

Case No: 68563
Event No: 621964
Decision No: 391/11/COL

EFTA SURVEILLANCE AUTHORITY DECISION

of 14 December 2011

on the Power Contract between the National Power Company in Iceland (*Landsvirkjun*) and Alcan for Straumsvík Aluminium Plant.

(Iceland)

The EFTA Surveillance Authority (“the Authority”),

HAVING REGARD to the Agreement on the European Economic Area (“the EEA Agreement”), in particular to Articles 61 to 63 and Protocol 26,

HAVING REGARD to the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice (“the Surveillance and Court Agreement”), in particular to Article 24,

HAVING REGARD to Protocol 3 to the Surveillance and Court Agreement (“Protocol 3”), in particular to Article 1(3) of Part I and Article 4(2) of Part II,

Whereas:

I. FACTS

1. Procedure

- (1) By letter received on 9 July 2010 (Event No 563735) the Icelandic authorities notified, for legal certainty, a power contract entered into between the National Power Company, Landsvirkjun, and Alcan Iceland Ltd. pursuant to Article 1(3) of Part I of Protocol 3. Additional information was received separately from Landsvirkjun by letter received by the Authority on 16 July 2010 (Event No 564442) as a part of the notification.
- (2) By letter dated 16 September 2010 (Event No 569572) the Authority requested additional information. By letter received 18 November 2010 (Event No 578067), the Icelandic authorities replied to the information request.
- (3) By letter dated 19 January 2011 (Event No 583435) the Authority requested additional information from the Icelandic authorities. The Authority received a reply on 1 March 2011 (Event No 589002), and by letters received 19 April and 30 May 2011 (Events Nos 595072 and 599689) Landsvirkjun provided additional clarifications. Subsequently, by letter dated 13

July 2011 (Event No 603266) the Authority requested additional information from the Icelandic authorities. By letter received 15 September 2011 (Event No 608805) the Icelandic authorities replied to the information request and, finally, provided further clarifications in a letter received 6 October 2011 (Event No 610675).

2. Description of the proposed measure.

- (4) Landsvirkjun and Alcan Iceland Ltd. signed on 15 June 2010 a contract (“the Power Contract”) on the provision of electricity from Landsvirkjun to Alcan Iceland Ltd. for the aluminium smelter the latter operates in Straumsvík, Hafnarfjörður, Iceland.
- (5) The Icelandic authorities have notified the Power Contract to the Authority for legal certainty. They are of the opinion that the Power Contract does not entail the granting of state aid.

2.1 The parties to the Power Contract

- (6) Alcan Iceland Ltd. (“Alcan”), organized under Icelandic law, has operated an aluminium smelter in Straumsvík (“the Straumsvík Smelter”) since 1 October 1969. The sole owner of Alcan is Rio Tinto Alcan Inc., a corporation governed by the laws of Canada, operating smelters through subsidiaries worldwide and selling aluminium to Europe.
- (7) The Straumsvík Smelter currently has a production capacity of approximately 182 thousand tonnes of primary aluminium per annum and intends to expand the Smelter to a total capacity of 225 thousand tonnes per annum.
- (8) Landsvirkjun is a public partnership company regulated by Act No 42/1983 on Landsvirkjun (“the Landsvirkjun Act”).
- (9) Landsvirkjun produces electricity from renewable hydro and geothermal sources. Landsvirkjun processes 75% of all electricity in Iceland and is the country's biggest electric generator¹. Landsvirkjun sells 85% of its electricity to power intensive industries. Apart from providing power for the Straumsvík Smelter, Landsvirkjun provides power to two additional aluminium smelters in Iceland: Norðurál Grundartangi (1,612 GWh) and Alcoa Fjarðaál (5,044 GWh).
- (10) Following the liberalization of the electricity sector the Electricity Act was adopted in 2005 and the Landsvirkjun's Transmission Division became Landsnet, an independent limited liability company and a subsidiary of Landsvirkjun. Landsnet owns and operates the Icelandic transmission system.
- (11) Landsvirkjun was established as an enterprise, jointly owned by the State Treasury and the City of Reykjavík in equal parts, on the basis of Act 59/1965 on Landsvirkjun, by a Partnership Agreement of 1 July 1965 between the Government of Iceland and the City Council of Reykjavík. Laxá Power Station, a power company jointly owned by the Town of Akureyri and the State Treasury, was merged with Landsvirkjun with effect from 1 July 1983 and as a result Landsvirkjun became a national electricity company, whereas it had been operating only in parts of the country before.

