I. TRANSPARENCY OF FINANCIAL RELATIONS BETWEEN MEMBER STATES AND PUBLIC UNDERTAKINGS
Application of Articles 92 and 93 of the EEC Treaty to public authorities' holdings in company capital

(Bulletin EC 9- 1984, pages 28- 29 of the English version)

2.1.30. More and more often recently the Commission has had to rule on the compatibility of the acquisition of public authorities' holdings in company capital with the EEC Treaty rules on State aids.

To prevent a major breach in State aid discipline which could imperil all the Community is doing in this connection, the Commission has felt essential to spell out how this discipline applies in cases where the authorities acquire a participation in undertakings.

The Commission also felt it should have access to the information necessary to keep a proper watch on such acquisitions since it is frequently not apparent that they involve aid.

The Commission has therefore sent Member States a paper\(^1\) explaining its general approach to the acquisition of shareholdings by the public authorities and setting out Member States' obligations in the field.

The paper in no way prejudices the question whether such aids are actually compatible or incompatible with the discipline and rules applying to them under the Treaty.

Public authorities' holdings in company capital

The Commission's position

(Bulletin EC 9- 1984, pages 93- 95 of the English version)

3.5.1. The Commission has sent Member States a paper explaining its general approach to the acquisition of shareholdings by the public authorities and setting out Member States' obligations in the field:

'Public holding' means a direct holding of central, regional or local government, or a direct holding of financial institutions or other national, regional or industrial agencies\(^2\) which are funded from State resources within the meaning of Article 92(1) of the EC Treaty, or over which central, regional or local government exercises a dominant influence.

The Commission has already had occasion in the past to consider the question of public holdings in company capital from the angle of policy on State aid; in most cases, in view of the particular circumstances, it has regarded them as constituting State aid. This position is spelt out clearly in the steel and shipbuilding codes.

The steel code states that 'the concept of aid includes ... any aid elements contained in the financing measures taken by Member States in respect of the steel undertakings which they directly or indirectly control and which do not count as the provision of equity capital according to standard company practice in a market economy' (Commission Decision No \(^1\) Point 3.5.1.

2320/81/ECSC of 7 April 1981 establishing Community rules for aid to the steel industry\(^3\): recital II, last paragraph, and Article 1). Pursuant to that Decision the Commission has usually regarded any contribution of capital to companies as State aid.

The shipbuilding code contains a formula identical to the one in the steel code (Council Directive No 81/363/EEC of 28 April 1981 on aid to shipbuilding\(^4\): last recital and Article 1(e)).

1. The Treaty establishes both the principle of impartiality with regard to the system of property ownership (Article 222) and the principle of equality between public and private undertakings. This means that Commission action may neither penalize nor favour public authorities which provide companies with equity capital. Nor is it for the Commission to express any opinion as to the choice companies make between methods of financing - loan or equity - whether the funds are of private or public origin.

Where, applying the guidelines laid down in this paper, it is apparent that a public authority which injects capital by acquiring a holding in a company is not merely providing equity capital under normal market economy conditions, the case has to be assessed in the light of Article 92 of the EC Treaty.

2. Four types of situation can be distinguished in which public authorities may have occasion to acquire a holding in the capital of companies:

(a) the setting up of a company,

(b) partial or total transfer of ownership from the private to the public sector,

(c) in an existing public enterprise, injection of fresh capital or conversion of endowment funds into capital,

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

3. On this basis four cases can be distinguished.

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

3.2. Nor is State aid involved where fresh capital is contributed in circumstances that would be acceptable to a private investor operating under normal market economy conditions. This can be taken to apply:

(i) where a new company is set up with the public authorities holding the entire capital or a majority or minority interest, provided the authorities apply the same criteria as provider of capital under normal market economy conditions;

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

\(^3\) OJ L 228, 13.8.1981.

\(^4\) OJ L 137, 23.5.1981.
(iii) where the public holding in a company is to be increased, provided the capital injected is proportionate to the number of shares held by the authorities and goes together with the injection of capital by a private shareholder; the private investor's holding must have real economic significance;

(iv) where, even though the holding is acquired in the manner referred to in either of the last two indents of Section 3.3 below, it is in a small or medium-sized enterprise which because of its size is unable to provide adequate security on the private financial market, but whose prospects are such as to warrant a public holding exceeding its net assets or private investment;

(v) where the strategic nature of the investment in terms of markets or supplies is such that acquisition of a shareholding could be regarded as the normal behaviour of a provider of capital, although profitability is delayed;

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

3.3. On the other hand, there is State aid where fresh capital is contributed in circumstances that would not be acceptable to a private investor operating under normal market economy conditions.

This is the case:

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

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

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

(iv) where the public authorities' holding involves the taking over or the continuation of all or part of the nonviable operations\(^5\) of an ailing company through the formation of a new legal entity;

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

(vi) where the amount of the holding exceeds the real value (net assets plus value of any goodwill or knowhow) of the company, except in the case of companies of the kind referred to in the fourth indent of Section 3.2. above.

3.4. Some acquisitions may not fall within the categories indicated in Sections 3.2 and 3.3 so that it cannot be decided from the outset whether they do, or do not constitute State aid.

\(^5\) Excluding the straightforward takeover of the assets of a company which has become insolvent or gone into liquidation.
In certain circumstances, however, there is a presumption that there is indeed State aid.

This is the case where:

(i) the authorities' intervention takes the form of acquisition of a holding combined with other types of intervention which need to be notified pursuant to Article 93(3);

(ii) the holding is taken in an industry experiencing particular difficulties, without the circumstances being covered by Section 3.3; accordingly, where the Commission finds that an industry is suffering from structural overcapacity and even though most such cases will be within the scope of Section 3.3, it may consider it necessary to monitor all holdings in that industry, including those coming under Section 3.2.

4. Leaving aside the fact that the Commission has at all times the right to request information from the Member States case by case, the obligations devolving on Member States in the light of the Commission's practice to date and the approach outlined here should be set out anew and specified in detail.

4.1. In the case referred to at 3.1, there is no need to place any particular obligations on Member States.

4.2. In the cases referred to at 3.2, the Commission would ask Member States to inform it retrospectively by means of regular, and normally annual, reports on holdings acquired by financial institutions and directly by public authorities. The information given should include the following at least, possibly as part of the financial institutions' reports:

(i) name of the institution or authority which acquired the holding,

(ii) name of the company involved,

(iii) amount of the holding,

(iv) capital of the company before the holding was acquired,

(v) industry in which the company operates,

(vi) number of employees.

4.3. As regards the cases referred to in Section 3.3, since these do constitute State aid, Member States are required to notify the Commission pursuant to Article 93(3) of the EC Treaty before they are put into effect.

4.4. With regard to the cases referred to in Section 3.4 in which it is not clear from the outset whether or not they involve State aid, Member States should inform the Commission retrospectively by means of regular and normally annual reports in the manner described in Section 4.2.

In cases of the kind described in Section 3.4 where there is a presumption of State aid, the Commission should be informed in advance. On the basis of an examination of the information received, it will decide within 15 working days whether the information should be regarded as notification for the purposes of Article 93(3) of the EC Treaty.

4.5. Without prejudice to the Commission's right to ask for information on specific cases, the obligation to supply regular retrospective information only applies to shareholdings in companies where one of the following thresholds is exceeded:
(i) balance sheet total: ECU 4 million,

(ii) net turnover: ECU 8 million,

(iii) number of employees: 250.

The Commission may review these thresholds in the light of future experience.

5. Member States also use certain forms of intervention which, while not having all the features of a capital contribution in the form of acquisition of a public holding, resemble this sufficiently to be treated in the same way. This is the case notably with capital contributions taking the form of convertible debenture loans or of loans where the financial yield is, at least in part, dependent on the company's financial performance.

The criteria in Section 3 also apply in respect of these forms of intervention, and Member States are under the obligations set out in Section 4.

6. In certain cases the Commission has authorized aid measures which also include the acquisition of holdings in certain circumstances. The various procedural clauses in the authorization decisions are not affected by the provisions in this paper.

7. This paper also applies to holdings in agricultural undertakings. It may be adapted to take account of any new circumstances arising from the accession of new Member States.
COMMISSION COMMUNICATION TO THE MEMBER STATES
(93/C 307/03)

Following the annulment of the Commission’s communication, concerning the application of Articles 92 and 93 of the EEC Treaty and of Article 5 of Commission Directive 80/723/EEC to public undertakings in the manufacturing sector, by the Court of Justice of the European Communities, in June 1993, the Commission has decided to adopt as a directive, the obligation for Member States to provide the Commission with financial data on an annual basis. This Directive has been forwarded to Member States and has been published (1).

