 (concerning the provisions applicable to holding funds) that the funding agreement entered into between the holding fund and the managing authority or the Member State shall, in particular, make provision for:

(i) A call for expression of interest addressed to financial intermediaries or urban development funds;

(ii) The appraisal, selection and accreditation of financial intermediaries or urban development funds by the holding fund.

This means that the law imposes, at least, that a call for expression of interest shall be launched for the choice of the financial engineering instruments to which the holding fund will contribute. According to the

Note of the Commission services on Financial Engineering in the 2007-12 programming period (16th July 2007 Final version), the selection procedures should be based on specific and appropriate selection criteria relating to the objectives of the operational programmes, criteria which should be approved by the monitoring committee. Such conclusion arises from the fact that contributions of financial engineering instruments come from Structural Funds and shall therefore comply with its specific rules and objectives.

Further to the requirements established in Commission Regulations (EC) n. 1828/2006 and (EC) n. 1083/2006[11], it may happen that the contribution from the holding fund (i.e., from operational programmes) to the financial engineering instrument corresponds to a public procurement of services governed by EC law or national public procurement law, which will force compliance with such rules.

Once the Portuguese Holding Fund is the EIB the possible need of compliance with public procurement rules shall be referred to the EIB.

It is important to highlight that CCP is not applicable since the EIB is not a contracting authority according to CCP. Also the public procurement European directives are not applicable to the EIB, given its EU Treaty based nature.

In this context, the EIB shall within the selection process of the financial engineering instruments comply with the provisions of the above mentioned regulations, which, through the mandatory provisions to be included in the funding agreement, oblige it to launch a call for expression of interest and to select the UDFs according to the criteria pursuant to the funding agreement.

Furthermore, EIB shall also comply with the provisions of the EC treaty, mainly the general principles of the European procurement law (equal treatment, non-discrimination, confidentiality and transparency). This means, according to the European Court of Justice Jurisprudence[12], that a transparent procedure, duly publicized and with objective appraisal criteria[13] shall be launched by EIB for the selection of financial engineering instruments[14]

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[11] Either in what concerns the financial instruments selection procedure, or the necessary authorizations (namely of the monitoring committee).

[12] See Cases C-324/98, Telaustria, [2000] ECR I-10745, paragraph 62, C-231/03, Coname, judgment of 21.7.2005, paragraphs 16 to 19 and C-458/03, Parking Brixen, judgment of 13.10.2005, paragraph 49.

[13] Such appraisal criteria shall also be in accordance with Commission Regulations (EC) n. 1828/2006 and (EC) n. 1083/2006 and shall take into account the business plan submitted

Compliance by the EIB of the minimum requirements above-mentioned does not prejudice the compliance with more demanding terms of the procedures, namely according to EIB procurement guidelines[15] or according to additional requirements that may have been agreed in the funding agreement under the light of article 44 (3) of Commission Regulation (EC) n. 1828/2006 of 8 December 2006[16].

(iii) Selection of Projects by UDF's

As foreseen in article 46 of Commission Regulation (EC) n. 1828/2006 of 8 December 2006, urban development funds shall invest in public-private partnerships or other projects included in an integrated plan for sustainable urban development and such investment shall be made through equity, loans and guarantees.

The urban projects will be selected by the financial engineering instruments (the urban development funds), although such choice may have been conditioned by the specific provisions of the criteria applicable for the selection of operations included in the funding agreements entered into between the managing authorities and the holding fund or between the holding fund and the urban development fund[17].

In any event, it is very important to highlight the role of the Investment Board, whose members are appointed by the managing authorities, in the selection of projects (meaning that the appraisal criteria shall be considered and approved by it).

The degree of freedom the UDFs have in selecting the projects they will invest in varies depending on the quality of "contracting authority" in the UDF and also on the type of the "contracting authority". In fact, in case

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by the financial instruments candidates to the contributions form the holding fund (articles 43 and 44 of Regulation 1828/2006).

[14] According to the Note of the Commission services on Financial Engineering in the 2007-12 programming period (16th July 2007 Final version), "where possible, more than one financial engineering instrument should be selected, with a view to producing the best possible leverage effects (…)".

[15] Guide for internal procurement issued by EIB can be found at http://www.eib.org/projects/faq/procurement/how-does-the-eib-manage-procurement-of-services,-supplies-and-works-for-its-own-account.htm?lang=-en

[16] According to such provision, "the terms and conditions for contributions for venture capital funds, guarantee funds, loan funds and urban development funds from holding funds supported by operational programmes shall be set out in a funding agreements, to be concluded between the venture capital fund, guarantee fund, loan fund or urban development fund, on one hand, and the holding fund, on the other."

[17] Our analysis is only anchored on national or European community principles and rules and not on any contractual agreement of any party.

an UDF constitutes a "contracting authority" in the sense of the CCP (transposing the European directives, as above mentioned), it is then subject to the procurement rules therein established.

In the situation that the UDF adopts a public form (as a State entity or a public institute or association), any agreement it enters into is then subject to procurement rules and the choice of the specific procedure is subject to the applicable criteria as foreseen in CCP.

If the UDF does not adopt a public form but corresponds to a contracting authority, in the sense of a "body governed by public law"[18], it is also subject to public procurement rules foreseen in CCP although in different terms as the contracting authorities that adopt a public form. When the contracting authority is a "body governed by public law", there are two relevant differences that must be stressed. On the one hand, the limit contract value for the choice of the applicable procedure is different and higher in this type of contracting authority. This means that it is easier, e.g., in this case, to adopt a negotiated procedure without a notice. On the other hand, a body governed by public law is only subject to public procurement rules in case the agreement includes contractual renderings that correspond to one of the following agreements: public works contract, public works concession, public services concession, lease and purchase of goods and services purchase (article 6, n. 2, of CCP).

In this context, when the UDF (acting as a "body governed by public law") invests through equity, loans and guarantees, we may say that generally such agreements do not include renderings typical of the above mentioned contracts. In so far as the agreements entered into by the UDF do not involve any of such renderings, it is not subject to the public procurement rules foreseen in CCP.

In any case, it is relevant to stress the importance of the general principles foreseen in the EC Treaty, which, even in contracts that are not subject to public procurement rules, determine the compliance with its provisions, namely with the material consequences of competition principle and principles of equal treatment, transparency and of public access.

In this context, it is important to highlight that according to article 43 (3) of Regulation (EC) 1828/2006, financial engineering instruments may be set up "as a separate block of finance within a financial institution". This

[18] Meaning that it was established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character, has legal personality and is 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.

possibility implies that in case the UDF has no autonomous legal personality and is a mere block of finance within a financial institution, the agreements entered into for the benefit and interest of the fund shall be attributed to one legal entity, the financial institution that manages the fund.

The financial institution shall comply with the relevant public procurements rules to which itself is subject to. According to CCP, it is only subject to procurements rules, in case it is a contracting authority. Generally, financial institutions are entities entirely governed by private law, which do not fulfil with the requirements set out in CCP to a "body governed by public law"[19].

Despite the above described conclusions arising from a strict application of public procurement rules set forth in CCP to the possible forms to be adopted by an UDF, the fact is that both the holding fund and the UDF's are financial engineering instruments, which act on the last interest and benefit of the managing authorities of the operational programmes (although the particular interest of such instruments also exists).

Therefore, even if UDF's are outside the scope of Public Procurements Rules, a minimum set of these rules should apply. It is advisable that the use of financial engineering tools is matched with a comfortable degree of transparency. In line with such interpretation, independently of CCP provisions, UDF should be subject to the same procurement principles that the EIB is bound to comply.

(iv) Selection process of any supplier or services provider

Lastly, the Projects themselves (i.e. the public-private partnerships or other projects) in which the UDF invest in, may also correspond to a contracting authority in the sense of CCP, depending on its features - which cannot be anticipated at this stage.

It is also relevant to take into consideration that the projects may also be financed by the Operational programmes funds as grants.

[19] It is necessary to conduct a case-by-case analysis in order to verify whether a certain entity is a "body governed by public law". In this context, it is noteworthy to refer that the Portuguese financial institution that could be closer to such quality (Caixa Geral de Depósitos, a wholly State-owned Portuguese bank) has not been acting as a "body governed by public law", as it considers that it acts under an entirely market and competitive regime.

It may happen that, even if the Project or the public-private partnerships is not a contracting authority under CCP, a specific agreement is subject to the compliance with national public procurement rules.

(v) Selection of private partners in financial engineering instruments

It is important to bear in mind that, either according to Portuguese national law or to Community Law[20] public-private partnerships (PPPs) are usually characterized as follows:

- The relatively long duration of the relationship, involving cooperation between the public partner and the private partner on different aspects of a planned project;
- The method of funding the project, in part from the private sector, sometimes by means of complex arrangements between the various players. Nonetheless, public funds - in some cases rather substantial - may be added to the private funds;
- The important role of the economic operator, who participates at different stages in the project (design, completion, implementation, funding). The public partner concentrates primarily on defining the objectives to be attained in terms of public interest, quality of services provided and pricing policy, and it takes responsibility for monitoring compliance with these objectives;
- The distribution of risks between the public partner and the private partner, to whom the risks generally borne by the public sector are transferred. However, a PPP does not necessarily mean that the private partner assumes all the risks, or even the major share of the risks linked to the project. The precise distribution of risk is determined case by case, according to the respective ability of the parties concerned to assess, control and cope with this risk.

As part of the analysis of the Green Paper on public-private partnerships, it is proposed, and has been followed by Portuguese law, to make a distinction between:

[20] See n. 2 of the Green Paper on public-private partnerships and Community law on public contracts and concessions /* COM/2004/0327 final.

- PPPs of a purely contractual nature, in which the partnership between the public and the private sector is based solely on contractual links, and
- PPPs of an institutional nature, involving cooperation between the public and the private sector within a distinct entity.

This distinction is based on the observation that the diversity of PPP practices encountered in the Member States can be traced to two major models. Each of these raise specific questions regarding the application of Community law on public contracts and concessions, and merit a separate study, as undertaken in the following chapters[21].

The analysis of article 44 of Regulation (EC) n. 1083/2006 immediately reveals the presence of PPP's within JESSICA when it refers that the financial engineering instruments shall invest in *public-private partnerships* and other projects included in an integrated plan for sustainable urban development.

Apart from the contractual PPP's, as analysed in the preceding sections, it is time to investigate whether institutional PPP's have a place within JESSICA. It should be stressed that the case of pre-existing mixed entities participating in the procedures for the award of public contracts (by the UDFs), in the context of a contractual PPP's, does not give rise to much comment in terms of the public procurement rules[22].

Specific problems, which deserve special attention, related to institutional PPP's concern the selection of the private partner for such partnership.

In our view, the intersection of the problematic of institutional PPP's with JESSICA may occur, at least, in two different levels:

(i) the constitution of the UDF, which may combine private and public participations and

(ii) the (public-private partnerships) projects in which the funds invest in, as such investment may be made through equity[23].

In both levels, public procurement rules may apply.

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[21] See n. 20 of the Green Paper on public-private partnerships and Community law on public contracts and concessions /* COM/2004/0327 final.

[22] Only in the case where the entity in question meets the characteristics of an 'in house' entity, within the meaning of the Teckal Case Law of the Court of Justice (transposed to article 4. n.2 of CCP), is the contracting authority entitled not to apply the usual rules.

[23] Such projects may also aggregate other public shareholders further to the FDU (in case the FDU shall be considered public entity).

Regarding community law, it is clear that a transaction creating a mixed-capital entity is not included in the material scope of the directives as it does not strictly correspond to a public works contract or to a services acquisition agreement or even to a concession. However, when such a transaction is accompanied by the award of tasks through an act which can be designated as a public contract, or even a concession, it is important that there be compliance with the rules and principles arising from this law (the general principles of the Treaty or, in certain cases, the provisions of the Directives)[24].