¹ Total electricity production in Iceland is 17 059 GWh. Landsvirkjun produces 12 534 GWh (2010 figures).

- (12) The founding of Landsvirkjun in 1965 may be traced to the Icelandic government's growing interest in increasing the utilization of hydroelectric energy resources by attracting foreign investors for power-intensive industry in Iceland. This happened following the Swiss Aluminium Ltd. interest in building an aluminium plant in Iceland; the Straumsvík Aluminium Plant. Swiss Aluminium Ltd. (now Alcan Holdings Switzerland AG) is wholly owned by Rio Tinto Alcan Ltd. .
- (13) Landsvirkjun is now governed by the provisions of the Landsvirkjun Act from 1983, as amended. The legal form of the company is a public partnership according to Art 1(1) of the Landsvirkjun Act with a joint liability, which means that the owners are liable for all of Landsvirkjun's liabilities.
- (14) As of 1 January 2007, the State Treasury took over the ownership shares of the Town of Akureyri and the City of Reykjavík in Landsvirkjun. The company remained a partnership company with joint liability of the owners. Landsvirkjun is now jointly owned by the State Treasury (99.9 %) and Eignarhlutir ehf. (0.1 %). The latter is a limited liability company wholly owned by the State Treasury. The state's interests are controlled by the Ministry of Finance. Subsequent to the signing of the Power Contract, the Landsvirkjun Act was amended by Act No 21/2011. Since the Power Contract under assessment was signed before the amendments and thus do not influence the contract, these amendments will not be addressed in this Decision.
- (15) According to the Landsvirkjun Act, the company shall be financially independent. It is foreseen that Landsvirkjun shall pay dividends to its owners, determined on the basis of the performance of the company and the profits carried forward from preceding years.
- (16) Landsvirkjun's board of directors is composed of five members and an equal alternate members, all appointed by the Minister of Finance. The board adopts their own Rules of Procedure and according to the information provided by the Icelandic authorities the board functions like any other independent board of directors of a company engaging in competitive business operations.

2.2 The notified Power Contract

2.2.1 Background information

- (17) The Power Contract replaces previous contracts entered into by the same parties (i) on 28 June 1966 with amendments dated respectively on 28 October 1969, 10 December 1975, 5 November 1984 and 16 November 1995, and (ii) on 23 January 2003 on additional power (collectively referred to as "the Old Contract" in this Decision). The Old Contract was attached to an agreement ("the Master Agreement") between the Icelandic Government and Swiss Aluminium Ltd. (now Alcan Holdings Switzerland AG, wholly owned by Rio Tinto Alcan Ltd.) from 28 March 1966, see Act No 76/1966 on the entry into force of the Master Agreement². The Master Agreement had various references to the Old Contract and specific references to the delivery of power. The Old Contract could not be amended without the approval of the Icelandic Government. The Old Contract would have expired 30 September 2014. The Old Contract was subject to an optional extension period of 10 years which in that case would have had an ultimate expiry date on 30 September 2024.