At the same time the Commission readopted the above communication omitting the reporting requirement that was contained in paragraphs 45 to 53, and references thereto, previously set out in paragraphs 2, 27, 29, 31 and 54.

This revised text is reproduced below:


Commission communication to the Member States

I. INTRODUCTION

1. A reinforced application of policy towards State aids is necessary for the successful completion of the internal market. One of the areas identified as worthy of attention in this respect is public undertakings. There is need for both increased transparency and development of policy for public undertakings because they have not been sufficiently covered by State aid disciplines:

— in many cases only capital injections and not other forms of public funds have been fully included in aid disciplines for public undertakings,

— in addition, these disciplines in general only cover loss-making public undertakings,

— finally it also appears that there is a considerable volume of aid to public undertakings given other than through approved aid schemes (which are also available to private undertakings) which have not been notified under Article 93 (3).

2. This communication is designed to remedy this situation. In the first place it explains the legal background of the Treaty and outlines the aid policy and case-law of the Council, Parliament, Commission and Court of Justice for public enterprises. This will, in particular, focus, on the one hand, on Directive 80/723/EEC on the transparency of the financial relationship between public undertakings and the State, and, on the other hand, it will develop the well established principle that where the State provides finances to a company in circumstances that would not be acceptable to an investor operating under normal market economy conditions, State aid is involved. The communication then explains how the Commission intends to increase transparency by applying this principle to all forms of public funds and to companies in all situations.

3. This communication does not deal with the question of the compatibility under one of the derogations provided for in the EEC Treaty because no change is envisaged in this policy. Finally, this communication is limited to the manufacturing sector. This will not, however, preclude the Commission from using the approach described by this communication in individual cases or sectors outside manufacturing to the extent that the principles in this communication apply in these excluded sectors and where it feels that it is essential to determine if State aid is involved.

II. PUBLIC UNDERTAKINGS AND THE RULES OF COMPETITION

4. Article 222 states: ‘This Treaty shall in no way prejudice the rules in Member States governing the system of property ownership’. In other words the Treaty is neutral in the choice a Member State may make between public and private ownership and does not
prejudice a Member State's right to run a mixed economy. However, these rights do not absolve public undertakings from the rules of competition because the institution of a system ensuring that competition in the common market is not distorted is one of the bases on which the Treaty is built (Article 3 (f)). The Treaty also provides the general rules for ensuring such a system (Articles 85 to 94). In addition the Treaty lays down that these general rules of competition shall apply to public undertakings (Article 90 (1)). There is a specific derogation in Article 90 (2) from the general rule of Article 90 (1) in that the rules of competition apply to all public undertakings including those entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly in so far as the application of such rules does not obstruct the performance in law or in fact of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community. In the context of the State aid rules (Articles 92 to 94), this means that aid granted to public undertakings must, like any other State aid to private undertakings, be notified in advance to the Commission (Article 93 (3)) to ascertain whether or not it falls within the scope of Article 92 (1), i.e. aid that affects trade and competition between Member States. If it falls within Article 92 (1), it is for the Commission to determine whether one of the general derogations provided for in the Treaty is applicable such that the aid becomes compatible with the common market. It is the Commission's role to ensure that there is no discrimination against either public or private undertakings when it applies the rules of competition.

5. It was to ensure this principle of non-discrimination, or neutrality of treatment, that the Commission adopted in 1980 a Directive on the transparency of financial relations between Member States and public undertakings (1). The Commission was motivated by the fact that the complexity of the financial relations between national public authorities and public undertakings tended to hinder its duty of ensuring that aid incompatible with the common market was not granted. It further considered that the State aid rules could only be applied fairly to both public and private undertakings when the financial relations between public authorities and public undertakings were made transparent.

6. The Directive obliged Member States to ensure that the flow of all public funds to public undertakings and the uses to which these funds are put are made transparent (Article 1). Member States shall, when the Commission considers it necessary so to request, supply to it the information referred to in Article 1, together with any necessary background information, notably the objectives pursued (Article 5). Although the transparence in question applied to all public funds, the following were particularly mentioned as falling within its scope:

- the setting-off of operating losses,
- the provision of capital,
- non-refundable grants or loans on privileged terms,
- the granting of financial advantages by forgoing profits or the recovery of sums due,
- the forgoing of a normal return on public funds used,
- compensation for financial burdens imposed by the public authorities.

7. The Commission further considered that transparency of public funds must be achieved irrespective of the manner in which such provision of public funds is made. Thus, not only were the flows of funds directly from public authorities to public enterprises deemed to fall within the scope of the Transparency Directive, but also the flows of funds indirectly from other public undertakings over which the public authority holds a dominant influence (Article 2).

8. The legality of the Transparency Directive was upheld by the Court of Justice in its judgment of 6 July 1982 (2).

8.1. On the argument that there was no necessity for the Directive and that it infringed the rule of proportionality, the Court held as follows (paragraph 18): 'In view of the diverse forms of public undertakings in the various Member States and the ramifications of their activities, it is inevitable that their financial relations with public authorities should themselves be very diverse, often complex and therefore difficult to supervise, even with the assistance of the sources of published information to which the applicant governments have referred. In those circumstances there is an undeniable need for the Commission to seek additional information on those relations by establishing common criteria for all the Member States and for all the undertakings in question'.


(2) Joined Cases 188 to 190/80, France, Italy and the United Kingdom v. Commission [1982] ECR 2545.
8.2. On the argument that the Directive in question infringed the principle of neutrality of Article 222 of the Treaty, the Court held that (paragraph 21), 'it should be borne in mind that the principle of equality, to which the governments refer in connection with the relationship between public and private undertakings in general, presupposes that the two are in comparable situations. ... private undertakings determine their industrial and commercial strategy by taking into account in particular requirements of profitability. Decisions of public undertakings, on the other hand, may be affected by factors of a different kind within the framework of the pursuit of objectives of public interest by public authorities which may exercise an influence over those decisions. The economic and financial consequences of the impact of such factors lead to the establishment between those undertakings and public authorities of financial relations of a special kind which differ from those existing between public authorities and private undertakings. As the Directive concerns precisely those special financial relations, the submission relating to discrimination cannot be accepted.'

8.3. On the argument that the Directive's list of public funds to be made transparent (Article 3) was an attempt to define the notion of aid within the meaning of Articles 92 and 93, the Court stated as follows (paragraph 23): 'In relation to the definition contained in Article 3 of the financial relations which are subject to the rules contained in the Directive, it is sufficient to state that it is not an attempt by the Commission to define the concept of aid which appears in Articles 92 and 93 of the Treaty, but only a statement of the financial transactions of which the Commission considers that it must be informed in order to check whether a Member State has granted aids to the undertakings in question, without complying with its obligation to notify the Commission under Article 93 (3)'.

8.4. On the argument that the public enterprises on which information was to be provided (Article 2) was an attempt to define the notion of public undertakings within the meaning of Article 90 of the Treaty, the Court stated that (paragraph 24), 'it should be emphasized that the object of those provisions is not to define the concept as it appears in Article 90 of the Treaty, but to establish the necessary criteria to delimit the group of undertakings whose financial relations with the public authorities are to be subject to the duty laid down by the Directive to supply information'. It continued in paragraph 25 as follows: 'According to Article 2 of the Directive, the expression "public undertakings" means any undertaking over which the public authorities may exercise directly or indirectly a dominant influence. According to the second paragraph, such influence is to be presumed when the public authorities directly or indirectly hold the major part of the undertaking's subscribed capital, control the majority of the votes, or can appoint more than half of the members of its administrative, managerial or supervisory body'. It continued in paragraph 26 as follows: 'As the Court has already stated, the reason for the inclusion in the Treaty of the provisions of Article 90 is precisely the influence which the public authorities are able to exert over the commercial decisions of public undertakings. That influence may be exerted on the basis of financial participation or of rules governing the management of the undertaking. By choosing the same criteria to determine the financial relations on which it must be able to obtain information in order to perform its duty of surveillance under Article 90 (3), the Commission has remained within the limits of the discretion conferred upon it by that provision'.

9. The principles developed by the Court of Justice with respect to the Transparency Directive are now part of the established jurisprudence and of particular importance is the fact that the Court has confirmed that:

— making financial relations transparent and the provision, on request, of information under the Directive is necessary and respects the principle of proportionality,

— the Directive respects the principle of neutrality of treatment of public and private undertakings,

— for the purposes of monitoring compliance with Articles 92 and 93 the Commission has a legitimate interest to be informed of all the types of flows of public funds to public enterprises, and

— for the purposes of monitoring compliance with Articles 92 and 93 the Commission has a legitimate interest in the flows of public funds to public undertakings that come either directly from the public authorities or indirectly from other public undertakings.