In this respect, Portuguese law, i.e. CCP, has gone further than Community Law. As referred to above every agreement entered into by a contracting authority is subject to public procurement rules, provided there is market competition. This means that the transaction creating a mixed capital entity is included in the scope of CCP, as it expressly refers to in article 16, n. 2. Therefore, one of the procedures foreseen in CCP shall be chosen by the contracting authority in order to select the private partner.

Applying to JESSICA, (i) an entity that intends to constitute an UDF, and is a contracting authority, by associating private capital shall adopt the relevant public procedure and (ii) in case the UDF is a contracting authority and is willing to invest, through equity, in a project included in an integrated plan for sustainable urban development it must also adopt the relevant procedure as established in CCP.

Two very relevant notes must be added in what concerns to Portuguese Law regarding transactions creating a mixed capital entity and the choice of the private partner.

The first one is that, among the applicable criteria for the choice of the applicable procedure, CCP[25] specifically allows, regarding transactions creating a new entity, although in specific cases of relevant public interest, the award of the agreement through a negotiated procedure without a notice (meaning that it is possible for the contracting authority to choose its private partner, without having to submit it to market competition). In any event, it

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[24] See n. 57 of the Green Paper on public-private partnerships and Community law on public contracts and concessions (COM/2004/0327 final). See also Commission interpretative communication on the application of Community law on Public Procurement and Concessions to institutionalized PPP (IPPP) - *Official Journal C 091 , 12/04/2008 P. 0004 – 0009*. This Communication contains several recommendations for the procedure of selection of the private partner.

[25] See article 31. n.3.

must be stressed that such possibility will be interpreted as a very exceptional one: it has to be very well justified and such decision must comply with the general principles of the EC Treaty. In other words, courts will only accept such solution if it is possible to demonstrate that the breach of the equal treatment principle is justified and complies with the proportionality principle, in a case by case analysis.

Another relevant note is that such transactions are only subject to public procurement rules set out in CCP when the contracting authority is the State, a public institute, association or foundation, but not when the contracting authority is a "body governed by public law", in the sense referred to above. Nevertheless, it is relevant to stress the above referred importance of the general principles foreseen in the EC Treaty.

It also adequate in this context to remind that, according to the preceding analysis, for the sake of the transparency framework under which JESSICA is to be operated, independently of CCP provisions, the UDF should be subject to the same provisions in what concerns PPP's that would apply to EIB.

5.3 State Aid limitations

5.3.1 Sequence

This section deals with the conformity of JESSICA's implementation in Portugal with State Aid rules. For this purpose, the present analysis will commence by describing State aid rules, under national and European Law, taking into consideration not only the rules and principles that derive from the EC Treaty but also the development the European Court of Justice (ECJ) has been giving to articles 87-89 of the EC Treaty, in order to, on a second stage, apply such description to JESSICA specific situation.

5.3.2. State aid and Portuguese Competition Law

Under article 13 of the Portuguese Competition Law (Law 18/2003, of 11th June), State aid should not impede or restrict competition in the market (nr. 1) and, under request of any interested party, the Competition Authority (Autoridade da Concorrência) may analyze any given aid or project of aid and formulate recommendations to the Government in this regard (nr. 2). However, the Competition Authority has no power to forbid or enforce the said prohibition laid down in article 13, 1.

5.3.3 Limitations on State aid under Article 87 of the EC Treaty

The situation is clearly different under the EC Treaty rules on state aid, which are applicable in Portugal in the same terms as in the other Member States[26]. The broad limitation on State aid is stated under Article 87(1), which provides:

> '*Save as otherwise provided in this Treaty, any aid granted by a Member 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 shall, in so far as it affects trade between Member States, be incompatible with the common market*.'

The aim of Article 87(1) is "to prevent trade between Member States from being affected by benefits granted by public authorities which, in various forms, distort competition by favouring certain undertakings or the production of certain products."

To ensure that Article 87(1) prohibition is respected, a review is required to determine whether a company has received State aid. A granting of State aid will be found when an advantage was granted by, or through, Member State resources on a selective basis affecting trade between Member States and distorting competition.[27] Therefore, a measure of public support is classified as State aid only if all the conditions defined in Article 87(1) are satisfied regarding the aid, that must:

(1) Be granted by a Member State or through State resources;
(2) Confer an advantage to the recipients;
(3) Be selective, i.e. favour certain undertakings or productions;
(4) Distort competition; and
(5) Affect trade between Member States.[28]

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[26] The issue was the topical subject of the 2006 FIDE Congress, in Cyprus (2006): see FIDE, *State Aid: The effective application of EU state aid procedures: From a plan to grant aid to the recovery of illegal aid – the role of national law and practice*, Xenios L. Xenopoulos (Ed.), Topic 2, FIDE 2006 National Reports, 2006.

[27] BELLAMY & CHILD, *European Community Law of Competition*, (2008), 1504.

[28] *Op. cit.*. 1504. See also GIAN MICHELE ROBERTI, *Gli Aiuti di Stato nel Diritto Comunitário*, CEDAM, 1997; MANUEL MARTINS, *Auxílios de Estado no Direito Comunitário*, Principia, Cascais, 2002; ABEL ESTOA PÉREZ, *El Control de las Ayudas de Estado*, Iustel, 2006; BEGOÑA PÉREZ BERNABEU, *Ayudas de Estado en la jurisprudência comunitária – concepto y tratamento*, Univ. Alicante, 2008.

Each element must be analyzed to determine if a company has received State aid.

However, there are some situations where despite the presence of the aforementioned factors, the intervention does not constitute State aid in the strict sense of the term, namely:

(a) where the State conducts itself like a private commercial investor;[29]

(b) where the State is discharging obligations of a civil nature such as the obligation to make reparation for loss and damage or to pay back sums unduly required;[30] and

(c) where the exceptional measure forms part of a general system—of taxation or social security, for example—and is justified by the nature of general scheme of the system[31]; or

(d) under the ECJ *Altmark*[32] conditions.

5.3.4. Exemptions from State aid rules

Despite the broad ban on State aid, the EC Treaty does allow for some possible circumstances where State aid may be granted. However, the aid must be compatible with the common interest[33] of the market. Article 87(2) provides that an aid will be compatible with the common market if it falls within any of these three categories:

(a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;

(b) aid to make good the damage caused by natural disasters or exceptional occurrences;

(c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division.»

It should be noted that the Commission considers that these

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29 Case C-301/87, *France v Commission* (1990) ECR I-307, par.39

30 Case C-61/79 *Amministrazione delle Finance dello Stato v Denkavit Italiana* (1980) ECR 1205, par.31.

31 Case C-173/73 *Italy v Commission* (1974) ECR 709, par.13.

32 Case C-280/00, *Altmark*, ECR, 2003, I-7747. About Altmark, see the recent Thomas Muller, «Efficiency Control in State aid and the Power of Member States to define SGEIs», *European State Aid Quarterly*, Vol. 8, n. 1, 2009, pp. 39.

33 "Common interest" refers to the interests generally held in the Community. See BELLAMY & CHILD, *European Community Law of Competition*, (2008), 1547-8.

"automatically justified" forms of aid are to be strictly interpreted, even though the recent financial crisis led to some flexibility, especially in the analysis of the article 87 (3) provisos[34], stating the cases where state aid may be considered as *per se* compatible:[35]:

> *(a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;*
> *(b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;*
> *(c) 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;*[36]
> *(d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest.*
>
> *(e) such other categories of aid as may be specified by decision of the Council acting by qualified majority on a proposal from the Commission.*

5.3.5. Block Exemptions for State aid

There are also the Block Exemption Regulations, like the Commission Regulation (EC) Nr. 800/2008, of 6th August 2008, which allows Member States to grant aid, under specific categories, if they fulfil conditions, thus exempting them from the requirement of prior notification and Commission approval. The general block exemption simplifies and allows for some prioritization[37], replacing the former specific block exemptions in the areas of regional aid[38], small and medium-sized enterprises (SMEs)[39], research

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34 See the special number of the *European State Aid Law Quarterly*, Vol. 8, n. 2, 2009.

35 The Commission has laid out Guidelines specifying the criteria which it applies when assessing the compatibility of various types of aid with Article 87(3); see http://ec.europa.eu/competition/index_en.html.

36 Article 87(3)(c) permits aid to be grated to develop a sector of the economy. Also, an aid can only facilitate development within the meaning of Article 87(3)(c) if the beneficiaries are at least potentially competitive; BELLAMY & CHILD, *European Community Law of Competition*, (2008), 1546

37 Kristyna Deiberova/ Harold Nyssens, «The new General Block Exemption Regulation (GBER): What Changed?», *European State Aid Law Quarterly*, Vol. 8, n. 1, 2009, page 27.

38 Commission Regulation (EC) nr. 1628/2006 of 24.10.2006 (block exemption regulation for regional aid), revoked by article 43 of Regulation (EC) 800/2008 (see article 13), and *Guidelines on National Regional Aid for 2007-2013* (OJ, C 54, of 4.3.2006, pp. 13).

and development and innovation (R&D[40]), the environment[41], deprived urban areas, training[42], employment[43], keeping a separate regimen for the general *de minimis* aid regulation.[44]

5.3.6 State aid and JESSICA's financial engineering

Within JESSICA's structure, there are at least three different levels contributing funds to beneficiaries which may trigger State aid rules. The first level is contributions from operational programmes to holding funds. The second level is contributions from the holding funds to the urban development funds. The third level is contributions from HF and/or UDF to specific projects. In order to determine if and how these funding levels implicate State aid rules, they must be analysed under the elements found in Article 87(1) of the EC Treaty, Regulation 800 (EC)/2008 and the applicable Commission notices, although the latter is not binding on the Courts[45]:

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39 Under the conditions laid previously down in Commission Regulation (EC) nr. 70/2001, of 12.1.2001 (OJ, L 10, of 13.1.2001, p. 33), in the wording of Regulations (EC) nr. 364/2004, 1857/2006 and 1976/2006, and, now, under Regulation (EC) 800/2008 (article 43, § 2, and article 15).

40 Under the *Community Framework for State Aid for Research and Development and Innovation* (OJ, C 323, of 30.12.2006, pp. 1) and articles 30 et seq. of Regulation (EC) 800/2008.

41 According to the *Community guidelines on state aid for environmental protection* (OJ, C 82, of 1.4.2008, pp. 1) and, of course, under articles 21 to 25 of Regulation (EC) 800/2008.

42 Formerly covered by Regulation (EC) nr. 68/2001, and now under Regulation (EC) 800/2008 (see articles 38 and 39).

43 Now under Regulation (EC) 800/2008, that replaced Regulation (EC) 2204/2002, specifically in articles 13 or 15.

44 For *de minimis* aid, see the Commission Regulation (EC) Nr. 1998/2006 of 15 December 2006. The basic relevant criteria for an aid to be considered *de minimis* are, in this regard:

a) Not exceeding 200 000 € within a fiscal 3-year period of time;
b) In principle, the recipient is prevented from receiving aid through other approved scheme (see, however, article 7 of Regulation (EC) 800/2008, namely nr. 3, according to which «[a]id exempted by this Regulation shall not be cumulated with any other aid exempted under this Regulation or *de minimis* aid fulfilling the conditions laid down in Commission Regulation (EC) No 1998/2006 *or with other Community funding in relation to the same – partly or fully overlapping – eligible costs* if such cumulation would result in exceeding the highest aid intensity or aid amount applicable to this aid under this Regulation) (emphasis added);
c) The aid element is "transparent" ("aid for which it is possible to determine in advance the gross grant equivalent without needing to undertake a risk assessment");
d) If a guarantee is involved, it may not exceed 1.5 M €.

45 As *soft law* instruments, Commission Guidelines and communications are primarly mandatory to the Commission services (see the ECJ at the *L' Oreal* decision, of 10.7.1980),

namely the 2006 *Guidelines on State Aid to Promote Risk Capital Investments in SME*,[46] the 2008 notice regarding state aid in the form of guarantees[47] and, more informally, the *Commission Staff Working Document* on "State Aid Control and Regeneration of Deprived Urban Areas"[48].