² Available at <http://www.althingi.is/alttext/86/s/pdf/0434.pdf>

- (18) In the Old Contract, like other power contracts with aluminium companies in Iceland, the price was linked to the price of aluminium as of the 1975 amendment referred to in paragraph 17.
- (19) Alcan purchased all its power for the operation of the Straumsvík Smelter under the Old Contract in the quantity of approximately 335 MW corresponding to 2,932 GWh per year in terms of energy supplied.
- (20) In 2005 Alcan expressed its interest in enlarging the Straumsvík Smelter by 280 thousand tons which would require 470 MW of electric power in addition to the existing 335 MW. Initially, Alcan planned to obtain 270 MW from Landsvirkjun and 200 MW from Reykjavík Energy. A preliminary agreement was reached between Landsvirkjun and Alcan at the end of 2006 but as Alcan did not get the permission required to expand the Straumsvík Smelter, the agreement did not enter into force. In February 2008 yet another preliminary agreement was reached between Landsvirkjun and Alcan, to extend the Old Contract and to provide additional 75 MW for a more moderate expansion of the Straumsvík Smelter. This preliminary agreement foresaw [...] % increase in the power price from the Old Contract and the [...] in Iceland was paying, according to Landsvirkjun's best knowledge, yet connected to the price of aluminium. However, in October 2008 the financial crisis in Iceland put the negotiation on hold.
- (21) During 2009 Landsvirkjun commissioned the British consultancy company CRU to review and assess the existing preliminary agreement with Alcan. According to the information provided³, CRU established that out of 184 aluminium smelters worldwide, Iceland provided the 14th lowest price and 3rd lowest out of 32 smelters in Europe. In line with CRU's conclusion, Landsvirkjun's new management concluded that the terms of the preliminary agreement reached with Alcan in 2008 were not acceptable, considering in particular higher cost of capital, less favourable credit rating of Landsvirkjun, limited access to credit and less possibilities of hedging linked to the price of aluminium. The management also referred to the long duration of the preliminary agreement; until 2038 without any revision of the price. Furthermore, the management referred to the considerable increased power price in the US and in Europe in the past years and the risk involved in linking the power price to aluminium prices.
- (22) In May 2010 the negotiations resulted in a new draft agreement between Landsvirkjun and Alcan. The power price would be ≥ 30 USD per MWh from 1 October 2010 to 31 March 2012 and ≥ 30 USD thereafter, for a total 410 MW and 3,590 GWh per year. The price would be linked to US Consumer Price Index of January 2010. The additional power needed would be available on 1 April 2012 and the duration of the contract would be 24 years as of that date, with a revision of the price as of 1 April 2024. The management estimated that the new draft agreement would generate up to [...] million USD additional profit (net present value) compared to the preliminary agreement of 2008. The Power Contract was signed on 15 June 2010 on this basis. On 22 December 2010 the Old Contract was removed from the Master Agreement by way of Act No 145/2010⁴.

³ Information received from Landsvirkjun on 19.4.2011 (Event No 595072); Minutes of the Board, dated 19.2.2010.

⁴ Available at <http://www.althingi.is/alttext/139/s/0589.html>

2.2.2 The terms of the Power Contract

- (23) As previously mentioned, the Power Contract was signed on 15 June 2010 and entered into force on 1 October 2010. The duration of the Power Contract is 25 ½ years, or until 31 March 2036. According to Article 22 the contract can be extended for additional five years, subject to negotiation.
- (24) The Power Contract is twofold. First, it involves a renegotiated price on the sale of energy under the Old Contract, and secondly, it entails a provision of additional power (75 MW) for Alcan's production increase. The increase in power (from the current 335 MW to 410 MW) Landsvirkjun will make available in steps during the years 2012 to 2014 during which Alcan will expand its smelter from the current production capacity of 182 tonnes of primary aluminium per annum to 225 tonnes per annum.
- (25) Total volume of the Power Contract is 3,590 GWh or 21% of total power production in Iceland and 29% of the total power processed by Landsvirkjun.
- (26) According to Article 12 of the Power Contract, the power price is ≥ 30 USD per MWh for the period from 1 October 2010 to 31 March 2012 and ≥ 30 USD from 1 April 2012 until the expiry of the contract in 2036. The power price applicable for each month shall be calculated on the basis of the US Consumer Price Index for January 2010. The price shall be revised once, 1 April 2024, according to a Price Equilibrium Mechanism prescribed in the Power Contract. This mechanism's objective shall be to keep a similar competitive position of the Straumsvík Smelter as it was at the time of signing the Power Contract (June 2010) and Landsvirkjun is given the opportunity to ensure that its power remains competitive in line with other energy producers supplying power to the aluminium industry. Included in the power price is transmission cost.
- (27) According to Article 3 of the Power Contract, Landsvirkjun undertakes to continue making available for Alcan an annual energy of total 2,932 GWh, whereof 2,639 GWh is to be made available on a firm basis ("Firm Energy") and 293 GWh on an interruptible basis ("Secondary Energy"). During the years 2012, 2013 and 2014 Landsvirkjun will make available additional power in steps, resulting in a total supply as shown in Table 1:

		Firm Energy	Secondary Energy	Total at year end
2012	Capacity (pr hour)	333 MW	37 MW	370 MW
	Energy per calendar year	2,745 GWh	305 GWh	3,050 GWh
2013	Capacity (pr hour)	353 MW	39 MW	392 MW
	Energy per calendar year	3,024 GWh	336 GWh	3,360 GWh
2014	Capacity (pr hour)	369 MW	41 MW	410 MW
	Energy per calendar year	3,222 GWh	358 GWh	3,580 GWh
2015-2036	Capacity (pr hour)	369 MW	41 MW	410 MW
	Energy per calendar year	3,231 GWh	359 GWh	3,590 GWh

Table 1 - Contract Power

- (28) Article 7 of the Power Contract contains a "Take or Pay Obligation" for Alcan. The Article states that the Straumsvík Smelter must pay for a minimum a fixed amount of energy per calendar year regardless of whether the actual consumption is less, as shown below:

2011	[...] GWh
2012	[...] GWh
2013	[...] GWh
2014	[...] GWh
2015 throughout 2035	[...] GWh
1.1. to 31.3.2036	[...] GWh

Table 2 - Take or Pay Obligation

- (29) This constitutes [...] of the Contract Power and [...] of the portion constituting Firm Energy (see Table 1). The obligation is substantially similar to that applicable to the other Icelandic smelters.
- (30) The continued power supply (335 MW) will come from Landsvirkjun's existing power plants whereas the additional power supply (75 MW) will mainly come from a new facility; Búðarháls Power Plant ("the Power Plant").
- (31) The construction of the Power Plant started in November 2010 and the plant is estimated to begin delivery of energy at the end of 2013. The estimated power of the station is about 95 MW and its energy capacity is up to 585 GWh per annum.
- (32) Landsvirkjun has provided profitability calculation of the Power Plant based on the Discounted Cash Flow method where the net present value of the expected cash flow is computed and discounted at Landsvirkjun's weighted average cost of capital (WACC). The investment cost was budgeted at 208.5 million USD and the expected rate of return on equity (ROE) is [...].% The life span of the Power Plant is estimated to be 60 years, which is said to be normal based on Landsvirkjun's maintenance strategy for new hydropower plants and reinvestments every 10 years. No terminal value is assumed after the 60 years.
- (33) The assumptions of the Discounted Cash Flow are the following: The WACC estimated after taxes in [...].% based on [...].% debt financing and [...].% equity. Landsvirkjun's return on equity, ROE, minimum rate is [...].%. Landsvirkjun estimated funding cost is around [...].bp plus US Libor rate with maturity from 16 to 21 years. The expected internal rate of return (IRR) for the project is [...].% and based on the financing split the expected ROE is around [...].% or [...].percentage points higher than the minimum rate.
- (34) Landsvirkjun has provided sensitivity analysis for the project cost ranging from 85% to 115% of the cost estimates which gives ROE from [...].% to [...].%. The power price is expected to increase by [...].% when the Power Contract expires in 2036. Ranging from 0% to 50% increase gives ROE [...].% to [...].%.
- (35) Landsvirkjun has further explained that it has decided to reduce its dependency of adjusting price with the price of aluminium. It has submitted that the main reason for that is risk of mitigation, a risk that became quite apparent during years 2008 and 2009, when the price of primary aluminium dropped from 3,300 USD per ton to 1,300 USD per ton. Having close to 70% of the company's revenues fluctuating with the price of aluminium was not acceptable to Landsvirkjun's risk committee. Furthermore, the credit rating companies had repeatedly referred to the company's aluminium price risk and the need to reduce that risk.