III. PRINCIPLES TO BE USED IN DETERMINING WHETHER AID IS INVOLVED

10. Having established over which enterprises and over which funds the Commission has a legitimate interest for the purposes of Articles 90 and 92, it is necessary to examine the principles to be used in determining whether any aid is involved. Only if aid is involved is there any question of any prior notification. Where aid is involved it is necessary to then examine whether any of the derogations provided for in the Treaty are applicable (5). This analysis of determining on the one hand whether aid is involved and on the other whether the aid is compatible under one of the derogations of the Treaty, must be kept as a two stage process if full transparency is to be assured.

(5) See also points 32 and 33 below.
11. When public undertakings, just like private ones, benefit from monies granted under transparent aid schemes approved by the Commission, then it is clear that aid is involved and under what conditions the Commission has authorized its approval. However, the situation with respect to the other forms of public funds listed in the Transparency Directive is not always so clear. In certain circumstances public enterprises can derive an advantage from the nature of their relationship with public authorities through the provision of public funds when this latter provides funds in circumstances that go beyond its simple role as proprietor. To ensure respect for the principle of neutrality the aid must be assessed as the difference between the terms on which the funds were made available by the State to the public enterprise, and the terms which a private investor would find acceptable in providing funds to a comparable private undertaking when the private investor is operating under normal market economy conditions (hereinafter 'market economy investor principle'). As the Commission points out in its communication on 'Industrial policy in an open and competitive environment' (COM(90) 556), 'competition is becoming ever more global and more intense both on the world and on Community markets'. This trend has many implications for European companies, for example with regards to R&D, investment strategies and their financing. Both public and private enterprises in similar sectors and in comparable economic and financial situations must be treated equally with respect to this financing. However if any public funds are provided on terms more favourable (i.e. in economic terms more cheaply) than a private owner would provide them to a private undertaking in a comparable financial and competitive position, then the public undertaking is receiving an advantage not available to private undertakings from their proprietors. Unless the more favourable provision of public funds is treated as aid, and evaluated with respect to one of the derogations of the Treaty, then the principle of neutrality of treatment between public and private undertakings is infringed.

12. This principle of using an investor operating under normal market conditions as a benchmark to determine both whether aid is involved and if so to quantify it, has been adopted by the Council and the Commission in the steel and shipbuilding sectors, and has been endorsed by the Parliament in this context. In addition the Commission has adopted and applied this principle in numerous individual cases. The principle has also been accepted by the Court in every case submitted to it as a yardstick for the determination of whether aid was involved.

13. In 1981 the Council adopted the principle of the market economy investor principle on two occasions. Firstly it approved unanimously the Commission decision establishing Community rules for aids to the steel industry (\(^\text{(*)}\)), and secondly it approved, by a qualified majority, the Shipbuilding Code (\(^\text{(**)}\)). In both cases the Council stated that the concept of aid includes any aid elements contained in the financing measures taken by Member States in respect of the steel/shipbuilding undertakings which they directly or indirectly control and which do not count as the provision of equity capital according to standard company practice in a market economy. Thus not only did the Council approve or adopt the market economy principle, it went along the same lines as the Commission in the abovementioned Transparency Directive, which brought within its scope not only the direct provision of funds but also their indirect provision.

14. The Council has maintained this general principle, most recently in 1989 in the case of steel (\(^\text{(*)}\)), and in 1990 in the case of shipbuilding (\(^\text{(**)}\)). In fact in the 1989 steel aid code the Council agreed to prior notification of all provisions of capital or similar financing in order to allow the Commission to decide whether they constituted aid, i.e. could be regarded as a genuine provision of risk capital according to usual investment practice in a market economy (Article I (2)). The Council also reaffirmed and approved unanimously this principle in Commission Decision 89/218/ECSC concerning new aid to Finsider/ILVA (\(^\text{(*)}\)).

15. The Parliament has been called upon to give its opinion on the market economy investor principle contained in the Shipbuilding Directives. For these Directives the Parliament agreed to the Commission drafts which included this principle (\(^\text{(**)}\)).

16. The Commission adopted the same market economy investor principle when it laid down its position in general on public holdings in company capital which still remains valid (\(^\text{(*)}\)). It stated 'where it is apparent that a public authority which injects capital ... in a company is not merely providing equity capital under normal market economy conditions, the case has to be assessed in the light of Article 92 of the EEC Treaty' (para-

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\(^{(\text{*)}}\) OJ No L 86, 31. 3. 1989, p. 76.


\(^{(\text{*)}\text{(*)}\text{*)}}\) Communication to the Member States concerning public authorities holdings in company capital. (Bulletin EC 9 — 1984).
I.2. It considered in particular that State aid was involved 'where the financial position of the company, and particularly the structure and volume of its debts, is such that a normal return (in dividends or capital gains) cannot be expected within a reasonable time from the capital invested'.

17. The Commission has moreover applied this market economy investor principle in many individual cases to determine whether any aid was involved. The Commission examined in each case the financial circumstances of the company which received the public funds to see if a market economy investor would have made the monies available on similar terms. In the Leeuwarden decision the Commission established the capital injections constituted aid because 'the overcapacity in the ... industry constituted handicaps indicating that the firm would probably have been unable to raise on the private capital market the funds essential to its survival. The situation on the market provides no reasonable grounds for hope that a firm urgently needing large-scale restructuring could generate sufficient cash flow to finance the replacement investment necessary ...' (14). This policy has been applied consistently over a number of years. More recently in the CDF/Orkem decision (15), the Commission established that the public authority 'injected capital into an undertaking in conditions that are not those of a market economy'. In fact, the company in question 'had very little chance of obtaining sufficient capital from the private market to ensure its survival and long-term stability'. In the ENI-Lanerosi decision (16), the Commission stated that 'finance was granted in circumstances that would not be acceptable to a private investor operating under normal market economy conditions, as in the present case the financial and economic position of these factories, particularly in view of the duration and volumes of their losses, was such that a normal return in dividends or capital gains could not be expected for the capital invested' (17). There have also been a number of cases where the Commission has clearly stated that capital injections by the State have not constituted aid because a reasonable return by way of dividends or capital growth could normally be expected (18).

18. The Commission has also applied the market economy investor principle to many individual cases under the shipbuilding Directives and steel aid codes. In shipbuilding, for example in Bremer Vulkan (19), the Commission considered that a bridging loan and the purchase of new shares constituted State aid because it did 'not accept the argument put forward by the German Government that [it] ... only acted like a private investor who happened to be better at foreseeing future market developments than anyone else.' In steel, for example, it took decisions in several individual cases where capital injections were considered as aid (20).

19. It is noteworthy that in many of the above described cases the capital injected into the public undertaking came not directly from the State but indirectly from State holding companies or other public undertakings.

20. The Court has been called upon to examine a number of cases decided by the Commission in its application of the market economy investor principle set out in the 1984 guidelines. In each case submitted to it, the Court accepted the principle as an appropriate one to be used to determine whether or not aid was involved. It then examined whether the Commission decision sufficiently proved its application in the specific circumstances of the case in question. For example, in its judgment in Case 40/85 (21) (Boch), the Court stated (paragraph 13):


(18) Decisions CDF/Orkem, in parts, (op. cit.), Quimigal, in parts, (op. cit.), Inter mills II (Bulletin EC 4-1990, point 1.1.34) and Ernaitzle (18th Competition Report, points 212 and 213).
(19) Not yet published.
(20) OJ No L 227, 19. 8. 1983, p. 1. See also, in particular, cases relating to Arbed, Sidmar, ALZ, Hoogovens, Irish Steel, Saciott/Usimo and British Steel where the same reasoning can be found. In all these steel cases the aid was held to be compatible. More recently, the Council unanimously approved this principle in the Finsider/ILVA case — see point 26 below.
An appropriate way of establishing whether [the] measure is a State aid is to apply the criterion, which was mentioned in the Commission's decision and, moreover, was not contested by the Belgian Government, of determining to what extent the undertaking would be able to obtain the sums in question on the private capital markets. In the case of an undertaking whose capital is almost entirely held by the public authorities, the test is, in particular, whether in similar circumstances a private shareholder, having regard to the foreseeability of obtaining a return and leaving aside all social, regional policy and sectoral considerations, would have subscribed the capital in question.