5.3.7 The Necessary Elements of State Aid

Under Article 87(1) of the EC Treaty,[49] State aids are prohibited. In order to determine whether State Aid is involved, as discussed in Part I of this Study, the following criteria must be present: (1) an advantage; (2) granted by a Member State or through State resources; (3) favoring certain undertakings or the production of certain goods; (4) distorting competition; and (5) affecting inter-State trade.[50]

Thus, an analysis under each element must be made in order to determine if JESSICA actors and beneficiaries will be receiving State aid.

5.3.8 State Aid: Granted by a Member State or through State resources

In order for Aid to fall within the scope of Article 87(1) of the EC Treaty, the aid must first be granted directly or indirectly through State resources and must be imputable to the State.[51] Funds derive from the State if they come directly from the State's budget, from resources directly or indirectly controlled by the State, or from resources used by a public

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giving Member States, companies and other interester parties legitimate expectations that the Commission must uphold. Soft law instruments enacted by the Commission perform a post-law function (in this sense, Linda Senden, *Soft Law in European Community Law*, Hart, 2004, pp. 118-121 e 181). Whatever the value one gives to Commission positions, it is recognized that these acts are not capable of creating «*any obligations in addition to the existing Community legislation*» (L. Senden, *Soft Law*, cit., pág. 298). For others, however, lacking a general competence by the Commission to enact such acts, they could perform a influencial function (Triantafyllou, *Des Compétences d'attribution au domaine de la loi. Etude sur les fondements juridiques de l' action administrative en droit communautaire*, Bruylant, Bruxelles, 1997, pp. 345 e 368-376).

46 OJ, C 194, of 18.8.2006. Aid in form of risk capital is dealt with by article 29 of Regulation (EC) 800/2008.

47 OJ, C, 155, of 20.6.2008, pp. 10.

48 The 1996 Guidelines were repealed by the Commission in 2002 (OJ, Although informal Commission documents are unable to confer to the Commission's interpretation of any given rule a «caractère communautaire authentique» (see ECJ decision of 18.6.1970, *Hauptzollamt Bremen-Freihafen contre Waren-Import-Gesellschaft Krohn & Co.*, proc. 74/69, Rec., 1970, pp. 451).

49 See Article 87(1) of the EC Treaty.

50 BELLAMY & CHILD, *European Community Law of Competition*, (2008), 1504.

51 See Case C-379/98 *Preussen Elektra AG v Schleswag AG* (2001) ECR I-2099, (2001) 2 CMLR 833, (2001) ALL ER (EC) 330.

company which have particular financial relations with the State. Thus, the use of a public undertaking's own resources can constitute State resources if the State has control over it.[52]

Also, the presence of State resources does not require the actual transfer of resources to an undertaking.[53] For example, a waiver of tax revenues will involve State resources even though there is no transfer of resources.

Moreover, the aid must also be imputable to the State to constitute State aid. For examples, a measure cannot be imputed to the State where the State is merely implementing Community legislation, even if State resources are involved.[54]

Under JESSICA, it is clear that a portion of the project's funding originates directly from a Member State's resources. In addition, the funding is imputable to the Member State since it voluntarily implemented JESSICA. Thus, it is not merely carrying out EC legislation. However, even though JESSICA is being directly co-funded through State resources, this fact alone is insufficient to consider it State aid, since all the elements of the State aid concept must be present: the funds must also constitute an advantage to selective companies which distorts competition and affects inter-State trade. These other factors are discussed in turn below.

5.3.9 State Aid: An advantage

Article 87(1) of the EC Treaty applies to aid whatever form it assumes. Aid is any advantage granted by, or through, the State which would not have otherwise been enjoyed by the favoured company or sector, thus distorting or threatening to distort competition and affecting inter-State trade.[55] In other words, State aid is given when an undertaking receives an economic advantage which it would not have obtained under normal market conditions.[56]

Advantages encompass any grants, subsidies, loans or guarantees given by the State whereby the State fails to collect the funds back without any objective reason. Therefore, an aid is defined by reference to its effects:

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52 See C-482/99 *France v Commission (Stardust Marine)* (2002) 2 CMLR 1069, par. 54.

53 BELLAMY & CHILD, *European Community Law of Competition*, (2008), 1515; also *Stardust Marine*, par. 36.

54 *Op. cit.*., 1516.

55 Case C-387/92 *Banco Exterior de España v Ayuntamiento de Valencia* (1994) ECR I-877, (1994) 3 CMLR 473, par.12; and Case 173/73 *Italy v Commission (Aids to the Textile Industry)* (1974) ECR 709, (1974) 2 CMLR 593, par.13.

56 See Case C-39/94 *SFEI and Others* (1996) ECR, I-3547, par. 60; also Case C-342/96 *Spain* v *Commission* (1999) ECR, I-2459, par.41

the decisive criterion is not the form that the intervention takes, nor of course, its legal nature or the aim it pursues, but rather the result to which it leads.[57] Therefore, the Commission always seeks to establish whether the State action can be justified on objective commercial criteria, or otherwise consider it State aid.

Under JESSICA, funds allocated from the Operational Programme to the Holding Funds, from the Holding Funds to the UDFs or from any of the former to private undertakings, will not constitute State aid as long as the investment is commercially justifiable in the sense that a private investor in a similar position would adopt an equivalent measure.[58] In other words, State aid rules will not be implicated provided that the investments are under normal market conditions and do not improve the financial position of the recipient(s), or reduce the costs, which the recipient(s) would have otherwise borne. For that reason, the lending of funds to the projects must be at no advantage, and hence must be at market conditions.

For JESSICA, the crucial component will be the private investors who are expected to contribute to the urban development projects. This is crucial because State aid is usually found when the terms on which funds have been provided go beyond those that a private investor would find acceptable when providing funds to a comparable private undertaking ("the private investor principle").

For example, in *Chronopost v Ufex and Others*[59], the ECJ found that the compensation paid by SFMI-Chronopost (an express courier services company) to La Poste (French incumbent postal operator) was not State aid. UFEX, a French trade association, complained that SFMI-Chronopost allegedly benefited from unfair advantages because the price paid for the use of La Poste's postal network was, in their view, not in accordance with normal market conditions. The ECJ, however, found the price paid "was comparable to that demanded by a private holding company or a private group of undertakings not operating in a reserved sector, pursuing a structural policy – whether general or sectorial – and guided by long term prospects," and thus did not constitute an advantage within the meaning of Article 87(1).[60]

However, it has been shown in a previous study that if resources of the private investors are returned to the private investors with "asymmetrical profit distribution in favour of the private investor (which is

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57 BELLAMY & CHILD, *European Community Law of Competition*, (2008), 1503; *Italy v Commission* (n 26 supra) at par. 22.

58 See Case T-36/99, *Lenzing v Commission* (2004) para149-150

59 THOMAS MULLER, «Efficiency Control in State aid and the Power of Member States to define SGEIs», *European State Aid Quarterly*, Vol. 8, n. 1, 2009, page 41.

60 Joined Cases C-341/06 P and C-342/06 P (2008) at par..41

permissible following article 43 paragraph 7 of the Implementation Regulation [Regulation (EC) 1828/2006]), the type and amount of the distribution must conform to EU State aid law"[61].

Thus, for JESSICA to fulfil the private investor principle, it is vital to look, first, at the conduct of the investors and whether they are placing their capital in the urban development projects with the prospect of long-term profitability. If an investment by the State in the UDFs, or in the urban development projects, is accompanied by an investment on the same terms by one or more private investors, then it is unlikely that the injection of funds by the Member State to the JESSICA projects will be considered State aid.

In short, there are two types of advantages: the first type is measures to attain particular economic and social objectives of a Member State, and the second type is measures which are commercially justifiable in the sense that a private undertaking or investor in a similar position would adopt an equivalent measure.[62] The latter type is generally not State aid. Hence, with "advantages," the Commission is looking for an objective justification for why the State granted aid to an undertaking. The State action must be commercially justifiable as being within the "normal course of business" to avoid being considered as an "advantage." In other words, if the State acts as a rational private investor in the market, then the State is not providing a State aid.

5.3.10 State Aid: Favouring certain undertakings or the production of certain goods

Under Article 87(1) of the EC Treaty, an advantage given by a Member State must also favour certain undertakings or the production of certain goods in order to qualify as State aid. In other words, Article 87(1) refers only to aid given to certain undertakings or economic entities.[63]

Thus, the aid must be selective, benefiting some undertakings or economic activities and excluding others, for example, only to one or more specified undertakings or only to undertakings in a particular sector or industry.[64] On the other hand, even if the State is not selective in terms of sector, industry, or by reference to a restricted category of undertakings, general measures may still qualify as State aid if the State is granting aid on a discretionary basis. The State could be discretionary, for instance, in the

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61 *Urban Development Funds in Europe - Ideas for implementing the JESSICA Initiative*, Preliminary Draft 16.09.2008, page 16.

62 BELLAMY & CHILD, *European Community Law of Competition*, (2008), 1504.

63 BELLAMY & CHILD, *European Community Law of Competition*, (2008), 1517.

64 *Op. cit.*.

selection of beneficiaries of the aid, the amount of the aid, and the conditions under which the aid is provided.[65] Furthermore, issuing a preferential interest rate could qualify as State aid as well.[66]

Consequently, not all measures of public support, even those that may involve subsidies, are necessarily classified as State aid. Normally, aid will not be regarded as State aid when it applies to all companies regardless of their industry or sector.[67] Thus, in order for the aid to escape Article 87(1) prohibition it must be a general measure.

Hence, for JESSICA to escape Article 87(1) its application must be general, without any discriminatory effect among undertakings and its benefits should be made available to any undertaking[68].

JESSICA, therefore, differs from measures such as the one involved in *Essent Netwerk Noord BV and Others v Aluminium Delfzijl BV and Others* where the surcharge, levied on imported electricity transmitted, paid to SEP was aid found to favour only the domestic electricity generating sector and, for that reason, was considered State aid. The sums received by the surcharge offset the burden borne by the domestic electricity transmitted, and therefore was selective.[69]

Thus, aid that is selective and favours only certain industries is State aid. Alternatively, aid measures aimed at the general promotion of the social and economical values horizontally valid and being applied to all undertakings in a given Member State will not be caught by the State aid rules because they help to sustain the economy as a whole and benefit all enterprises without distinction. However, funding by Holding Funds or UDF to certain projects may give the private undertakings beneficiaries – either primary beneficiaries (like banks, promoters, etc.) or secondary beneficiaries (the private undertakings that will perform a project/plan) – a specific advantage that will be qualified as state aid.

5.3.11 State Aid: Distorting competition

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65 *Op. cit.*.1518.

66 *Op. cit.*.1518.

67 *Op. cit.*., 1517.

68 According to the Commission's *Vademecum* on regeneration of urban deprived areas now in force, investment in infrastructures, renewing or upgrading of residential areas or properties (if the funding is made available to «the owner/occupiers of the new or renewed dwellings in question», aid to individual shops and enterprises exercising a pure local activity, are not to be considered as state aid. Furthermore, and evidently, if the *de minimis* thresholds are not surpassed, even a State aid measure should not be notified.

69 Case C-206/06 *Essent Netwerk Noord BV and Others v Aluminium Delfzijl BV and Others* (2008) at par.71 & 87.

For aid to be caught under Article 87(1), it must also be capable of distorting competition. The test is whether the aid is liable to distort competition and not whether competition has actually been distorted.[70] Also, small effects on trade are sufficient to conclude them as distortions. Thus, a measure favouring certain undertakings or constituting an advantage which the recipient undertaking would not have obtained under normal market conditions is normally found to be at risk of distorting competition.[71]

Thus, in order for JESSICA to avoid distorting competition it must not favour certain undertakings and cannot grant an advantage which the recipient undertaking would not have obtained under normal market conditions. Companies must be able to obtain equal treatment so as to avoid giving selective treatment, and therefore causing a competitive distortion.