2.3 Comments from the Icelandic authorities

- (36) The Icelandic authorities submit that the Power Contract is negotiated at an arm's length on commercial terms and does not entail any granting of state aid. They have further explained that the Power Contract is partly a prolongation of an older contract, entered into in 1966. The Old Contract provided electricity to a smelter with annual production capacity of 182,000 tonnes. The notified Power Contract will provide electricity to a smelter with 225,000 tonnes annual capacity. The expansion of the Straumsvík Smelter will be powered mostly by a new hydro power facility, Búðarháls Power Plant as of 2014. The Icelandic authorities have explained that Landsvirkjun estimates the rate of return on equity of the 210 million USD investment in the Power Plant to be [...]%
- (37) The Icelandic authorities have further submitted, that the isolation of the Icelandic power market from the rest of the European interconnected power market has characterized the market for electricity to industries in Iceland. The following information have been provided⁵ on Landsvirkjun's average power price to power intensive industry in Iceland in the past⁶:

Year	USD per MWh
2002	12.8
2003	13.8
2004	17.0
2005	21.6
2007	27.8
2008	30.3
2009	19.0
2010	25.1

Table 3 – Average price to power intensive industry in Iceland

- (38) The power price under the Power Contract was [≥ 30] USD per MWh (incl. transmission costs) in its first term according to information provided by the Icelandic authorities. As of 1 April 2012 the price will be [≥ 30] USD per MWh, adjusted according to the Consumer Price Index in the US, with base period index for January 2010 which is 217.587 points.
- (39) The Icelandic authorities have estimated that the notified Power Contract will entail around [...] % higher power price than the Old Contract, which was linked to aluminium prices.
- (40) The Icelandic authorities have submitted that in order to minimize the risk of overinvestment and safeguard the revenues of new power plants, long term power contracts (up to 20 years) have been necessary, with a Take or Pay Obligation. According to the information provided by the Icelandic authorities the other six existing power contracts in Iceland, entered into by Landsvirkjun with power intensive industries from 1979 to 2010, are of 20 to 21 years of duration and some of them have two 20 years contact periods with a mid-term revision. The Icelandic authorities have pointed out that the Old Contract was due for an extension term of

⁵ Letters from the Icelandic authorities received on 18.11.2010 (Event No 578067) and on 1.3.2011 (Event No 589002).

⁶ The Authority understands that transmission costs are included in the average prices provided as explained on page 2 in a letter from the Icelandic authorities received on 15.9.2011 (Event No 60885).

10 years in year 2014; *i.e.* until 2024. Therefore, the notified Power Contract expiring in 2036, in fact only adds 12 years to the Old Contract as regards the volume of power that was already provided under that contract.

II. ASSESSMENT

1. The presence of state aid

(41) Article 61(1) of the EEA Agreement reads as follows:

“Save as otherwise provided in this Agreement, any aid granted by EC Member States, EFTA States or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Contracting Parties, be incompatible with the functioning of this Agreement.”

1.1 State resources

(42) In order to establish that a measure involves the grant of state aid under Article 61(1) of the EEA Agreement the Authority must establish that the measure confers an economic advantage which the undertaking would not have received in the normal course of business. To be qualified as state aid, the advantage must be granted by the State or through state resources. The advantage can also be granted through a public undertaking provided there is imputability to the State⁷. The European Court of Justice held in *Stardust Marine*⁸ that:

“...“Art. 87 (1) EC covers all the financial means by which the public authorities may actually support undertakings, irrespective of whether or not those means are permanent assets of the public sector. Therefore, even if the sums corresponding to the measure in question are not permanently held by the Treasury, the fact that they constantly remain under public control, and therefore available to the competent national authorities, is sufficient for them to be categorised as State resources. [...]

The State is perfectly capable, by exercising its dominant influence over such undertakings of directing the use of their resources in order, as occasion arise, to finance specific advantages in favour of other undertakings. [...] the position of a public undertaking cannot be compared with that of a private undertaking. Through its public undertakings, the State may pursue objectives other than commercial ones, [...].”

(43) In this judgment the Court of Justice however also clarified that the mere fact of the company giving out the funds being public does not suffice to establish the presence of state resources. According to the Court the decisive elements are, on the one hand, whether the State is in a position to control the public undertaking and exercise a dominant influence over its operations and, on the other hand, whether it actually does exercise this

⁷ Case C482/99 *France v Commission (Stardust Marine)* [2002] ECR I-4397, paragraphs 50-59 and Article 1 of the Transparency Directive.