The Court has recently reaffirmed this principle in the Boussac judgment (4), where it stated (paragraphs 39 and 40): 'In order to determine if the measures constitute State aid, it is necessary to apply the criterion in the Commission's decision, which was not contested by the French Government, whether it would have been possible for the undertaking to obtain the funds on the private capital market, and the financial situation of the company was such that it would not except an acceptable return on the investment within a reasonable time period and that Boussac would not have been able to find the necessary funds on the market' (unofficial translation) (5). The Court has recently further refined the market economy investor principle by making a distinction between a private investor whose time horizon is a short-term even speculative one, and that of a private holding group with a longer-term perspective (Alfa/Fiat and Lanerossi (6)). 'It is necessary to make clear that the behaviour of a private investor with which the intervention of the public investor ... must be compared, whilst not necessarily that of an ordinary investor placing his capital with a more or less short-term view of its profitability, must at least be that of a private holding or group of enterprises which pursue a structural, global or sectoral policy and which are guided by a longer-term view of profitability'. On the basis of the facts of the case 'the Commission was able to correctly conclude that a private investor, even if taking decisions at the level of the whole group in a wider economic context, would not under normal market economy conditions, have been able to expect an acceptable rate of profitability (even in the long term) on the capital invested ...' (unofficial translation). 'A private investor may well inject new capital to ensure the survival of a company experiencing temporary difficulties, but which after, if necessary, a restructuring will become profitable again. A mother company may also, during a limited time, carry the losses of a subsidiary in order to allow this latter to withdraw from the sector under the most favourable conditions. Such decisions can be motivated not only by the possibility to get a direct profit, but also by other concerns such as maintaining the image of the whole group or to redirect its activities. However, when the new injections of capital are divorced from all possibility of profitability, even in the long term, these injections must be considered as aid ...' (unofficial translation).

21. The fact that in many of the cases decided by the Court the injections came indirectly from State holding companies or from other public undertakings and not directly from the State, did not alter the aid character of the monies in question. The Court has always examined the economic reality of the situation to determine whether State resources were involved. In the Steinicke and Weining judgment (7), the Court stated that '... save for the reservation in Article 90 (2) of the Treaty, Article 92 covers all private and public undertakings and all their production' and that 'in applying Article 92 regard must primarily be had to the effects of aid on the undertakings or producers favoured and not the status of the institutions entrusted with the distribution and administration of the aid'. More recently in the Crédit Agricole judgment (8), the Court confirmed this and added that '... aid need not necessarily be financed from State resources to be classified as State aid ... there is no necessity to draw any distinction according to whether the aid is granted directly by the State or by public or private bodies established or appointed by it to administer aid'.

IV. INCREASED TRANSPARENCY OF POLICY

22. To date most but by no means all of the cases which have come before the Council, the Commission and the Court where the market economy investor principle has been applied have concerned capital injections in loss-making or even near-bankrupt companies. One of the aims of this communication is to increase transparency by more systematically applying aid disciplines

— to public undertakings in all situations, not just those making losses as is the case at present,

— to all the forms of public funds mentioned in the Transparency Directive (Article 3 — see points 6 and 8.3 above), in particular, for loans, guarantees and the rate of return, not just for capital injections as is the case at present.

23. This increased transparency of policy is to be brought about by clearly applying the market economy

(4) Case C-78/76.
(5) Case 290/83.
investor principle to public undertakings in all situations and all public funds covered by the Transparency Directive. The market economy investor principle is used because:

- it is an appropriate yardstick both for measuring any financial advantage a public undertaking may enjoy over an equivalent private one and for ensuring neutrality of treatment between public and private undertakings,

- it has proved itself practical to the Commission in numerous cases,

- it has been confirmed by the Court (see particularly points 20 and 21 above), and

- it has been approved by the Council in the steel and shipbuilding sector.

Unless this clarification is implemented there is a danger not only of lack of transparency, but also of discrimination against private undertakings which do not have the same links with the public authorities nor the same access to public funds. The current communication is a logical development of existing policy rather than any radical new departure and are necessary to explain the application of the principle to a wider number of situations and a wider range of funds. In fact the Court, the Commission and the Council have already applied the principle of the market economy investor in a limited number of cases to the forms of public funds other than equity which are also the object of this communication — i.e. guarantees, loans, return on capital (*).  

24. Guarantee. In IOR/Finalp (op. cit.) the Commission considered that when a State holding company became the one and only owner of an ailing company (thereby exposing it to unlimited liability under Italian commercial law) this was equivalent to taking extra risk by giving in effect an open-ended guarantee. The Commission using its well established principle stated that a market economy investor would normally be reluctant to become the one and only shareholder of a company if as a consequence he must assume unlimited liability for it; he will make sure that this additional risk is outweighed by additional gains.

25. Loan. In Boch (op. cit.) the Court stated (paragraphs 12 and 13): ‘By virtue of Article 92 (1) … the provisions of the Treaty concerning State aid apply to aid granted by a Member State or through State resources in any form whatsoever. It follows … that no distinction can be drawn between aid granted in the form of loans and aid granted in the form of a subscription of capital of an undertaking … An appropriate way of establishing whether such a measure is a State aid is to apply the criterion … of determining to what extent the undertaking would be able to obtain the sums in question on the private capital markets.’

26. Return on capital. When it opened the Article 88 procedure of the ECSC Treaty (letter to the Italian Government of 6 May 1988) in the Finsider/ILVA case, the Commission considered that the loans granted by State credit institutions were not granted to the undertaking in question under conditions acceptable to a private investor operating under normal market conditions, but were dependent on an (implicit) guarantee of the State and as such constituted State aid. In fact at a later date this implicit guarantee was made explicit when the debts were honoured. The opening of the procedure led to a decision with the unanimous approval of the Council (**) which imposed conditions on the enterprise in question to ensure that its viability would be re-established, and a minimum return on capital should be earned.

V. PRACTICALITY OF THE MARKET ECONOMY INVESTOR PRINCIPLE

27. The practical experience gained by the Commission from the application of State aid rules to public enterprises and the general support among the Community institutions for the basic themes of the market economy investor principle confirm the Commission’s view that it is as such an appropriate yardstick to determine whether or not aid exists. However it is noted that the majority of cases to which the mechanism has been applied have been of a particular nature and the wider application of the mechanism may appear to cause certain difficulties. Some further explanations are therefore warranted. In addition, the fear has been expressed that the application of the market economy investor principle could lead to the Commission’s judgment replacing the investor and his appreciation of investment projects. In the first place this criticism can be refuted by the fact that this principle

(*) It should be noted that this is not an exhaustive list of the different forms of financing which may entail aid. The Commission will act against the provision of any other advantages to public undertakings in a tangible or intangible form that may constitute aid.

(**) OJ No L 86, 31. 3. 1989, p. 76. See also the Commission Communication to the Council of 25 October 1988 — SEC(88) 1485 final and point 207 of the 14th Competition Report. In fact, the whole aim of the Steel Code for all Member States was to restore viability through a minimum return and self-financing according to market principles.
has already shown itself to be both an appropriate and
practical yardstick for determining which public funds
constitute aid in numerous individual cases. Secondly it is
not the aim of the Commission in the future, just as it
has not been in the past, to replace the investor's
judgment. Any requests for extra finance naturally calls
for public undertakings and public authorities, just as it
does for private undertakings and the private providers
of finance, to analyse the risk and the likely outcome of
the project.

In turn, the Commission realizes that this analysis of risk
requires public undertakings, like private undertakings,
to exercise entrepreneurial skills, which by the very
nature of the problem implies a wide margin of judgment
on the part of the investor. Within that wide margin the
exercise of judgment by the investor cannot be regarded
as involving State aid. It is in evaluation of the justifi-
cation for the provision of funds that the Member State
has to decide if a notification is necessary in conformity
with its obligation under Article 93 (3). In this context, it
is useful to recall the arrangements of the 1984
communication on public authorities' holdings which
stated that where there is a presumption that a financial
flow from the State to a public holding constitutes aid,
the Commission shall be informed in advance. On the
basis of an examination of the information received it
will decide within 15 working days whether the infor-
mation should be regarded as notification for the
purposes of Article 93 (3) (point 4.4.2). Only where there
are no objective grounds to reasonably expect that an
investment will give an adequate rate of return that
would be acceptable to a private investor in a comparable
private undertaking operating under normal market
conditions, is State aid involved even when this is
financed wholly or partially by public funds. It is not the
Commission's intention to analyse investment projects on
an ex-ante basis (unless notification is received in
advance in conformity with Article 93 (3)).