In *Regione Autonoma Friuli Venezia Giulia v Commission* the ECJ found that the aid in question reduced the normal costs of undertakings in a specific sector (commercial road haulage) in a specific region (the Friuli-Venezia Giulia Region) and therefore a state of affairs considered to most likely cause a distortion of competition.[72] Therefore, so long as JESSICA grants funding on an unselective basis, creating an open opportunity for co-financing parties, to participate in urban development projects, then competition will be preserved.

Moreover, competition will be maintained so long as all funding will be granted to the projects under terms that do not differ from those that an undertaking acting under normal market conditions would offer, for example, loans at market rates of interest. Furthermore, the funding to the projects are not grants, and for that reason, they must be re-paid. Requiring repayment of all funding under market conditions would not amount to be offering a distorted advantage, because the similar funding at the same terms would be obtainable in the normal market. In the alternative, any preferential conditions would entail a State aid analysis under the applicable EC legislation.

5.3.12 State Aid: Affecting inter-State trade

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70 BELLAMY & CHILD, *European Community Law of Competition*, (2008), 1520.

71 BELLAMY & CHILD, *European Community Law of Competition*, (2008), 1521; see also Case C-451/03 *Servizi Ausiliari Dottori Commercialisi v Calafiori* (2006) ECR I-2941, (2006) 2 CMLR 1135, paras 51-71.

72 See Case T-288/97 *Regione Autonoma Friuli Venezia Giulia v Commission* (2001) ECR II-1169 par.42.

Lastly, aid that affects, or is capable of affecting, trade between Member States also falls within Article 87 (1).[73] Thus, aid granted to an undertaking must be analyzed to determine the effect the aid is likely to have on inter-State trade.

To affect inter-State trade, the basic requirement is that the aid strengthens the position of an undertaking compared with other undertakings in intra-Community trade.[74] Therefore, the two conditions, namely that trade between Member States must be affected and competition distorted, are as a general rule inextricably linked. As the ECJ stated in *Philip Morris* v *Commission*, "when State financial aid strengthens the position of an undertaking compared with other undertakings competing in intra-Community trade, the latter must be regarded as affected by that aid."[75]

Therefore, JESSICA has the best opportunity to escape being considered as affecting inter-State trade if it preserves intra-State competition. In other words, if the other elements under Article 87(1) are not satisfied, such as no selective advantage has been granted and no distortion to competition, then JESSICA would not be considered to be an affect on inter-State trade.

Also, it is not significant that the aid recipient is not itself engaged in inter-State trade.[76] When aid is granted, this may maintain or increase domestic production of a product, thus reducing the opportunities for undertakings established in other Member States to export to the market of that Member State.[77] Thus, JESSICA does not actually have to be trading between Member States to be considered as affecting inter-State trade.

5.3.13. Possible applicability of Block Exemptions to JESSICA

As described above (point 5.3.5), the Commission has recently adopted a general block exemption regulation concerning State aid (Regulation (EC) nr. 800/2008), which allows for State aid to be conferred to

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73 Case 102/87 *France v Commission (FIM)* (1988) ECR 4067, (1989) 3 CMLR 713, where the ECJ held that a subsidised loan to a French brewer was capable of affecting trade between Member States and distorting competition where that undertaking's products competed with products coming from other Member States even if the aided undertaking did not itself export its products.

74 Case 730/79 *Philip Morris v Commission* (1980) ECR 2671, par. 11.

75 Case 730/79 *Philip Morris* v *Commission* [1980] ECR 2671, par. 11-12.

76 BELLAMY & CHILD, *European Community Law of Competition*, (2008), 1522; also Case C-66/02 *Italy v Commission* (2005) ECR I-10901, par. 77.

77 Case T-55/99 *CETM v Commission* (2001) ECR II-3207, par.86; Case 102/87 *France v Commission* (1988) ECR 4067, par. 19.

undertakings without having to be previously notified and approved by the Commission.[78]

JESSICA plans to promote sustainable investment, growth and jobs in urban areas. The selection of projects which may, for example, be funded are: urban infrastructure in the sectors of ports, water, sanitation, energy, etc.; rehabilitation of abandoned industries; office space for SMEs and/or the sectors of IT and R&E; components of historical or cultural for tourism or other sustainable purposes; university buildings; social housing[79], and better energy efficiency.

Each of these projects has a possibility of falling into the block exemption. However, this could only be analysed in the light of the criteria laid down in Regulation (EC) nr. 800/2008 to make sure that the aid both leads to new activities that would not have otherwise have taken place, and promote economic development without unduly distorting competition. In particular the aid element should also be transparent[80] and comply with the specifics of the Regulation and guidelines, so that no questions should emerge or, even emerging, that the criteria for obtaining an authorisation are met, regarding a sound justification, an overall beneficial balance of the projects and an aid element strictly proportional to the goals to be achieved.

These conditions and requirements are laid down in Community legislation and guidelines that determine eligible beneficiaries, sets maximum aid intensities, defines eligible expenses and may also include additional conditions for certain aid measures.[81]

If the non-notification criteria laid down in the applicable legislation are not met, the aid schemes must be notified to the Commission, accompanied by the *rationale* of the projects and measures at stake, so that the Commission may appreciate the elements of aid prior to their enforcement.

5.3.14 The Need for a Concrete Assessment of State Aid Compliance

Under State aid law, JESSICA's regime requires a comprehensive analysis and review in order to ensure JESSICA's substantive and

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78 BELLAMY & CHILD, *European Community Law of Competition*, (2008), 1500; also http://ec.europa.eu/competition/state_aid/legislation/block.html.

79 If it is performed as a service of general economic interest (SIEG).

80 See Kristyna Deiberova/ Harold Nyssens, «The new General Block Exemption Regulation (GBER): What Changed?», *European State Aid Law Quarterly*, Vol. 8, n. 1, 2009, pp. 31-32.

81 See Guidelines at http://ec.europa.eu/competition/state_aid/legislation/block.html.

procedural structure are within complete compliance with Article 87 of the EC Treaty and the secondary legislation. This comprehensive analysis is required for the projects applying and receiving JESSICA funding to determine if they are in conformity with State Aid rules and prohibitions. However, since the final structure of JESSICA in Portugal is yet to be determined, only the preliminary analysis was possible at this stage. Hence, a more concrete assessment of State aid compliance will be required of each project once details of the projects themselves are formulated and resolved[82].

5.4 Unequal treatment of investors

Article 43 (7) of Regulation (EC) 1828/2006 allows for uneven rights between investors in UDF - *inter alia*, between public and private parties.

This aspect of JESSICA's legal architecture does not raise any issue under Portuguese Law. In fact, the investment instruments to be used clearly accommodate the possibility of different rights to co-investors.

On the one hand, the investment in shares, for instance, can be made through the issuance of shares of different classes – which is allowed under the Portuguese Corporation Act[83].

On the other hand, investment funds can have different classes of investment units[84].

Lastly, loans are based in contracts, which may shape differently the rights of each financing party, according to the general principle of contractual freedom of parties[85].

However, regarding the measure to which public investment is treated differently, the constraints derived from the prohibition of State aid, discussed above[86], must be strictly complied with.

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[82] A full list of Commission approved urban regeneration measures until 2006 can be found in the Commission Staff Working Document "State Aid Control and Regeneration of Deprived Urban Areas". According to the Interservice Group on Urban Development of the Commission paper "The urban dimension in the other Community policies for the period 2007-2013" (available at http://ec.europa.eu/regional_policy/sources/docgener/guides/urban/index_en.htm), the *vademecum* "is purely informative and does not create a new urban regeneration State aid policy but serves as a guide for practitioners in the field" (page 11).

[83] Articles 24 and 302 Companies Act, approved by Decree-Law n. 262/86, 2 September 1986.

[84] Article 7 n.. 3 of Decree-Law n. 252/2003, 17 October, and article 4, n. 3 and 60 s) of Decree-Law n. 60/2002, 20 March. See generally PAULO CÂMARA, *Manual de Direito dos Valores Mobiliários,* (2009), at 183.

[85] Article 405 Portuguese Civil Code.

[86] See supra, 5.3.

5.5 Competition Law constraints

5.5.1 In general

This section deals with the conformity of JESSICA's implementation in Portugal with Competition law, both at national and at European level. The relevant sources for this analysis are, respectively, the Portuguese Law of Competition (Law 18/2003, of June 11) and Articles 81 or 82 of the European Community Treaty[87].

Any conduct may infringe only national or, simultaneously, national and EC competition law (*double barrier*), as it is long recognized by the European Court of Justice (since *Walt Whilhelm*, in 1969).

As a preliminary remark, it is worth noting, as it is generally perceived, that the concept of undertaking here involved is not legal but of economic nature. Therefore, an undertaking is a *economic unity acting in a market* and, prevailing a functional notion, a conglomerate or a group of companies may constitute a single undertaking for Competition law purposes. For that reason, it is indifferent the legal nature - private, public, cooperative, etc. - or the way it finances itself, in order to qualify as an undertaking or as more than one undertaking. What really matters, according to the ECJ case-law and to article 2 of Law 18/2003 is the economic unity of action in the market and the sole *indirizzo* that one, ten or hundreds of legal persons may show in the market.

For Article 81 of the EC Treaty (and the correspondent Articles 4 and 5 of the Portuguese Competition Law) purposes, the abovementioned notion of undertaking is most relevant, for these provisos are only applicable to coordinated[88] behaviour of two or more undertakings.

Article 4 of Law 18/2003 and Article 81 of the EC Treaty prohibited several forms of collusive behaviour (in the form of agreements, decisions of association of undertakings or concerted practices[89]) which may, by their

[87] State aid law was dealt with separately. See *supra*, 5.3.

[88] Shaun Goodman, *EU Competition Law*, Vol. III, Cartel Law – Restrictive Agreements and Practices between Competitors, (Mario Siragusa/Cesare Rizza, editors), Claeys & Castels, 2007, page 9.

[89] An agreement may be informal; it may be written or oral and is inferred from all the circumstances. For that reason, all which is required between the parties is their joint intention to restrict competition (Case T-41/96 *Bayer v Commission* ('ADALAT') (2000) ECR II-3383, (2001) 4 CMLR 126, (2001) All ER (EC) 1). A mere unilateral action, however, taken by one undertaking without any agreement with another undertaking does not infringe Competition Law (Cases 228 & 229/82 *Ford v Commission* (1984) ECR 1129, (1984) 1 CMLR

object of effect, restrict competition[90] in the market (or on a substantial part of it). However, in order to article 81 EC be applicable there is further the need that the "agreement" sensibly affects the trade between Member States[91].

This being said, it is worth pointing out that all the actors involved in JESSICA that actually act in the market are bound to respect the prohibition of agreements restricting competition. That applies both to private or public financial institutions involved as long as their activities may have a market and of an economic nature.

Therefore, agreements in order to present projects or bids to JESSICA may not include anticompetitive clauses or be applied with anticompetitive purposes or effects.

It must therefore be made clear to applicants and to all undertakings participating in the framework of JESSICA that restrictive practices are not permissible and will, for instance, be severally pursued by the managing structures of JESSICA.

Thus, for example, cooperative joint ventures built to apply to JESSICA may not include the exchange of confidential information[92] and bid rigging (or suspicions of bid rigging) will be considered as a ground to exclude applicants and participants. Also, discrimination will not be allowed and differences in treatment may only be based on objective grounds.

Therefore, the manner in which the financial engineering instruments are implemented to the JESSICA projects or any public-private partnerships must be arranged with pro-competitive behaviour. The investors must offer financing to the JESSICA projects, through capital, loans or guarantees, under normal market conditions. Thus, there can be no combined planning between parties to coordinate financing terms and conditions for JESSICA projects. For that reason, transparency in how financing is provided will be a crucial component to preventing violations of Competition Law.

In short, JESSICA supports the development of participative, integrated strategies between undertakings to tackle the high concentration

649, 16).