⁸ Case 482/99 *France v Commission (Stardust Marine)*, cited above, paragraph 57.

right of control over the undertaking paying out the funds. At the same time the Court clarified that “it cannot be demanded that it be demonstrated, on the basis of a precise inquiry, that in the particular case the public authorities incited the public undertaking to take the aid measure in question”.

- (44) As a consequence, imputability to the State may be inferred from a set of indicators arising from the circumstances of the case and the context in which that measure was taken. The judgment also contains a non-exhaustive list of possible indicators, including
- a. the legal status of the undertaking (in the sense of its being subject to public law or ordinary company law);
 - b. any other indicator showing, in the particular case, an involvement by the public authorities in the adoption of a measure or the unlikelihood of their not being involved, having regard also to the compass of the measure, its content or the conditions which it contains.
- (45) In his opinion, Advocate General Jacobs also provided a similar non-exhaustive list of possible indicators, including “a general practice of using the undertaking in question for ends other than commercial ones or of influencing its decisions”.
- (46) This list of indicators and the Court’s general formulation, according to which the public authorities must be regarded as having been involved “in one way or another”, seems to suggest that any kind of conduct (active or passive) of the public authorities could suffice to establish imputability. Likewise “the unlikelihood of [the public authorities] not being involved having regard also to the compass of the measure, its content or the conditions which it contains ” shows that imputability could be established merely on the basis of some characteristics of the measure at stake, i.e. when they are such as to render unlikely the non involvement of the State.
- (47) Against this background, the Authority cannot exclude that the conclusion of the notified Power Contract is imputable to the State. Not only is Landsvirkjun fully owned and controlled by the Icelandic state, it has, at least in the past, evidently been used by the State to attract foreign investment by means of offering long term power contracts⁹. This would in particular be the case in the Power Contract under assessment, since it is originated in a contract signed in 1966 which was annexed to a contract between the Icelandic state and the mother company of Alcan, and the very first power contract with the power intensive industry signed in Iceland. It would seem arguable that this would be exactly what AG Jacobs had thought of when he mentioned “a general practice of using the undertaking for ends other than commercial ones” in his opinion on Stardust.
- (48) Moreover, and perhaps most compelling, the legal status of Landsvirkjun, as mentioned by the Court in Stardust, which makes the State fully liable for all of Landsvirkjun’s liabilities, appear to be on its own a very strong indicator for imputability. A prudent owner

⁹ Cf. Opening speech of the former minister of Industry and Commerce Ms. Valgerður Sverrisdóttir, International Aluminium and Power Conference, 4-5 March 2004, available at <http://eng.efnahagsraduneyti.is/minister/speeches/nr/1385>: “For now over 40 years it has been the policy of all governments to promote the utilisation of the country’s clean and renewable hydro and geothermal energy resources for sustainable power development. [...] By promoting the utilisation of these resources, we are diversifying the industrial activity and economy and improving the living standard of the people. We further aim to expand merchandise exports and stimulate foreign investments, such as in the primary aluminum industry. Intensive energy marketing efforts initiated by the Ministry for Industry and Commerce, particularly in the last 15 years, have brought about large investments in the power and energy intensive industry, which gradually have put Iceland on the world map as a serious alternative location for light metal production”.

in a limited liability company would in all likelihood already closely monitor the negotiation and conclusion of contracts of such economic significance as the contract at hand, which would already indicate imputability. However, a limited liability company owner could at most lose his entire investment, the capital that he injected in the company.

- (49) Whereas a (fictitious) limited liability owner could at most lose the entire investment, i.e. the capital that was invested in the company, Landsvirkjun's owner, the Icelandic state, is subject to an all-encompassing obligation to guarantee the company's liabilities. Therefore, at the time of signing the Power Contract, it cannot but be expected to pay even more attention to and possibly exert its influence in situations as the one under assessment, as agreeing on contracts of such importance will not only have economic repercussions for 24 years, but could entail liabilities far exceeding the capital position of the State in Landsvirkjun.
- (50) Overall, the Authority is therefore, in light of the legal status of Landsvirkjun, the past evident use of Landsvirkjun as a tool to attract foreign investment and the general circumstances unable to exclude that the measure is imputable to the State, and that it entails State resources if and to the extent it confers an advantage on Alcan. Whether the contract confers an advantage on Alcan, which would be a further strong indicator of imputability, is assessed below.