28. There is no question of the Commission using the
benefit of hindsight to state that the provision of public
funds constituted State aid on the sole basis that the
out-turn rate of return was not adequate. Only projects
where the Commission considers that there were no
objective or bona fide grounds to reasonably expect an
adequate rate of return in a comparable private under-
taking at the moment the investment/financing decision is
made can be treated as State aid. It is only in such cases
that funds are being provided more cheaply than would
be available to a private undertaking, i.e. a subsidy is
involved. It is obvious that, because of the inherent risks
involved in any investment, not all projects will be
successful and certain investments may produce a
sub-normal rate of return or even be a complete failure.
This is also the case for private investors whose
investment can result in sub-normal rates of return or
failures. Moreover such an approach makes no discrimi-
nation between projects which have short or long-term
pay-back periods, as long as the risks are adequately and
objectively assessed and discounted at the time the
decision to invest is made, in the way that a private
investor would.

29. This communication, by making clearer how the
Commission applies the market economy investor
principle and the criteria used to determine when aid is
involved, will reduce uncertainty in this field. It is not
the Commission's intention to apply the principles in this
communication (in what is necessarily a complex field) in
dagmatic or doctrinaire fashion. It understands that a
wide margin of judgment must come into entrepreneurial
investment decisions. The principles have however to be
applied when it is beyond reasonable doubt that there is
no other plausible explanation for the provision of public
funds other than considering them as State aid. This
approach will also have to be applied to any cross-
subsidization by a profitable part of a public group of
undertakings of an unprofitable part. This happens in
private undertakings when either the undertaking in
question has a strategic plan with good hopes of
long-term gain, or that the cross-subsidy has a net
benefit to the group as a whole. In cases where there is
cross-subsidization in public holding companies the
Commission will take account of similar strategic goals.
Such cross-subsidization will be considered as aid only
where the Commission considers that there is no other
reasonable explanation to explain the flow of funds other
than that they constituted aid. For fiscal or other reasons
certain enterprises, be they public or private, are often
split into several legally distinct subsidiaries. However
the Commission will not normally ask for information of
the flow of funds between such legally distinct subdi-
aries of companies for which one consolidated report is
required.

30. The Commission is also aware of the differences
in approach a market economy investor may have
between his minority holding in a company on the one
hand and full control of a large group on the other
hand. The former relationship may often be charac-
terized as more of a speculative or even short-term
interest, whereas the latter usually implies a longer-term
interest. Therefore where the public authority controls
an individual public undertaking or group of under-
takings it will normally be less motivated by purely
short-term profit considerations than if it had merely a minority/non-controlling holding and its time horizon will accordingly be longer. The Commission will take account of the nature of the public authorities’ holding in comparing their behaviour with the benchmark of the equivalent market economy investor. This remark is also valid for the evaluation of calls for extra funds to financially restructure a company as opposed to calls for funds required to finance specific projects (\(^\ast\)). In addition the Commission is also aware that a market economy investor’s attitude is generally more favourably disposed towards calls for extra finance when the undertaking or group requiring the extra finance has a good record of providing adequate returns by way of dividends or capital accumulation on past investments. Where a company has underperformed in this respect in comparison with equivalent companies, this request for finance will normally be examined more sceptically by the private investor/owner called upon to provide the extra finance. Where this call for finance is necessary to protect the value of the whole investment the public authority like a private investor can be expected to take account of this wider context when examining whether the commitment of new funds is commercially justified. Finally where a decision is made to abandon a line of activity because of its lack of medium/long-term commercial viability, a public group, like a private group, can be expected to decide the timing and scale of its run down in the light of the impact on the overall credibility and structure of the group.

31. In evaluating any calls for extra finance a shareholder would typically have at his disposal the information necessary to judge whether he is justified in responding to these calls for additional finance. The extent and detail of the information provided by the undertaking requiring finance may vary according to the nature and volume of the funding required, to the relationship between the undertaking and the shareholder and even to the past performance of the undertaking in providing an adequate return (\(^\ast\)). A market economy investor would not usually provide any additional finance without the appropriate level of information. Similar considerations would normally apply to public undertakings seeking finance. This financial information in the form of the relevant documentation should be made available at the specific request of the Commission if it is considered that it would help in evaluating the investment proposals from the point of view of deciding whether or not their financing constitutes aid (\(^\ast\)). The Commission will not disclose information supplied to it as it is covered by the obligation of professional secrecy. Therefore investment projects will not be scrutinized by the Commission in advance except where aid is involved and prior notification in conformity with Article 93 (3) is required. However where it has reasonable grounds to consider that aid may be granted in the provision of finance to public undertakings, the Commission, pursuant to its responsibilities under Articles 92 and 93, may ask for the information from Member States necessary to determine whether aid is involved in the specific case in question.

VI. COMPATIBILITY OF AID

32. Each Member State is free to choose the size and nature of its public sector and to vary it over time. The Commission recognizes that when the State decides to exercise its right to public ownership, commercial objectives are not always the essential motivation. Public enterprises are sometimes expected to fulfill non-commercial functions alongside or in addition to their basic commercial activities. For example, in some Member States public companies may be used as a locomotive for the economy, as part of efforts to counter recession, to restructure troubled industries or to act as catalysts for regional development. Public companies may be expected to locate in less developed regions where costs are higher or to maintain employment at levels beyond purely commercial levels. The Treaty enables the Commission to take account of such considerations where they are justified in the Community interest. In addition the provision of some services may entail a public service element, which may even be enforced by political or legal constraints. These non-commercial objectives/functions (i.e. social goods) have a cost which ultimately has to be financed by the State (i.e. taxpayers) either in the form of new finance (e.g. capital injections) or a reduced rate of return on capital invested. This aiding of the provision of public services can in certain circumstances distort competition. Unless one of the derogations of the Treaty is applicable, public undertakings are not exempted from the rules of

\(^\ast\) This may be particularly important for public undertakings that have been deliberately under-capitalized by the public authority owner for reasons extraneous to commercial justifications (e.g. public expenditure restrictions).

\(^\ast\) Minority shareholders who have no ‘inside’ information on the running of the company may require a more formal justification for providing funds than a controlling owner who may in fact be involved at board level in formulating strategies and is already party to detailed information on the undertaking’s financial situation.

\(^\ast\) The provision of this information on request falls within scope of the Commission’s powers of investigation of aid under Articles 92 and 93 in combination with Article 5 of the EEC Treaty and under Article 1 (c) of the Transparency Directive which states that the use to which public funds are put should be made transparent.
competition by the imposition of these non-commercial objectives.

33. If the Commission is to carry out its duties under the Treaty, it must have the information available to determine whether the financial flows to public undertakings constitute aid, to quantify such aid and then to determine if one of the derogations provided for in the Treaty is applicable. This communication limits itself to the objective of increasing transparency for the financial flows in question which is an essential first step. To decide, as a second step, whether any aid that is identified is compatible, is a question which is not dealt with because such a decision will be in accordance with the well known principles used by the Commission in the area to which no change is envisaged. (It should be stressed that the Commission is concerned with aid only when it has an impact on intra-Community trade and competition. Thus, if aid is granted for a non-commercial purpose to a public undertaking which has no impact on intra-Community trade and competition, Article 92 (1) is not applicable). This obligation of submitting to Community control all aid having a Community dimension is the necessary counterpart to the right of Member States being able to export freely to other Member States and is the basis of a common market.

VII. DIFFERENT FORMS OF STATE INTERVENTION

34. In deciding whether any public funds to public undertakings constitute aid, the Commission must take into account the factors discussed below for each type of intervention covered by this communication — capital injections, guarantees, loans, return on investment (*). These factors are given as a guide to Member States of the likely Commission attitude in individual cases. In applying this policy the Commission will bear in mind the practicability of the market economy investor principle described above. This communication takes over the definition of public funds and public undertakings used in the Transparency Directive. This is given as guidance for Member States as to the general attitude of the Commission. However, the Commission will obviously have to prove in individual cases of application of this policy that public undertakings within the meaning of Article 90 and State resources within the meaning of Article 92 (1) are involved, just as it has in individual cases in the past. As far as any provision of information under the Transparency Directive is concerned, these definitions have been upheld by the Court for the purposes of the Directive and there is no further obligation on the Commission to justify them.

(*) This list is not exhaustive — see footnote 24 above.

Capital injections

35. A capital injection is considered to be an aid when it is made in circumstances which would not be acceptable to an investor operating under normal market conditions. This is normally taken to mean a situation where the structure and future prospects for the company are such that a normal return (by way of dividend payments or capital appreciation) by reference to a comparable private enterprise cannot be expected within a reasonable time. Thus, the 1984 communication on capital injections remains valid.