[90] An agreement may be informal; it may be written or oral and is inferred from all the circumstances. For that reason, all which is required between the parties is their joint intention to restrict competition (Case T-41/96 *Bayer v Commission* ('ADALAT') (2000) ECR II-3383, (2001) 4 CMLR 126, (2001) All ER (EC) 1). A mere unilateral action, however, taken by one undertaking without any agreement with another undertaking does not infringe Competition Law (Cases 228 & 229/82 *Ford v Commission* (1984) ECR 1129, (1984) 1 CMLR 649, 16).

[91] Commission Notice — *Guidelines on the effect on trade concept contained in Articles 81 and 82 of the Treaty*, OJ, C 101, 27.4.2004, pp. 81.

[92] RODGER & MACCULLOCH, *Competition Law and Policy in the EC and UK*, 2004, 134, 136

of economic, environmental and social problems affecting urban areas. However, the joint efforts of the undertakings within JESSICA must be made to maintain competition, and not to prevent, restrict or distort competition in the market.

5.5.2 JESSICA and abuse of dominant position

Article 82 of the EC treaty (and the similar article 6 of Law 18/2003), on the other hand, prohibits the abuse of dominant positions by one or more undertakings.

Dominant positions are not forbidden and may even be encouraged[93], although the behaviour of dominant firms is analysed in a very strict way, under Competition law. A 'dominant' position is defined as the "position of economic strength enjoyed by an undertaking which enables it to hinder the maintenance of effective competition on the relevant market by allowing it to behave to an appreciable extent independently of its competitors and customers and ultimately of consumers."[94]

In this regard, JESSICA will not, in principle, lead to the creation or reinforcement of dominant positions in the relevant urban rehabilitation markets.

Thus, in determining whether Article 82 has any legal implications which may affect JESSICA requires an analysis of JESSICA's financial engineering. Under JESSICA, the Operational Programmes (OPs), as well as private investors, will contribute funds to support financial engineering instruments for enterprises and for urban developments funds, that is, funds which will invest in public-private partnerships (PPPs) and other urban development projects. The financial engineering instruments can be in the form of venture capital funds, guarantee funds and loans funds. Also, the financial engineering instruments may be organized through holding funds, that is, funds which will be an intermediary vehicle responsible for initiating the investment, or guarantee or loan to enterprises and urban development funds.[95]

Hence, the scope of JESSICA's financial engineering is wide and allows for various financing tools and vehicles to contribute funding in urban development projects. Thus, whichever financial tool or vehicle is chosen for JESSICA it is critical that the conditions, under which funding will be provided, are in complete compliance with the prohibitions set out by Competition Law.

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[93] Case 247/86 *Alsatel v Novasam* (1988) ECR 5987, (1990) 4 CMLR 434, para 23

[94] Case 322/81 *Michelin v Commission* (1983) ECR 3461, (1985) 1 CMLR 282, para 30

[95] The task of managing the holding funds may be assigned to the EIB, EIF or another financial institution.

Examples of abusing a dominant position include: excessive pricing[96], exclusive contracts[97], discrimination[98], predatory pricing[99], and refusal to deal[100]. All of these forms of abuses include the intent to restrict, distort or prevent competition. Thus, it is imperative that the dominant undertakings that may be providing financing to the JESSICA urban development projects avoid unfair terms and conditions.[101] Hence, any financial investment vehicle involved in JESSICA must provide financing in conformity with current market conditions so as to maintain competition in the market. Any divergence from normal market conditions could be viewed as exploitative abuse, which is unfair or unreasonable conduct towards those undertakings that depend on the dominant firm for the supply of goods or services on the relevant market.[102] Therefore, in order to prevent violating Competition Law, the dominant undertakings participating in JESSICA cannot provide any unfair or excessive prices, rates and/or terms which unreasonably diverge from other competitors within the normal market.

Abuses may be of exploitative or exclusionary nature[103], being the latter the economic effect of impeding effective competition on the relevant market, by forcing out existing competitors and/or raising barriers to entry for potential new competitors. However, JESSICA's financial engineering aims at being a very open investment project, excluding no particular undertaking from participating in JESSICA. For that reason, JESSICA would not be restricting any undertaking from participating in the market and, thus, not infringing on prohibitions in Article 82 EC Treaty (or article 6 Law

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[96] "Excessive pricing" may be defined as a price that has no reasonable relation to the economic value of a product or service. It is where the enterprise concerned charges excessively high selling prices or extracts excessively low buying prices.

[97] "Exclusive contracts" refers to any agreement between a supplier and its customer whereby the customer is restrained from dealing with any of the supplier's competitors; See C-279/95 P *Langnese-Iglo GmbH v Commission* (1998) ECR I-05609

[98] "Discrimination" could be, for instance, charging different ***prices*** to different groups of consumers for what is more or less the same good or service

[99] "Predatory pricing" is the reduction of prices below fair market value as a competitive weapon to drive weaker competitors out of the market and attract more customers. Consequently, in a long time the company recoups the losses and accrues monopoly benefits.

[100] "Refusal to deal" includes any agreement which restricts, or is likely to restrict, by any method the persons or classes of persons to whom goods are sold or from whom goods are bought

[101] See Case T-83/91 *Tetra Pak International SA v. Commission* (1994) ECR II-755

[102] BELLAMY & CHILD, *European Community Law of Competition*, (2008), 952

[103] For example, Intel Corporation engaged in illegal anticompetitive practices to exclude competitors from the market by offering rebates and payments to its customers if they only purchased from Intel. Such conduct was viewed by the Commission as preventing customers from choosing alternative products, and therefore an abuse of Intel's dominant position; See IP/09/745 (2009) at http://europa.eu/

18/2003).

In addition, under JESSICA, the financial vehicles and tools chosen to fund the projects will be financed through the structural funds from the OPs, and also co-financed by the EIB, CEB and private investors. Thus, the scope of JESSICA's financial engineering is structured to allow any financial institution to participate to ensure competition remains intact in the market. Also, since JESSICA's objective is to provide funding in a transparent manner, there will be no granting of preferential terms or conditions to some projects, or undertakings, over others.

In sum, JESSICA's financial engineering actions and products could imply Competition Law prohibitions, but as long as JESSICA's financial engineering framework remains as an open and transparent mechanism to invest in urban development projects, it will uphold fair competition in the European market.

However, if a problem of abuse arises, JESSICA's managing bodies must be able to analyse it and, being the case, transmit the suspicions to the Portuguese Competition Authority (*Autoridade da Concorrência*), which is, in this area of law, the entity competent to uphold competition law at national level (Article 14 of Law 18/2003), having also the ability to cooperate with the European Commission within the *European Competition Network*.

5.5.3. Merger Law

It may also happen that undertakings willing to participate in JESSICA concentrate in order to facilitate the conditions to take advantage of the market opportunities provided by JESSICA or may find useful to create full-function joint ventures that may act in one, some or all of the relevant markets. In case these operations constitute a merger subject to previous authorization by the Portuguese Competition Authority or the European Commission (Regulation (EC) nr. 139/2004) and the relevant procedures therein established must be complied with.

5.5.4. The need for a successive degree analysis

Under Competition law, JESSICA's regime requires a comprehensive analysis and review in order to ensure JESSICA's substantive and procedural structure is within full compliance with Articles 81 and 82 of the EC Treaty and relevant provisions of Portuguese Competition law. This comprehensive analysis is required for all projects, at every level, receiving JESSICA funding to determine if they are in conformity with Competition law rules and prohibitions.

However, since the final structure of JESSICA in Portugal is yet to be determined, only a preliminary analysis is possible at this stage. Hence, a more concrete assessment of Competition law compliance will be required once details of the projects themselves are formulated and resolved.

5.6. Limitations deriving from Banking law

According to Portuguese Banking Act[104], only credit institutions and financial companies are able to grant credit on a professional basis.

This rule is a superimposition of Portuguese law in relation to the requirements set out in EU Banking law. According to Article 5 of EU Directive 2006/48/EC, 14 June 2006[105], Member States shall prohibit persons or undertakings that are not credit institutions from carrying on the business of taking deposits or other repayable funds from the public. Portugal, however, has goldplated such rules and extended its exclusive scope also to professional activity of granting credit.

In this context, the legislative notion of credit for this purpose is very large as it encompasses loans and guarantees[106].

However, it should be noted that such exclusion only applies if the credit is granted on a professional basis. The professional nature of the activity is usually considered as covering only regular and for-profit activities[107].

This limitation is relevant for the implementation of JESSICA in Portugal. In fact, the activity of JESSICA is to be considered as continuously exercised.

On the other hand, it is doubtful whether the programme in itself can be considered as a for-profit activity. If there is private capital involved in the fund, it seems clear that market-interest rates would be paid, which would qualify as a for-profit activity. It is even admissible that a general and comprehensive answer would not be possible for every type of fund. Nevertheless, the loans to be granted by UDF's under JESSICA are

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[104] Reference is made to the General Regime on Banking Institutions - *Regime Geral das Instituições de Crédito e Sociedades Financeiras* -, approved by the Decree-Law n. 298/92, 31 December 1992, and subsequently amended.

[105] OJ L 177 30.6.2006, p. 1.

[106] See, e.g., *Livro Branco sobre o Sistema Financeiro*, (1992), 40-42; MENEZES CORDEIRO, *Manual de Direito Bancário*, (2008), at page 786.

[107] See, e.g., CONCEIÇÃO NUNES, *Direito Bancário,* (1994), 160-161, 237-238.

repayable and, as such, such activity risks are being considered as professional, for the purpose of the Banking Law.

Therefore, this rule does operate as a limitation to be observed in terms of the concrete implementation of JESSICA in Portugal.

Once those limitations derive from the law, as a choice from the Portuguese law makers, it seems clear that a legislative derogation of such requirement is possible.

For instance, under current Portuguese legal framework, private equity companies – although loan contracting is within their activity - are not financial companies, as they are allowed under the law to operate as commercial companies, subject however to a special regime.

From this perspective, two main options would be apt to overcome this constraint. The first option is to choose a financial institution as a legal form to UDF's. Alternatively, a special legal intervention would also solve this problem.

III. MAXIMIZING THE BENEFITS REGARDING THE LEGAL ARCHITECTURE OF URBAN DEVELOPMENT FUNDS

6. Optimizing the UDF Legal Form

The following section is aimed at briefly describing the basic features of legal vehicles that might be used for the purpose of setting up the Portuguese UDF. It does not contain an exhaustive description of the corresponding legal regime. The analysis takes into account the existing regulatory landscape, in order to assess the type of legal form that is ideal to suit JESSICA's implementation in Portugal. Finally we will provide a global overview of the Portuguese tax framework related with Corporate Income Tax ("CIT") rules applicable to the implementation of each of the proposed vehicles[108].

Nevertheless, a prospective view on possible future legislative developments is also to be considered. In this respect, it is worth mentioning that in its Plan of Activities for 2009, the Securities Market Regulator (CMVM – Comissão do Mercado de Valores Mobiliários) has announced its intention to promote an autonomous legislative text to deal with Urban Development Funds[109]. The Securities Commission has the opinion that the existing legislation should be adapted to the specificity of UDF's, and

[108] Nonetheless please be aware that part of the activity that will be undertaken by the Portuguese vehicle will be subject to Value Added Tax ("VAT") in Portugal. In fact, bearing in mind that VAT is a European harmonized tax, the rules set out in the Portuguese VAT legislation are generally similar to those which are in force in other EU Member States. The VAT Code establishes that activities regarding the supply of goods, rendering of services carried out in Portuguese territory, import of goods and intra-community acquisitions of goods in Portugal, in an onerous way, by a taxpayer acting as such, are subject to VAT (Article 1, no. 1, paragraph a) of the VAT Code). Furthermore, the Portuguese legislation considers all the operations that cannot be considered as a supply of goods as a rendering of services (Article 4, no. 1 of the VAT Code). In light of the above, individuals and corporate entities undertaking, on a continuous and independent basis, activities, namely carrying out productive, trading, rendering of services, extractive or agricultural activities, shall be considered VAT taxpayers, as the rendered operations are subject to this tax (Article 2, no. 1, paragraph a) of the VAT Code). Please consider that rendering of services includes financial operations. The VAT Code refers the subjection to tax regarding service renderings when made by a resident company (or with by a permanent establishment) in Portugal from which the operations are performed (Article 6, no. 8 of the VAT Code). Therefore, financial operations rendered by a Portuguese company are subject to tax (Article 6, no. 4 in conjunction with no. 5 of the VAT Code). However all the "financial" operations referred in the no. 27 of the article 9 of the VAT Code are exempt from VAT.