1.2 Favours certain undertakings or the production of certain goods

- (51) When governments make financial transactions and investments, the European Court of Justice has stated that in order to confirm whether a state measure constitutes aid, it is necessary to establish whether the recipient undertaking receives an economic advantage, which it would not have obtained under normal conditions¹⁰. In doing so, the Authority has to apply the market economy investor test¹¹, which in essence provides that state aid is granted whenever a state makes funds available to an undertaking which in the normal course of events would not be provided by a private investor applying ordinary commercial criteria and disregarding other considerations of a social, political or philanthropic nature¹².
- (52) The measures at hand – a power contract, with a publicly owned company as a seller, could thus entail an element of state aid if its terms are such that they would not have been acceptable to a private market investor and that the sale of electricity could not have been expected to be sufficiently profitable for a private operator.
- (53) The Authority observes that the issue is to examine whether a private investor operating in a market economy would have chosen to enter into a long term bilateral contract for the same price and on the same terms as in the agreement under assessment.¹³ However, in making that assessment the Authority cannot replace the seller's judgment with its own, which implies that the seller of electricity must enjoy a wide margin of judgment. Whilst the Authority fully recognises the right for public companies such as Landsvirkjun to

¹⁰ Case C-39/94, *SFEI v La Poste*, 2006 ECR I/3547, at paragraph 60.

¹¹ This principle is explained in the Authority's guidelines Part IV Rules on public service compensation, state ownership of enterprises and aid to public enterprises, Application of state aid provisions to public enterprises in the manufacturing sector.

¹² Cf. for example Opinion of Advocate General Jacobs, Joined Cases C-278/92, C-279/92 and C-280/92 *Kingdom of Spain v Commission* [1994] ECR I-4103, at paragraph 28.

¹³ See the Authority's decision No 305/09COL on power sales agreement entered into by Notodden municipality and Becromal Norway AS.

operate on the market on commercial terms, it nevertheless must consider carefully whether similar agreements would have been concluded by a private market investor.¹⁴ Moreover, the Authority must base its assessment of the price and terms of the contracts between Landsvirkjun and Alcan on the information available at the time of the conclusion of the contract.

- (54) As described above, Alcan will be buying power from facilities owned by the state controlled Landsvirkjun. As described under paras 31 – 32 above, the electricity will be partly provided by the existing facilities of Landsvirkjun (the continued provision of 335 MW at renegotiated terms). The additional power (75 MW) which Landsvirkjun will make available in steps during the years 2012 to 2014 will mainly be provided by the new Búðarháls Power Plant.
- (55) First, the Authority will establish whether the construction of the Búðarháls Power Plant is profitable.
- (56) As described in paragraphs 32 to 34 above, Landsvirkjun has provided profitability calculation of the Power Plant based on the so-called Discounted Cash Flow method. The expected rate of return on equity (ROE) for the Power Plant is [...] % based on the assumptions made, whereas the minimum ROE for Landsvirkjun is [...] %.
- (57) Landsvirkjun has provided sensitivity analysis for the project cost ranging from 85% to 115% of the cost estimates which gives ROE from [...] % to [...] %. The lifetime of the Power Plant is expected to be 60 years and the power price is expected to increase by [...] % when the Power Contract expires in 2036. Ranging from 0% to 50% increase gives ROE [...] % to [...] %.
- (58) With respect to the verification of the profitability of the investments made by Landsvirkjun, the cash flow analysis which is applicable for the facilities constructed gives an internal rate of return (IRR) of [...] %. This is higher than the weighted average cost of capital (WACC) which is [...] %.
- (59) Secondly, the analysis gives ROE of [...] % which is [...] percentage points over the minimum required and the sensitivity calculation indicates that the ROE is above the minimum required even at 0% increase in the power price after the expiry of the Power Contract in 2036.
- (60) The Authority concludes that the Búðarháls Power Plant appears to yield an acceptable return. Hence, it seems likely that a private market investor could, under similar circumstances, also have made similar business decisions.
- (61) Next, the Authority must verify whether the price - and other terms - of the part of the power already available and Landsvirkjun will *continue* to provide Alcan with, reflects market price.
- (62) In the case at hand, however, a market price for electricity to power intensive industry in Iceland is not readily available. In this respect it should be noted that there is no alternative outlet in the general Icelandic market for supply of electricity of the magnitude as in the case at hand. The isolated and limited size of the Icelandic market for general