A market economy investor would normally provide equity finance if the present value (*) of expected future cash flows from the intended project (accruing to the investor by way of dividend payments and/or capital gains and adjusted for risk) exceed the new outlay. The context within which this will have to be interpreted was explained above in paragraphs 27 to 31.

36. In certain Member States investors are obliged by law to contribute additional equity to firms whose capital base has been eroded by continuous losses to below a predetermined level. Member States have claimed that these capital injections cannot be considered as aid as they are merely fulfilling a legal obligation. However, this 'obligation' is more apparent than real. Commercial investors faced with such a situation must also consider all other options including the possibility of liquidating or otherwise running down their investment. If this liquidation or running down proves to be the more financially sound option taking into account the impact on the group and is not followed, then any subsequent capital injection or any other State intervention has to be considered as constituting aid.

37. When comparing the actions of the State and those of a market economy investor in particular when a company is not making a loss, the Commission will evaluate the financial position of the company at the time it is/was proposed to inject additional capital. On the basis of an evaluation of the following items the Commission will examine whether there is an element of aid contained in the amount of capital invested. This aid element consists in the cost of the investment less the value of the investment, appropriately discounted. It

(*) Future cash flows discounted at the company's cost of capital (in-house discount rate).
is stressed that the items listed below are indispensable to any analysis but not necessarily sufficient since account must also been taken of the principles set out in paragraphs 27 to 31 above and of the question whether the funds required are for investment projects or a financial restructuring.

37.1. **Profit and loss situation.** An analysis of the results of the company spread over several years. Relevant profitability ratios would be extracted and the underlying trends subject to evaluation.

37.2. **Financial indicators.** The debt/equity ratio (gearing of the company) would be compared with generally accepted norms, industry-sector averages and those of close competitors, etc. The calculation of various liquidity and solvency ratios would be undertaken to ascertain the financial standing of the company (this is particularly relevant in relation to the assessment of the loan-finance potential of a company operating under normal market conditions). The Commission is aware of the difficulties involved in making such comparisons between Member States due in particular to different accounting practices or standards. It will bear this in mind when choosing the appropriate reference points to be used as a comparison with the public undertakings receiving funds.

37.3. **Financial projections.** In cases where funding is sought to finance an investment programme then obviously this programme and the assumptions upon which it is based have to be studied in detail to see if the investment is justified.

37.4. **Market situation.** Market trends (past performance and most importantly future prospects) and the company’s market share over a reasonable time period should be examined and future projections subjected to scrutiny.

Guarantees

38. The position currently adopted by the Commission in relation to loan guarantees has recently been communicated to Member States (\(^{(*)}\)). It regards all guarantees given by the State directly or by way of delegation through financial institutions as falling within the scope of Article 92 (1) of the EEC Treaty. It is only if guarantees are assessed at the granting stage that all the distortions or potential distortions of competition can be detected. The fact that a firm receives a guarantee even if it is never called in may enable it to continue trading, perhaps forcing competitors who do not enjoy such facilities to go out of business. The firm in question has therefore received support which has disadvantaged its competitors i.e. it has been aided and this has had an effect on competition. An assessment of the aid element of guarantees will involve an analysis of the borrower’s financial situation (see point 37 above). The aid element of these guarantees would be the difference between the rate which the borrower would pay in a free market and that actually obtained with the benefit of the guarantee, net of any premium paid for the guarantee. Creditors can only safely claim against a government guarantee where this is made and given explicitly to either a public or a private undertaking. If this guarantee is deemed incompatible with the common market following evaluation with respect to the derogations under the Treaty, reimbursement of the value of any aid will be made by the undertaking to the Government even if this means a declaration of bankruptcy but creditors’ claims will be honoured. These provisions apply equally to public and private undertakings and no additional special arrangements are necessary for public enterprises other than the remarks made below.

38.1. Public enterprises whose legal status does not allow bankruptcy are in effect in receipt of permanent aid on all borrowings equivalent to a guarantee when such status allows the enterprises in question to obtain credit on terms more favourable than would otherwise be available.

38.2. Where a public authority takes a hold in a public undertaking of a nature such that it is exposed to unlimited liability instead of the normal limited liability, the Commission will treat this as a guarantee on all the funds which are subject to unlimited liability (\(^{20}\)). It will then apply the above described principles to this guarantee.

Loans

39. When a lender operating under normal market economy conditions provides loan facilities for a client he is aware of the inherent risk involved in any such venture. The risk is of course that the client will be unable to repay the loan. The potential loss extends to the full amount advanced (the capital) and any interest due but unpaid at the time of default. The risk attached to any loan arrangement is usually reflected in two distinct parameters:

(a) the interest rate charged;

(b) the security sought to cover the loan.

\(^{20}\) See point 24 above.
40. Where the perceived risk attached to the loan is high then *ceteris paribus* both (a) and (b) above can be expected to reflect this fact. It is when this does not take place in practice that the Commission will consider that the firm in question has had an advantage conferred on it, i.e. has been aided. Similar considerations apply where the assets pledged by a fixed or floating charge on the company would be insufficient to repay the loan in full. The Commission will in future examine carefully the security used to cover loan finance. This evaluation process would be similar to that proposed for capital injections (see point 37 above).

41. The aid element amounts to the difference between the rate which the firm should pay (which itself is dependent on its financial position and the security which it can offer on foot of the loan) and that actually paid. (This one-stage analysis of the loan is based on the presumption that in the event of default the lender will exercise his legal right to recover any monies due to him). In the extreme case, i.e. where an unsecured loan is given to a company which under normal circumstances would be unable to obtain finance (for example because its prospects of repaying the loan are poor) then the loan effectively equates a grant payment and the Commission would evaluate it as such.

42. The situation would be viewed from the point of view of the lender at the moment the loan is approved. If he chooses to lend (or is directly or indirectly forced to do so as may be the case with State-controlled banks) on conditions which could not be considered as normal in banking terms, then there is an element of aid involved which has to be quantified. These provisions would of course also apply to private undertakings obtaining loans from public financial institutions.

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**Return on investments**

43. The State, in common with any other market economy investor, should expect a normal return obtained by comparable private undertakings on its capital investments by way of dividends or capital appreciation (*)). The rate of return will be measured by the profit (after depreciation but before taxation and disposals) expressed as a percentage of assets employed. It is therefore a measure that is neutral with respect to the form of finance used in each undertaking (i.e. debt or equity) which for public undertakings may be decided for reasons extraneous to purely commercial considerations. If this normal return is neither forthcoming beyond the short term nor is likely to be forthcoming in the long term (with the uncertainty of this longer-term future gain not appropriately accounted for) and no remedial action has been taken by the public undertaking to rectify the situation, then it can be assumed that the entity is being indirectly aided as the State is foregoing the benefit which a market economy investor would expect from a similar investment. A normal rate of return will be defined with reference where possible being made to comparable private companies. The Commission is aware of the difficulties involved in making such comparisons between Member States — see particularly point 37. In addition the difference in capital markets, currency fluctuations and interest rates between Member States further complicate international comparisons of such ratios. Where accounting practices even within a single Member State make accurate asset valuation hazardous, thereby undermining rate of return calculations, the Commission will examine the possibility of using either adjusted valuations or other simpler criteria such as operating cash flow (after depreciation but before disposals) as a proxy of economic performance.

When faced with an inadequate rate of return a private undertaking would either take action to remedy the situation or be obliged to do so by its shareholders. This would normally involve the preparation of a detailed plan to increase overall profitability. If a public undertaking has an inadequate rate of return, the Commission could consider that this situations contains elements of aid, which should be analysed with respect to Article 92. In these circumstances, the public undertaking is effectively getting its capital cheaper than the market rate, i.e. equivalent to a subsidy.

44. Similarly, if the State forgoes dividend income from a public undertaking and the resultant retained profits do not earn a normal rate of return as defined above then the company in question is effectively being subsidized by the State. It may well be that the State sees it as preferable for reasons not connected with commercial considerations to forgo dividends (or accept reduced dividend payments) rather than make regular capital injections into the company. The end result is the same and this regular ‘funding’ has to be treated in the same way as new capital injections and evaluated in accordance with the principles set out above.

**45. Duration**

After an initial period of five years, the Commission will review the application of the policy described in this communication. On the basis of this review, and after consulting Member States, the Commission may propose any modifications which it considers appropriate.
COMMISSION DIRECTIVE 2006/111/EC  

of 16 November 2006  

on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings  

(TEXT WITH EEA RELEVANCE)  

(CODIFIED VERSION)  

THE COMMISSION OF THE EUROPEAN COMMUNITIES,  

Having regard to the Treaty establishing the European Community, and in particular Article 86(3) thereof,  

Whereas:  

(1) Commission Directive 80/723/EEC of 25 June 1980 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings (1) has been substantially amended several times (2). In the interests of clarity and rationality the said Directive should be codified.  