[109] See CMVM, *Programa Actual de Actividades*, (April 2009), available at http://www.cmvm.pt/NR/rdonlyres/4CEEF83C-A034-410B-BB69-4A14AF91D39C/11690/ProgramaAnualdeActividades2009.pdf , at page 21.

estimates that the preparatory works of such project will occur during the first semester of 2009[110].

It is important to point out, however, that the UDFs do not raise retail investor protection concerns, as they are tipically aimed at sharing risks at UDF level or co-financing projects with institutional investors.

A. PRIVATE LIMITED LIABILITY COMPANY (*SOCIEDADE POR QUOTAS*)

The private limited liability company is a type of company where the share capital is divided into parts (*quotas*) and the quotaholders – at least two – are jointly liable for all the contributions in the incorporation agreement, though, only the corporate assets answer for the creditors' debts. The initial share capital of this type of company amounts to € 5.000,00.

The choice of the corporate object is entirely free, provided that the economic activity to be performed turns out to be legal, possible, as well as determinable.

Regarding the private limited liability companies' members, please note that they may assume both private and public nature.

The flexibility of such companies is limited, on a first line, by the legal requirements established for the quotas' transfer. As a general rule, the transfer of quotas depends on the company's prior consent and only produces effects towards the company after written communication.

Regarding the financing instruments, a private limited liability company has at its disposal, besides the external financing products (loan, mortgage, financial lease), a wide variety of internal financing procedures, such as: increasing of the share capital, quotaholders loan, accessory payments, supplementary payments and issuance of bonds for private or public offering.

The governance regime of this type of company is also lighter, as it may have but does not involve necessarily a supervisory board[111]. This may affect its ability to serve as an entity aimed at receiving, managing and using structural funds.

The private limited liability company will be considered, for tax purposes, a Corporate Income Tax ("CIT") Portuguese taxpayer and the basis of the CIT due will be the income attributable to such company. In this regard, the company will be taxable in Portugal with respect to the income whether obtained in Portuguese territory or abroad. In general terms, the taxable income of a resident company is obtained by deducting the

[110] Id., *Ibidem*, at page 23.

[111] See article 262 Companies Code, which imposes an auditor only if companies exceed certain size limits.

following amounts from the income attributable to the company[112]: (i) tax losses and; (ii) tax benefits deductible to that income. The taxable basis – which corresponds to the taxable income less tax losses deductible from previous years –is generally taxed at a 25% tax rate, with an additional maximum 1,5% municipal surcharge, leading to a maximum final rate of 26,5%. The determination of the taxable income is based on the taxpayer's annual tax return, which can be controlled by the tax authorities, or, whenever a taxpayer's annual tax return is not presented, as determined by the tax authorities[113]. Finally and as a general rule, the tax year for CIT purposes coincides with a calendar year (i.e. 1 January to 31 December).

B. COMPANY BY SHARES

In companies by shares, the registered capital is divided into shares and each shareholder's liability is limited to the amount corresponding to his contributions. The initial share capital shall amount to € 50.000,00.

A company by shares shall be incorporated by, at least, five shareholders or by two shareholders in the event the State is the majority shareholder.

The shareholders may choose the corporate object under the same terms applicable to the private limited liability companies. Moreover, the companies' members may assume both private and public nature.

In this type of company, once its structure and organization tends to be more complex, it might be even harder to reach the required qualified majority to decide on particular matters. In order to avoid such loss of flexibility the company might issue special shares without voting right.

Finally, in what concerns the financial arrangements, the companies by shares may use any of the procedures mentioned for the private limited liability company.

These types of companies were namely used for the programme POLIS, that aimed at the requalification of specified urban areas (see, e.g., Decree-Law n. 231/2008, 28 November – Polis Litoral Norte – Sociedade para a Requalificação e Valorização do Litoral Norte, S.A.). In that case, however, these companies were entirely public-owned.

In respect of the taxation of the income obtained by companies by shares and considering that the general rules applicable to the taxation of this type of companies are the same that are applicable to the private limited liability companies, please refer to our comments made in the section A above.

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112 Article 15 of the CIT Code.

113 Article 16 of the CIT Code.

C. VENTURE CAPITAL FUNDS

Venture capital companies are a subtype of companies by shares, whose main object consists of the investment in venture capital, as well as the management of venture capital funds. As complementary object, these companies may also carry out the activities deemed necessary to the performance of its main object, in particular the provision of services regarding the technical, financial, administrative and commercial management of the participated companies.

Further to the Portuguese legal framework (Decree-Law no. 375/2007, of 8 November), the above mentioned activities are not classifiable as financial intermediation activities.

The share capital of such companies shall amount to € 250.000,00 in the event the corporate object is limited to the management of venture capital funds or to € 750.000,00 in the remaining cases.

The incorporation of the venture capital companies shall be registered before the Portuguese Securities Market Commission. Such companies shall comply with the regulations approved by the Portuguese Securities Market Commission and are subject to the payment of a supervision rate (cfr. Order no. 913-I/2003, of 30 August). This implies the payment of a fee in the amount of € 2.500,00. Furthermore, such companies are subject to the payment of a monthly supervision fee. The supervision fee amounts to 0,0133 of the total net value of the managed funds registered in the last day of each month and shall not be lower than € 100,00 neither higher than € 10.000,00 (cfr. Order no. 913-I/2003, of 30 August).

The regulatory costs associated with venture capital companies, above described, make it more interesting that the UDF may take the form of a venture capital fund. In this case, it is possible that the management policy is established and monitored by the managing authority. Venture capital funds require an *ex ante* declaration or registration before the Securities Commission (CMVM), according to Decree-Law n. 375/2007, 8th November[114]. A previous declaration will suffice if the venture capital funds are aimed at institutional investors or have a minimum subscription value of € 500,000.

Concerning the taxation of the income obtained by a Venture capital company please consider that the capital gains and capital losses resulting from the sale of shares held, for more than one year, are not accounted for its taxable income, neither are the financial expenses incurred with its acquisition. However, such rule is not applicable if the shares were acquired

[114] See Article 6 Decree-Law n. 375/2007, 8th November.

from related entities, entities domiciled in a black listed jurisdiction, or from Portuguese entities that benefit from a special regime of taxation and were held for less than 3 years.

Should any of the above-mentioned situations occur, the Venture capital company must aggregate capital gains obtained from the sale of shares with its taxable income, thus being subject to a tax rate of 25% with an additional maximum 1,5% municipal surcharge, leading to a maximum final rate of 26,5%.

On the other hand, the income obtained by Venture capital funds incorporated and that operate according to Portuguese legislation is exempt of CIT according to the no. 1 of the Article 23 of the Tax Benefits Code.

D. REAL ESTATE INVESTMENT FUNDS

Real estate investment fund management companies are a subtype of companies by shares, whose object comprises the performance of all the activities and operations required for the appropriate management of the real estate investment funds.

Pursuant to the Portuguese legal framework (Decree-Law no. 60/2002, of 20 March, with the subsequent amendments) the equity capital of real estate investment fund management companies shall not be lower than 0,5% of the total net amount in the event the investment funds managed amount to 75 million euros or lower than 0,1% in the remaining situations.

Moreover, the incorporation of this type of management companies shall be registered before the Portuguese Securities Market Commission and before the Bank of Portugal, being the incorporation procedure extremely burdensome.

During the performance of its activities, the real estate investment fund management company shall comply with the banking regulations issued by the Bank of Portugal, as well as with the financial intermediation regulations, in particular the orders approved by the Portuguese Securities Market Commission and the Portuguese Securities Market Code. These companies are also subjected to the payment of a supervision rate.

The real estate investment fund management companies are subject to the payment to the Portuguese Securities Market Commission of the following fees: registration fee in the amount of € 7.500,00; and supervision fee, which shall amount to € 0,0266 of the total net value of the managed funds registered in the last day of each month and shall not be lower than € 200,00 neither higher than € 20.000,00 (cfr. Order no. 913-I/2003, of 30 August).

These regulatory burdens associated with incorporation of investment funds management companies make it more interesting that the UDF may take the form of real estate investment funds. One should nevertheless take into account that, for open-end real estate funds, the development of rehabilitation projects cannot account for more than 60% of the investment of the fund. Such limitation does not apply in case of a closed-end real estate funds[115].

One of the most important features of this structure lies in the fact that real estate investment funds are subject to a favourable tax treatment if at least 75% of their assets are invested in urban regeneration, as described in the table below[116].

The regime presented below is applicable to Investment Funds – namely to Real Estate Investment Funds - incorporated and that operate according to Portuguese legislation. Please note that, as a general rule, this type of Funds is subject to CIT, but benefit from the special tax regime set out in the no. 6 of the Article 22 of the Tax Benefits Code. Thus, income obtained in Portuguese territory is subject to the following taxation: (i) in case of real estate property income will be subject to a flat rate of 20% on the net (of maintenance and conservation expenses, both duly documented) amount obtained in each year, which must be paid to the State by the end of April of the year following that to which the income relates; (ii) in case of real estate capital gains at a flat rate of 25% on 50% of the difference between the capital gains and the capital losses obtained in each year; (iii) in case of other types of income, if are not capital gains, the taxation will be made by withholding tax at source in the same conditions as those applicable to resident individuals; if it is a type of income that is not subject to withholding, the taxation will be made at a flat rate of 25% on the net amount obtained in each year, which must be paid to the State by the end of April of the year following that to which the income relates, by the fund management company.

It is relevant to mention that two Real Estate Regeneration Investment Funds have already been authorized by the Portuguese Securities Commission, during the course of this year, managed by the banking groups MNF (Príncipe Real – Fundo de Reabilitação Urbana) and Caixa Geral de Depósitos (Social Invest). Other Real Estate Regeneration Investment Funds have been incorporated in the past, managed by Orey Antunes and BES[117].

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[115] Articles 38 and 46 of Decree-Law n. 60/2002, 20th March.

[116] See Article 71 of the Special Tax Benefits Regime (*Estatuto dos Benefícios Fiscais*), as approved by Decree-Law n. 215/89, 1 July, and subsequently amended.

[117] Source: CMVM.

Therefore, although the new Regeneration Law allows for real estate regeneration investment funds, the permission to manage such funds is already clear under the current legislative framework.

Lastly, it is important to note that Real estate investment funds should fall under JESSICA's eligible instruments. The reference made in Regulation (EC) 1083/2006 to capital investment is to be regarded functional and allowing UDFs to investments with a high degree of risk. Therefore, that expression should be interpreted as to also include real estate investment funds, whose risk involved is mitigated, regardless of the nature of the fund (contractual or corporate form).

Tax benefits applicable to Urban Regeneration Funds

On the one hand, the incomes obtained by real estate investment funds, which have been constituted between 1 January 2008 and 31 December 2012, are exempted from corporation tax (IRC) provided that no less than 75% of the total assets are immovable assets object of urban regeneration operations. Furthermore, the incomes deriving from participation units in such funds are subject to income tax (IRS) and corporation tax (IRC) deduction at source, at a rate of 10%, excluding, as a general rule, the cases where its holders are entities free of tax in investment income or non resident entities without a permanent establishment in Portugal.

In addition, the capital gains arising from the transfer of participation units in the above mentioned funds are taxable at a rate of 10% in the event non resident entities not subjected to tax exemption or taxpayer residing in Portugal (whose incomes are not related with the performance of a commercial, industrial or agricultural activity) do not adhere to the aggregation option.

On the other hand, 30% of the charges borne by the owner regarding the regeneration of immovable assets located at "urban regeneration areas" and of leased immovable assets which have been restored are deductible from income tax (IRS), up to the amount of € 500,00.