¹⁴ See the Authority's guidelines, Part IV Rules on public service compensation, state ownership of enterprises and aid to public enterprises, Application of state aid provisions to public enterprises in the manufacturing sector, paragraph 5(1).

consumption of electricity would not be able to absorb the production generated by Landsvirkjun. The only outlet would be, as in the current case, large industrial consumers located in Iceland. The isolation of the market also means that the benchmark cannot be established as being the price in Europe.

- (63) In the absence of a relevant benchmark the Authority must rely on the information provided by the Icelandic authorities on the average price paid to Landsvirkjun in the past under the contracts with other power intensive businesses as described under paragraph 37 above, also considering the background of the Power Contract and the much less favourable terms for Landsvirkjun in the Old Contract.
- (64) The Authority observes that Landsvirkjun decided in 2010 to reduce its dependency of adjusting price with the price of aluminium and this seems to decrease the risk for the company. The Authority finds no reason to doubt the reliability of the price assumptions made by Landsvirkjun, demonstrating that the price under the Power Contract will be [...] % higher than foreseen under the Old Contract. Moreover, the price agreed under the new contract is higher than the average price paid by other large users. Furthermore, the Take or Pay Obligation ensures a constant sale of a considerable share of the electricity provided¹⁵. Considering the particular circumstances of this case and keeping in mind the information provided on the negotiation process from 2008 to 2010 described in paras 17 to 22 above, the Authority is of the opinion that the negotiation process prior to the signing of the Power Contract in June 2010 shows that the terms of the Power Contract could have been acceptable to a private investor.
- (65) This is so, in particular, taking into account the disconnection to the price of aluminium resulting in over [...] % higher price in the fourth quarter of 2010 than would have been the case under the Old Contract that was terminated. Moreover, the price for electricity under the new contract is estimated to be [...] % higher for the future, based on aluminium price forecast. Thirdly, the new contract contains a negotiated mid-term revision clause. Lastly, the Icelandic authorities have provided an estimate on the increased profit for Landsvirkjun compared with the preliminary agreement entered into in 2008.
- (66) Thus, for the above mentioned reasons, the Authority concludes that the terms of the new Power Contract fall within the margin of discretion that public companies enjoy in running their business. On the basis of the information provided by the Icelandic authorities, the Authority concludes that the Power Contract does not entail an advantage for Alcan.

1.3 Conclusion on the presence of aid

- (67) As the power contract does not seem to entail an advantage for Alcan, and the criteria laid down in Article 61(1) of the EEA Agreement are cumulative, the Authority will not assess in this decision whether the remaining conditions for a measure to be state aid are met.

2. Procedural requirements

- (68) Pursuant to Article 1(3) of Part I of Protocol 3, “the EFTA Surveillance Authority shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid (...). The State concerned shall not put its proposed measures into effect until the procedure has resulted in a final decision”.

¹⁵ 85% of the Contract Power and 94% of the Firm Energy, see paras 28 and 29 above.

(69) The Icelandic authorities submitted a notification of the Alcan Power Contract, on 9 and 16 July 2010 (Events Nos 563735 and 564442). However, the Power Contract entered into force on 1 October 2010, before the Authority had taken a final decision. The Icelandic authorities therefore did not respect the stand still obligation.

3. Conclusion

(70) On the basis of the foregoing assessment, the Authority considers that the Alcan Power Contract which has been implemented does not constitute state aid within the meaning of Article 61(1) of the EEA Agreement.

HAS ADOPTED THIS DECISION:

Article 1

The EFTA Surveillance Authority considers that the notified power contract between Landsvirkjun and Alcan does not constitute state aid within the meaning of Article 61 of the EEA Agreement

Article 2

This Decision is addressed to the Republic of Iceland.

Article 3

Only the English language version of this decision is authentic.

Decision made in Brussels, on 14 December 2011.

For the EFTA Surveillance Authority

Oda Helen Sletnes
President

Sverrir Haukur Gunnlaugsson
College Member