(2) Public undertakings play a substantial role in the national economy of the Member States.  

(3) Member States sometimes grant special or exclusive rights to particular undertakings, or make payments or give some other kind of compensation to particular undertakings entrusted with the operation of services of general economic interest. These undertakings are often also in competition with other undertakings.  

(4) Article 295 of the Treaty provides that the Treaty is in no way to prejudice the rules in Member States governing the system of property ownership. There should be no unjustified discrimination between public and private undertakings in the application of the rules on competition. This Directive should apply to both public and private undertakings.  

(5) The Treaty requires the Commission to ensure that Member States do not grant undertakings, public or private, aids incompatible with the common market.  

(6) However, the complexity of the financial relations between national public authorities and public undertakings tends to hinder the performance of this duty.  

(7) A fair and effective application of the aid rules in the Treaty to both public and private undertakings will be possible only if these financial relations are made transparent.  

(8) Such transparency applied to public undertakings should enable a clear distinction to be made between the role of the State as public authority and its role as proprietor.  

(9) Article 86(1) of the Treaty imposes obligations on Member States in the case of public undertakings and undertakings to which Member States grant special or exclusive rights. Article 86(2) of the Treaty applies to undertakings entrusted with the operation of services of general economic interest. Article 86(3) of the Treaty requires the Commission to ensure the application of the provisions of that Article and provides it with the requisite means to this end. In order to ensure the application of the provisions of Article 86 of the Treaty the Commission must have the necessary information. This entails defining the conditions for ensuring such transparency.  

(10) It should be made clear what is to be understood by the terms 'public authorities' and 'public undertakings'.  

(11) The Member States have differing administrative territorial structures. This Directive should cover public authorities at all levels in each Member State.  

(12) Public authorities may exercise a dominant influence on the behaviour of public undertakings not only where they are the proprietor or have a majority participation but also by virtue of powers they hold in management or supervisory bodies as a result either of the rules governing the undertaking or of the manner in which the shareholdings are distributed.  

(13) The provision of public funds to public undertakings may take place either directly or indirectly. Transparency must be achieved irrespective of the manner in which such provision of public funds is made. It may also be necessary to ensure that adequate information is made available as regards the reasons for such provision of public funds and their actual use.  


(2) See Annex I, Part A.
(14) Complex situations linked to the diverse forms of public and private undertakings granted special or exclusive rights or entrusted with the operation of services of general economic interest as well as the range of activities that might be carried on by a single undertaking and the different degrees of market liberalisation in the various Member States could complicate application of the competition rules, and particularly Article 86 of the Treaty. It is therefore necessary for Member States and the Commission to have detailed data about the internal and financial and organisational structure of such undertakings, in particular separate and reliable accounts relating to different activities carried on by the same undertaking.

(15) The accounts should show the distinction between different activities, the costs and revenues associated with each activity and the methods of cost and revenue assignment and allocation. Such separate accounts should be available in relation to, on the one hand, products and services in respect of which the Member State has granted a special or exclusive right or entrusted the undertaking with the operation of a service of general economic interest, as well as, on the other hand, for each other product or service in respect of which the undertaking is active. The obligation of separation of accounts should not apply to undertakings whose activities are limited to the provision of services of general economic interest and which do not operate activities outside the scope of these services of general economic interest. It does not seem necessary to require separation of accounts within the area of services of general economic interest or within the area of the special or exclusive rights, as far as this is not necessary for the cost and revenue allocation between these services and products and those outside the services of general economic interest or the special or exclusive rights.

(16) Requiring Member States to ensure that the relevant undertakings maintain such separate accounts is the most efficient means by which fair and effective application of the rules of competition to such undertakings can be assured. In 1996 the Commission adopted a Communication on services of general interest in Europe (1), which was supplemented by another Communication in 2001 (2), in which it emphasised the importance of such services. It is necessary to take account of the importance of the sectors concerned, which may involve services of general interest, the strong market position that the relevant undertakings may have and the vulnerability of emerging competition in the sectors being liberalised. In accordance with the principle of proportionality it is necessary and appropriate for the achievement of the basic objective of transparency to lay down rules on such separate accounts. This Directive does not go beyond what is necessary in order to achieve the objectives pursued, in accordance with the provisions of the third paragraph of Article 5 of the Treaty.

(17) In certain sectors provisions adopted by the Community require Member States and certain undertakings to maintain separate accounts. It is necessary to ensure an equal treatment for all economic activities throughout the Community and to extend the requirement to maintain separate accounts to all comparable situations. This Directive should not amend specific rules established for the same purpose in other Community provisions and should not apply to activities of undertakings covered by those provisions.

(18) Certain undertakings should be excluded from the application of this Directive by virtue of the size of their turnover. This applies to those public undertakings whose business is not conducted on such a scale as to justify the administrative burden of ensuring transparency. In view of the limited potential for an effect on trade between Member States, it is not necessary, at this time, to require separate accounts in relation to the supply of certain categories of services.

(19) This Directive is without prejudice to other provisions of the Treaty, notably Articles 86(2), 88 and 296, and to any other rules concerning the provision of information by Member States to the Commission.

(20) In cases where the compensation for the fulfilment of services of general economic interest has been fixed for an appropriate period following an open, transparent and non-discriminatory procedure it does not seem necessary to require such undertakings to maintain separate accounts.

(21) The undertakings in question being in competition with other undertakings, information acquired should be covered by the obligation of professional secrecy.

(22) A reporting system based on ex post facto checks of the financial flows between public authorities and public undertakings operating in the manufacturing sector will enable the Commission to fulfil its obligations. That system of control must cover specific financial information.

(23) In order to limit the administrative burden on Member States, the reporting system should make use of both publicly available data and information available to majority shareholders. The presentation of consolidated reports is to be permitted. Incompatible aid to major undertakings operating in the manufacturing sector will have the greatest distortive effect on competition in the common market. Therefore, such a reporting system may at present be limited to undertakings with a yearly turnover of more than EUR 250 million.

(24) This Directive should be without prejudice to the obligations of the Member States relating to the time-limits for transposition into national law of the Directives set out in Annex I, Part B.

HAS ADOPTED THIS DIRECTIVE:

Article 1

1. The Member States shall ensure that financial relations between public authorities and public undertakings are transparent as provided in this Directive, so that the following emerge clearly:

(a) public funds made available directly by public authorities to the public undertakings concerned;

(b) public funds made available by public authorities through the intermediary of public undertakings or financial institutions;

(c) the use to which these public funds are actually put.

2. Without prejudice to specific provisions laid down by the Community the Member States shall ensure that the financial and organisational structure of any undertaking required to maintain separate accounts is correctly reflected in the separate accounts, so that the following emerge clearly:

(a) the costs and revenues associated with different activities;

(b) full details of the methods by which costs and revenues are assigned or allocated to different activities.

Article 2

For the purpose of this Directive:

(a) ‘public authorities’ means all public authorities, including the State and regional, local and all other territorial authorities;

(b) ‘public undertakings’ means any undertaking over which the public authorities 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 public authorities shall be presumed when these authorities, directly or indirectly in relation to an undertaking:

(i) hold the major part of the undertaking’s subscribed capital; or

(ii) control the majority of the votes attaching to shares issued by the undertakings; or

(iii) can appoint more than half of the members of the undertaking’s administrative, managerial or supervisory body;

(c) ‘public undertakings operating in the manufacturing sector’ means all undertakings whose principal area of activity, defined as being at least 50% of total annual turnover, is in manufacturing. These undertakings are those whose operations fall under Section D — Manufacturing being subsection DA up to and including subsection DN of the NACE (Rev.1) classification (1);

(d) ‘undertaking required to maintain separate accounts’ means any undertaking that enjoys a special or exclusive right granted by a Member State pursuant to Article 86(1) of the Treaty or is entrusted with the operation of a service of general economic interest pursuant to Article 86(2) of the Treaty, that receives public service compensation in any form whatsoever in relation to such service and that carries on other activities;

(e) ‘different activities’ means, on the one hand, all products or services in respect of which a special or exclusive right is granted to an undertaking or all services of general economic interest with which an undertaking is entrusted and, on the other hand, each other separate product or service in respect of which the undertaking is active;

(f) ‘exclusive rights’ means rights that are granted by a Member State to one undertaking through any legislative, regulatory or administrative instrument, reserving it the right to provide a service or undertake an activity within a given geographical area;

(g) ‘special rights’ means rights that are granted by a Member State to a limited number of undertakings, through any legislative, regulatory or administrative instrument, which, within a given geographical area:

(i) limits to two or more the number of such undertakings, authorised to provide a service or undertake an activity, otherwise than according to objective, proportional and non-discriminatory criteria; or

(ii) designates, otherwise than according to such criteria, several competing undertakings, as being authorised to provide a service or undertake an activity; or

(iii) confers on any undertaking or undertakings, otherwise than according to such criteria, any legal or regulatory advantages which substantially affect the ability of any other undertaking to provide the same service or to operate the same activity in the same geographical area under substantially equivalent conditions.