Furthermore, the capital gains and the incomes from property obtained by an income tax (IRS) taxpayer resident in Portugal are taxable at a rate of 5%, without prejudice to the aggregation option in specific cases.

With regard to municipal tax (IMI), the restored urban properties are free of tax during five years as from the date of the regeneration's conclusion. Such exemption might be renewed for an additional term of five years.

Finally, the first purchase of an urban property or of its autonomous units, on a payment basis, for housing purposes is exempted from municipal transaction tax (IMT), provided that located at an "urban regeneration area".

E. JOINT ENTERPRISE AGREEMENT

A joint enterprise agreement is an agreement with legal personality under which terms its members – persons or collective entities and companies – undertake to cooperate in order to achieve an improvement of the performance's conditions and results of their economic activities.

According to the Portuguese regime – Law no. 4/73, of 4 June and Decree-law no. 430/73, of 25 August –, the obtaining and sharing of profit might only be an accessory purpose, provided that expressly foreseen in the incorporation agreement.

A joint enterprise agreement might be entered into by both private and public entities. Please note that the participation of the members in the agreement, with or without equity capital, shall not be represented by marketable securities.

As a general rule, the members of a joint enterprise agreement are jointly liable for its debts.

With regard to the financing vehicles, a joint enterprise agreement might issue bonds, provided that all its members are company by shares.

The joint enterprise agreement's legal capacity shall not comprise the following activities: acquisition of property right or others rights in rem, except the purchase of an immovable asset for its registered office; participation in other civil or commercial companies or in other joint enterprise agreements; or performance of functions in any company, association or joint enterprise agreement.

In this type of agreement, the transfer of a member's position, *inter vivos* or post *mortem*, shall only operate jointly with the transfer of the corresponding establishment or enterprise. Furthermore, the acquisition of the member's quality depends on the prior consent of the joint enterprise agreement.

A joint enterprise agreement is subject to the tax transparency regime[118] which, in general terms, foresees that the taxable income will be determined according to the rules of the CIT Code that we generally referred in the section A above. The referred taxable income will be directly attributed to the joint enterprise members. If such members are individuals the result will be taxed according to the rules foreseen in the Personal Income Tax Code. On the other hand, if the joint enterprise member is a company or a collective entity, that result will be taxed according to the rules foreseen in the CIT Code.

F. EUROPEAN JOINT ENTERPRISE AGREEMENT

[118] See no. 2 of the Article 6 of the CIT Code.

A European joint enterprise agreement is an agreement with legal personality, similar to a joint enterprise agreement, whose purpose is the improvement or increase of the economic activity of its members. Thus, the performed activity shall be inherent to the economic activity of its members, representing a complementary activity.

Pursuant to the European regime (Regulation CEE no. 2137/85 from the Council, of 25 July), a European joint enterprise agreement shall not control the performance of its members' activities, namely in what regards the employees, accounts and investments, or hold any participation in its members. Moreover, this legal form shall not be used by a company to grant loans or to transfer assets, unless it is under the exact terms foreseen in the legislation of the Member States.

Please note that in what regards certain matters – for instance, alteration of the agreement's purposes or of the members' obligations –, the decisions shall be unanimously taken by the members.

The members of the European joint enterprise agreement are personally and jointly liable for all its debts, regardless of their nature.

Furthermore, the transfer of the participations is subject to prior authorisation by all the members of the agreement. Such authorization is also required for the constitution of any guarantee over the participations, unless otherwise foreseen in the agreement. The holder of the guarantee shall not become a member of the agreement.

One of the most important financing instruments is the issuance of securities for particular offering. However, the European joint enterprise agreement is impeded to appeal to public investment.

Finally, in what regards the tax regime, the profits or losses arising from the activity's performance shall only be taxable directly to its members.

A European joint enterprise agreement is also subject to the tax transparency regime; thus, please see our comments in the section E above.

G. PORTFOLIO MANAGEMENT

A different option that has to be assessed is to entrust a credit institution with the function of managing the fund.

Portfolio management is an investment service whereby a sum of money or financial instruments is invested according to the specified and contracted goals.

In this case, the UDF would have no legal personality and technically the funds under management would remain as property of the Holding Fund.

The portfolio manager is normally in charge of project selection, financial analysis, plan implementation and ongoing monitoring of investments.

In respect to the income obtained by company which will provide the Portfolio management, please be aware that its taxation will depend on the type of company that will manage the portfolio. Nevertheless, and for a general overview, please refer to our comments made in the section A above.

I. PUBLIC LAW FORMS

Further to the above referred private law forms that an urban development fund may adopt, it is also adequate to consider under this analysis some public law forms that may also be adopted for the same purpose, although with different consequences as referred to below.

Among public forms, we will refer to public institutes, public associations, public foundations and public enterprises.

I. PUBLIC INSTITUTE

Public institutes[119] correspond to entities belonging to the state administration that have indeed an autonomous personality. Public institutes may only be created for the development of duties and competences that advise management that is not submitted to the Government direction, because of their technical specificity mainly in the sector of generation of rendering goods and services. Public institutes shall be created by a legal instrument, which approves its statutes and its specific regime. Usually public institutes have national territorial field of application.

Public institutes are subject to supervision and tutelage powers of the Government. Tutelage means the control of legality or, in certain cases, a judgement opportunity on the actions of certain entities. The power of supervision consists in the power to review, confirm, modify or revoke the actions undertaken by the supervised bodies or services.

Public institutes that are legally authorized to development funds financing management activities may proceed to applications in funds[120].

The estate of a public institute is a public and private entities and may not participate in public institutes.

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[119] The principles an rules that govern the legal regime of public institutes are set out in Law n. 3/2004, of January 15th.

[120] See article 13, n. 2, of Law n. 3/2004, of January 15th.

Public institutes, as public law entities, are generally subject to public law provisions, namely regarding administrative procedure, public procurement rules, jurisdiction, financial control, civil liability regime.

The public institutes are exempt from CIT according to the paragraph a) of the no. 1 of the Article 6 of CIT Code. However this exemption is not applicable to the capital gains obtained by the public institutes (no. 2 of the Article 6 of CIT Code).

II. PUBLIC FOUNDATION

Law n. 3/2004, of January 15th, which establishes the general regime for public institutes, also refers to public foundations as funds with legal personality[121], which have a similar legal regime as public institutes. It is correct to say that public foundations "are basically anchored in its assets, exist to manage it and live of its results"[122]. Public foundations are a group of public assets that are related to the prosecution of some special public purposes and objectives. In order to a public institute to be considered a public foundation, a significative part of its revenue shall arise from its assets which are dedicated to the special public purposes.

Public foundations are created by law, governed by Public law, and its regime is not designed to admit private participations. Like public institutes they are also subject to supervision and tutelage powers of the Government.

The public foundations are exempt from CIT according to the paragraph a) of the no. 1 of the Article 6 of CIT Code. However this exemption is not applicable to the capital gains obtained by the public institutes (no. 2 of the Article 6 of CIT Code).

III. PUBLIC UNDERTAKING (dominated either by the State or by local municipalities)

Another public entity, although much closer to a private law regime than the entities analysed above, are public undertakings.

It is important to stress that, according to the present legal regime of public enterprises[123], they may adopt both a public or a private law form,

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[121] See article 3, n.2.

[122] See DIOGO FREITAS DO AMARAL, *Curso de Direito Administrativo*, I, 3rd edition, Coimbra, p. 373.

[123] See for the state public enterprises, Decree-Law n. 558/99, of December 17th, and for local public enterprises, Law n. 53-A/2006, of December 29th.

provided they comply with the definition of public undertaking therein foreseen.

According to such legal instruments, public undertakings (either State or local) are undertakings which the State or the municipalities (as the case may be) may exercise directly or indirectly a dominant influence by virtue of their ownership of it, their financial participation therein, or the rules which govern it.

A dominant influence on the part of the contracting authorities shall be presumed when these authorities, directly or indirectly, in relation to an undertaking:

- hold the majority of the undertaking's subscribed capital, or
- control the majority of the votes attaching to shares issued by the undertaking, or
- can appoint more than half of the undertaking's administrative, management or supervisory body.

The criterion for an undertaking to be included in the public sector is, in line with EC law, the dominant influence of the public entities.

The regime of such undertakings is anchored on private law, although there are several provisions in the legal instruments referred to above that derive from public law and are applicable to such undertakings. As already mentioned, most of these entities may be considered a "body governed by public law" for purposes of application of public procurement rules.

Only public undertakings that assume public law form need to be created by legislative instruments and such undertakings may not be participated by private entities. Public undertakings that adopt private law form are created according to the public law regime, although they are subject to public law requirements established in the laws that set out the legal regime for public enterprises and may be subject to some other public law requirements foreseen in specific legislation (namely public procurement rules).

Public undertakings are generally subject to supervision and tutelage powers by the Government, which are stronger in case of public undertakings that adopt a public law form. If public undertakings are private law companies their Government control is mainly conducted through its shareholding rights, by which the public shareholder shall implement the strategic directives issued by the Government to the State undertakings sector or to that specific public undertaking.

In respect of the taxation of the income obtained by public undertakings - and considering that this type of companies are excluded of the exemption regime foreseen in the paragraph a) of the no. 1 of the Article 6 of the CIT Code -, please refer to our comments made in the section A above.

J. SUMMARY

There is no single best model to shape UDF's in Portugal. As seen, the legal form to be adopted by UDF's can be chosen out of a variety of options.

The vehicle can have legal personality or just be a separate block of finance within a financial institution. The main legal forms to be considered, as the more flexible forms that seem to better accommodate JESSICA's structure, are the following:

- Private company or company by shares;
- Public undertaking (dominated either by the State or by local municipalities)
- Separate funds (including real estate investment funds) managed by credit institutions, venture capital companies or investment fund management companies.

Moreover, it is possible that UDF's have different legal forms within the same jurisdiction; to the extent, of course, that those legal forms are permitted.

Both Private Law and Public Law forms are possible. The choice of legal form depends, *inter alia*, on:

- Financing technique adopted (loans, guarantees, equity or others);
- Degree of private co-investment and on whether private parties co-invest at the level of the UDF or at the level of each project.

This permitted diversity of UDF legal forms suits perfectly the conclusions of the Evaluation Study concerning the implementation of JESSICA in Portugal[124], which point out potential JESSICA projects with different structures and diverse sources of funding.

Among the various Public law forms, the value-added that can be contributed by JESSICA deployment when compared to existing institutional solutions for promoting and funding urban regeneration, e.g. via Sociedades de Reabilitação Urbana (SRUs) is considerably greater in public undertakings, as this accommodates the possibility of private investment, which does not occur in other Public law types of structure or in SRU's[125].

[124] See *supra*, 1.3.

[125] A description of the legal regime of SRU's can be found in Annex 1 of this Report.

These findings are summarised in the following Table:

LEGAL FORM	COMPATIBILITY OF PRIVATE INVESTMENT	PUBLIC PROCUREMENT REQUIREMENTS	REGULATORY FLEXIBILITY	TAX TREATMENT
PRIVATE LIMITED LIABILITY COMPANY	Fully compatible	Only in case it is a "body governed by public law"	Legal intervention required to grant credit or guarantees	Regular
COMPANY BY SHARES	Fully compatible	Only in case it is a "body governed by public law"	Legal intervention required to grant credit or guarantees	Regular
VENTURE CAPITAL FUND	Fully compatible	Only in case it is a "body governed by public law"	Require a previous declaration before the Securities Commission	Attractive
REAL ESTATE INVESTMENT FUNDS	Fully compatible	Only in case it is a "body governed by public law"	Require a previous registration before the Securities Commission	Attractive
JOINT ENTERPRISE AGREEMENT	Fully compatible	Only in case it is a "body governed by public law"	Legal intervention required to grant credit or guarantees	Regular
EUROPEAN JOINT ENTERPRISE AGREEMENT	Fully compatible	Only in case it is a "body governed by public law"	Legal intervention required to grant credit or guarantees	Regular
PORTFOLIO MANAGEMENT	Fully compatible	Only in case it is a "body governed by public law"	None	Regular

PUBLIC INSTITUTE	Non -compatible	Yes	Subject to supervision[126] and tutelage[127] of the Government	Regular
PUBLIC FOUNDATION	Non-compatible	Yes	Subject to supervision and tutelage of the Government	Attractive
PUBLIC UNDERTAKING	Compatible in private law form	Only in case it is a "body governed by public law"[128]	Subject to supervision and tutelage of the Government	Regular

6.2 Minimizing the negative effects of public procurement rules

It follows from what was written above, regarding the public procurement requirements of JESSICA structure, that, compared with the European directives, the Portuguese national law establishes a more detailed and stricter regime. Therefore, the analysis concerning the legal structures that allow a minimum set of public procurement limitations will be set down on CCP.

Considering the above mentioned regarding the holding fund and the circumstance that the Portuguese State has already signed with the EIB a funding agreement, the negative effects of public procurements rules are focused on the urban development funds.

Regarding public procurement requirements, the terms under which the contracting authorities are allowed to contract are much lighter and swifter if the contracting authorities are "bodies governed by public law" instead of state entities, regional or local authorities, public institutes, associations or foundations and, obviously, there is no need to comply with any of such rules if the relevant entities are private entities which do not

[126] The power of Supervision consists in the power to review, confirm, modify or revoke the actions undertaken by the supervised bodies or services.

[127] Tutelage means the control of legality or, in certain cases, a judgement opportunity on the actions of certain entities.

[128] Although it requires a case-by-case analysis, public undertakings are likely to be considered "bodies governed by public law".

fulfil the elements of a "body governed by public law" - this means that the closer to a private regime the urban development fund is, the less public procurement requirements it has to comply with. As above referred, the fact that both EIB and UDF's are financial engineering instruments may advise the compliance by the UDF, in any event, without prejudice of CCP rules, with the same provisions to which EIB is subject to.

In this context, it is important to highlight that, despite the need of a case by case analysis (as recommended by the Court of Justice), most of the Portuguese public undertakings comply with the legal requirements of a "body governed by public law".

IV. CONCLUSIONS, RECOMMENDATIONS AND PROPOSALS

A. General observations

1. *An innovative and specific financing tool for urban regeneration projects.* From a legal standpoint, JESSICA is a financing programme with innovative and specific features. The use of financial engineering techniques, the reimboursability of the funds invested and the possibility to serve, without any time limit, as a co-financing tool where private investors also participate altogether prove its value added as an additional financing tool for urban regeneration projects.

2. *No blocking issues in Portuguese Law but important legal requirements have to be met:* The Portuguese legal framework does not pose major obstacles as to the implementation of JESSICA in Portugal. Special attention has to be paid, however, to compliance with State aid limitations, as well as to public procurement impositions and banking law restrictions.

B. Compliance issues

3. *Limited application of light-touch regime on public procurement*. Due to the narrow time frame of application of the special regime for public procurement in areas such as urban rehabilitation (Decree-Law n. 34/2009), to expire by the end of 2010, and also to its limited impact, JESSICA's implementation will hardly benefit from such regime. Therefore, generally, the whole set of requirements deriving from the CCP, transposing EU requirements into Portuguese law, will apply.

4. *Public procurement requirements apply at multiple levels of the process.* The public procurement impositions apply at different stages – i.e. at the moment of the choice of the holding fund (except if it is awarded to the EIB), at the moment of the selection of the UDF, at the level of the selection of projects, at the level of the selection of any supplier or services provider or at the level of selection of private partners in financial engineering instruments.

5. *Publicity, transparency and objectiveness required on the selection of the UDF's by the EIB.* Although public procurement directives do not bind the EIB and despite the non-application of CCP, EIB is bound by the general principles set out in the EC Treaty and also by the specific provisions, regarding JESSICA, established in the applicable Regulations (namely Regulation (EC) 1828/2006). Concerning public procurement, the minimum requirements that the EIB must fulfil are, according to such provisions and principles: i) a call for expression of interest duly addressed; and ii) the appraisal, selection and accreditation of urban development funds under a transparent and objective atmosphere. This does not, obviously, interfere with the application and compliance with the EIB internal guidelines on procurement.

6. *Intervention of Investment Board at the choice of the UDF.* The Investment Board must approve the selection of the UDF; such approval is previous to the designation of the UDF.

7. *UDF's degree of freedom under CCP depends on whether the UDF is a contracting authority and on which type of contracting authority it is.* If the UDF adopts a public institutional form, any agreement it enters into is subject to procurement rules and the choice of the specific procedure is subject to the applicable criteria foreseen therein. In case it corresponds to what the Portuguese law describes as a "body governed to public law", its compliance with the CCP shall be subject to swifter terms and it may, in specific cases, be exempt of public procurement rules.

8. *The existence of public-private partnerships may create additional need to compliance to Public Procurement Rules.* The presence of PPP's within JESSICA may be relevant in two different levels: i) constitution of the UDF; and ii) investment by the UDF through equity in private capital vehicles. Such operations may imply compliance with CCP rules, through the due launching the relevant procedure for the choice of the private partner, in case the contracting authority adopts the public institutional form. As mentioned, the legal framework will differ if the

contracting party corresponds to a "body governed by public law".

9. *Even if UDF are outside the scope of Public Procurements Rules, a minimum set of these rules should apply.* It is advisable that the use of financial engineering tools is matched with a comfortable degree of transparency. In line with such interpretation, independently of CCP provisions, UDF should be subject to the same procurement principles that the EIB is bound to comply.

10. *State Aid compliance needs concrete and careful assessment in each project.* JESSICA funds allocated from the Operational Programme to the Holding Funds, from the Holding Funds to the UDFs or from any of the former to private undertakings, will not constitute State aid as long as the investment is commercially justifiable in the sense that a private investor in a similar position would adopt an equivalent measure. This assessment and the assessment of other state aid compliance elements involve a careful case-by-case analysis.

11. *Unequal treatment of investors does not raise any issue.* Article 43 (7) of Regulation (EC) 1828/2006 allows for uneven rights between investors in UDF - *inter alia*, between public and private parties. This does not raise any objection under Portuguese law, since loan contracts, equity capital and participation units in investment funds can attribute different rights to each category of investor. The constraints derived from the prohibition of State aid, however, must be strictly complied with.

12. *No reason for investor protection concerns.* Urban development funds do not raise retail investor protection concerns, as they are tipically aimed at sharing risks at UDF level or co-financing projects with institutional investors.

C. Maximizing the benefits of the legal architecture

13. *No EU-prescribed concept of urban development fund and no need for new legal person.* EC Regulations allow for a considerable degree of

flexibility in the concept of urban development "fund", and do not impose that such fund has legal personality nor prescribe a determined organisational form to be followed. The Holding Fund can namely enter into a contract with a financial intermediary to manage the fund, with no need to create a new separate legal entity.

14. *Wide range of options as to the UDF legal form.* The Portuguese legal system provides for a wide number of alternatives in terms of the nature of the UDF. Therefore, the strategy to be pursued in terms of the choice of a legal vehicle to UDF's in Portugal should be adaptive and flexible, and not limitative.

15. *Flexible framework suits Evaluation Study findings.* This permitted diversity of UDF legal forms suits perfectly the conclusions of the Evaluation Study concerning the implementation of JESSICA in Portugal[129], which point out potential JESSICA projects with different structures and diverse sources of funding.

16. *Choice of UDF legal form must take into account Banking Law restrictions.* Portuguese Banking Law imposes a significant restriction in the choice of UDF legal form, as it forces professional granting of loans and guarantees to be made through financial institutions. Such requirement can be derogated through a special legal intervention. It also does not apply to capital investment.

17. *The choice of UDF structure should maximise private investment.* Among the various legal forms, the value-added that can be contributed by JESSICA deployment when compared to existing institutional solutions for promoting and funding urban regeneration, e.g. via Sociedades de Reabilitação Urbana (SRUs) is greater in private law forms or in public undertakings, as this accommodates the possibility of private investment, which does not occur in other Public law types of structure or in SRU's.

[129] See *supra*, 1.3.

18. *No need for further domestic regulation on UDF's except if non-financial forms are considered.* A legislative intervention to provide for an autonomous legislative text to deal with Urban Development Funds does not seem necessary. While the intention to prepare such piece of legislation has been announced by the Securities Law Commission, the existing rules already provide for a wide range of alternatives in terms of the concrete form to be observed by the Portuguese UDF. A legislative intervention would only have to be considered if non-financial forms were considered.

19. *Real estate investment funds should fall under JESSICA's eligible instruments.* The reference made in Regulation (EC) 1083/2006 to capital investment must be regarded in a functional sense and allowing UDFs investments with a high degree of risk. Therefore, that expression should be interpreted as to also include real estate investment funds, whose risk involved is mitigated, regardless of the nature of the fund (contractual or corporate form).

20. *Some restrictions in open-ended real estate funds do apply.* The current regime for investment funds implies certain limitations for open-ended Real Estate Regeneration Investment Funds. Nevertheless, closed-ended funds may seem to fit aptly in this context, as open-ended funds raise recurrent doubts in terms of liquidity in troubled or bear markets.

Lisbon, 17 July 2009

ANNEX I
The Legal Regime of Sociedades de Reabilitação Urbana (SRUs): A Brief Description

Sociedades de Reabilitação Urbana (SRUs), or Urban Rehabilitation Companies, were established under decree-law (EC) n. 104/2004 of 7 May 2004, which contains the main principles involved in SRUs. A brief description of those main principles is found below.

First, SRUs are exclusively public owned companies, which capital is totally owned by the municipalities themselves. Only in special situations, where an exceptional public interest so advises, the SRU's, adopting the form of share companies, may also be participated by state entities.

This means that, under the framework of public authority, responsibility for the procedures of urban regeneration rests with each municipality, or in the above referred special cases, with the State.

Secondly, SRU's have authority over administrative matters in their respective areas of urban rehabilitation. Such powers include: the licensing and permitting of urban rehabilitation operations; the expropriation of property, and the rights attaching to them, for urban regeneration and providing administrative easements for those purposes; undertaking resettlement operations; and supervising the work of urban rehabilitation. Furthermore, SRUs have the powers provided for in Section V of Chapter III of the legal system of urbanization and construction, approved by Decree-Law n. 555/99 of December 16, and also the powers provided for in section b of paragraph 1 of Article 42, paragraph 2 of Article 44 and Article 46, all under Soil Law (Lei dos Solos).

The third principle of SRUs involves the balancing of the property owner's rights. There is the general principle that the property owners may promote the rehabilitation of their buildings. Therefore, the above mentioned law grants the property owner's the right to make a request to the municipality, or to the SRU, to make urban regeneration work plans. The owner is enabled to undertake the work directly and on its own account or to charge SRU of proceeding to the rehabilitation.

On the other hand, there are some highly important situations where the owner's building is expropriated, against the owner's consent, for public interest reasons.

However, even though the owner's building is expropriated, the owner still enjoys the right of first refusal in case the property is, after being rehabilitated, offered for sale.

The fourth principle of SRUs is the economic incentive for the intervention of private developers in the rehabilitation process. In this context, a framework was created for an urban rehabilitation contract, between the municipality, or the company, and the private promoters under which the parties may adjust the terms on how the private promoter is to carry out the operations of the urban rehabilitation. For reasons of transparency, the choice of the private promoter is through a public tender, giving the SRU in each situation a very wide margin for setting the recruitment criteria.

Lastly, SRUs legal regime involves the procedural speed and certainty as to the time limit of the procedures, as essential elements for the commitment of economic agents. Accordingly, it is noted that, against the ordinary procedural regime, procedures are simplified, the time limits are reduced, there is the use in all cases of tacit acceptance.

SRU's legal regime can be accessed at http://www.portaldahabitacao.pt/pt/portal/reabilitacao/sociedadesreabilitacaourbana/menusru.html.