Article 3

The transparency referred to in Article 1(1) shall apply in particular to the following aspects of financial relations between public authorities and public undertakings:

(a) the setting-off of operating losses;

(b) the provision of capital;

(c) non-refundable grants, or loans on privileged terms;

(d) the granting of financial advantages by forgoing profits or the recovery of sums due;

(e) the forgoing of a normal return on public funds used;

(f) compensation for financial burdens imposed by the public authorities.

Article 4

1. To ensure the transparency referred to in Article 1(2), the Member States shall take the measures necessary to ensure that for any undertaking required to maintain separate accounts:

(a) the internal accounts corresponding to different activities are separate;

(b) all costs and revenues are correctly assigned or allocated on the basis of consistently applied and objectively justifiable cost accounting principles;

(c) the cost accounting principles according to which separate accounts are maintained are clearly established.

2. Paragraph 1 shall only apply to activities which are not covered by specific provisions laid down by the Community and shall not affect any obligations of Member States or undertakings arising from the Treaty or from such specific provisions.

Article 5

1. As far as the transparency referred to in Article 1(1) is concerned, this Directive shall not apply to financial relations between the public authorities and:

(a) public undertakings, as regards services the supply of which is not liable to affect trade between Member States to an appreciable extent;

(b) central banks;

(c) public credit institutions, as regards deposits of public funds placed with them by public authorities on normal commercial terms;

(d) public undertakings whose total annual net turnover over the period of the two financial years preceding that in which the funds referred to in Article 1(1) are made available or used has been less than EUR 40 million. However, for public credit institutions the corresponding threshold shall be a balance sheet total of EUR 800 million.

2. As far as the transparency referred to in Article 1(2) is concerned, this Directive shall not apply:

(a) to undertakings, as regards services the supply of which is not liable to affect trade between Member States to an appreciable extent;

(b) to undertakings whose total annual net turnover over the period of the two financial years preceding any given year in which it enjoys a special or exclusive right granted by a Member State pursuant to Article 86(1) of the Treaty, or in which it is entrusted with the operation of a service of general economic interest pursuant to Article 86(2) of the Treaty is less than EUR 40 million; however, for public credit institutions the corresponding threshold shall be a balance sheet total of EUR 800 million;

(c) to undertakings which have been entrusted with the operation of services of general economic interest pursuant to Article 86(2) of the Treaty if the compensation they receive, in any form whatsoever, was fixed for an appropriate period following an open, transparent and non-discriminating procedure.

Article 6

1. Member States shall ensure that information concerning the financial relations referred to in Article 1(1) be kept at the disposal of the Commission for five years from the end of the financial year in which the public funds were made available to the public undertakings concerned. However, where the same funds are used during a later financial year, the five-year time limit shall run from the end of that financial year.
2. Member States shall ensure that information concerning the financial and organisational structure of undertakings referred to in Article 1(2) be kept at the disposal of the Commission for five years from the end of the financial year to which the information refers.

3. Member States shall, where the Commission considers it necessary so to request, supply to it the information referred to in paragraphs 1 and 2, together with any necessary background information, notably the objectives pursued.

Article 7

The Commission shall not disclose such information supplied to it pursuant to Article 6(3) as is of a kind covered by the obligation of professional secrecy.

The first paragraph shall not prevent publication of general information or surveys which do not contain information relating to particular public undertakings to which this Directive applies.

Article 8

1. Member States whose public undertakings operate in the manufacturing sector shall supply the financial information as set out in paragraphs 2 and 3 to the Commission on an annual basis within the timetable contained in paragraph 5.

2. The financial information required for each public undertaking operating in the manufacturing sector and in accordance with paragraph 4 shall be the annual report and annual accounts, in accordance with the definition of Council Directive 78/660/EEC (1). The annual accounts and annual report include the balance sheet and profit/loss account, explanatory notes, together with accounting policies, statements by directors, segmental and activity reports. Moreover, notices of shareholders’ meetings and any other pertinent information shall be provided.

The reports required shall be provided for each individual public undertaking separately, as well as for the holding or subholding company which consolidates several public undertakings in so far as the consolidated sales of the holding or subholding company lead to its being classified as ‘manufacturing’.

3. The following details, in so far as not disclosed in the annual report and annual accounts of each public undertaking, shall be provided in addition to the information referred to in paragraph 2:

(a) the provision of any share capital or quasi-capital funds similar in nature to equity, specifying the terms of its or their provision (whether ordinary, preference, deferred or convertible shares and interest rates; the dividend or conversion rights attaching thereto);

(b) non-refundable grants, or grants which are only refundable in certain circumstances;

(c) the award to the enterprise of any loans, including overdrafts and advances on capital injections, with a specification of interest rates and the terms of the loan and its security, if any, given to the lender by the enterprise receiving the loan;

(d) guarantees given to the enterprise by public authorities in respect of loan finance (specifying terms and any charges paid by enterprises for these guarantees);

(e) dividends paid out and profits retained;

(f) any other forms of State intervention, in particular, the forgoing of sums due to the State by a public undertaking, including inter alia the repayment of loans, grants, payment of corporate or social taxes or any similar charges.

The share capital referred to in (a) shall include share capital contributed by the State directly and any share capital received contributed by a public holding company or other public undertaking, including financial institutions, whether inside or outside the same group, to a given public undertaking. The relationship between the provider of the finance and the recipient shall always be specified.

4. The information required by paragraphs 2 and 3 shall be provided for all public undertakings whose turnover for the most recent financial year was more than EUR 250 million.

The information required above shall be supplied separately for each public undertaking including those located in other Member States, and shall include, where appropriate, details of all intra- and inter-group transactions between different public undertakings, as well as transactions conducted directly between public undertakings and the State.

Certain public enterprises split their activities into several legally distinct undertakings. For such enterprises the Commission is willing to accept one consolidated report. The consolidation should reflect the economic reality of a group of enterprises operating in the same or closely related sectors. Consolidated reports from diverse, and purely financial, holdings shall not be sufficient.

5. The information required under paragraphs 2 and 3 shall be supplied to the Commission on an annual basis.

The information shall be provided within 15 working days of the date of publication of the annual report of the public undertaking concerned. In any case, and specifically for undertakings which do not publish an annual report, the required information shall be submitted not later than nine months following the end of the undertaking’s financial year.

6. In order to assess the number of companies covered by this reporting system, Member States shall supply to the Commission a list of the companies covered by this Article and their turnover. The list is to be updated by 31 March of each year.

7. Member States will furnish the Commission with any additional information that it deems necessary in order to complete a thorough appraisal of the data submitted.

Article 9

The Commission shall regularly inform the Member States of the results of the operation of this Directive.

Article 10

Directive 80/723/EEC, as amended by the Directives listed in Annex I, Part A, is repealed, without prejudice to the obligations of the Member States relating to the time-limits for transposition into national law of the Directives set out in Annex I, Part B.

References to the repealed Directive shall be construed as references to this Directive and shall be read in accordance with the correlation table in Annex II.

Article 11

This Directive shall enter into force on 20 December 2006.

Article 12

This Directive is addressed to the Member States.

Done at Brussels, 16 November 2006.

For the Commission
Neelie KROES
Member of the Commission
ANNEX I

PART A

REPEALED DIRECTIVE WITH ITS SUCCESSIVE AMENDMENTS
(referred to in Article 10)

Commission Directive 80/723/EEC
Commission Directive 85/413/EEC
Commission Directive 93/84/EEC
Commission Directive 2005/81/EC

(OJ L 195, 29.7.1980, p. 35)
(OJ L 229, 28.8.1985, p. 20)
(OJ L 254, 12.10.1993, p. 16)
(OJ L 193, 29.7.2000, p. 75)
(OJ L 312, 29.11.2005, p. 47)

PART B

LIST OF TIME LIMITS FOR TRANSPOSITION INTO NATIONAL LAW
(referred to in Article 10)

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