

Case No: 68955
Event No: 578885
Dec. No: 418/10/COL

EFTA SURVEILLANCE AUTHORITY DECISION

of 3 November 2010

to initiate the formal investigation procedure with regard to regional aid concerning the construction of Verne Data Centre

(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(4) and 6 of Part II,

HAVING REGARD to the Authority’s Guidelines on national regional aid (“the Regional Aid Guidelines”) and on the application of state aid rules to measures relating to direct business taxation (“the Business Taxation Guidelines”),¹

Whereas:

I. FACTS

1. Procedure

On 1 September 2010, the Icelandic authorities notified the Authority of *ad hoc* state aid concerning the construction of a data centre in the municipality of Reykjanesbær, pursuant to Article 1(3) of Part I of Protocol 3, by a letter received and registered by the Authority on the same day (Event No 568140).

On 22 October 2010, the Authority received a written submission relating to the case from the Ministry for Foreign Affairs, dated 21 October 2010 (Event No 574691).

Prior to the notification, the Icelandic authorities had submitted information relating to the case to the Authority by letter of 27 August 2010 (Event No 567872) received and registered on 31 August 2010.

¹ Available at: <http://www.eftasurv.int/state-aid/legal-framework/state-aid-guidelines>

Pre-notification contacts between the Icelandic authorities and the Authority took place in the period from 23 December 2009 until 11 May 2010.

Apart from the notification letter, the Icelandic authorities have submitted a number of annexes, amongst other various agreements entered into by the beneficiary, a memorandum of understanding and email correspondence relating to it, a letter from the beneficiary, a letter from the Minister for Foreign Affairs, a calculation of aid impact on equity returns, a letter from an investor, calculation of estimated aid amount, PriceWaterhouseCoopers Benchmark Study and a KPMG report on the socioeconomic impacts of the project.

2. Description of the proposed measures

2.1. Introduction

The Icelandic authorities intend to provide, under the Regional Aid Guidelines, *ad hoc* aid to Verne Holdings ehf., for the construction of a data centre in a region eligible for regional aid pursuant to Article 61(3)(c) of the EEA Agreement in order to promote regional development.

2.2. The beneficiary of the aid

Verne Holdings ehf. is a privately held company registered in Iceland in June 2007. Verne has three wholly owned subsidiaries, Verne Global, Inc. registered in the United States of America, Verne Global Ltd., registered in the United Kingdom and Verne Real Estate ehf., registered in Iceland in March 2008².

According to information provided by the Icelandic authorities, Verne Holdings ehf. is owned by a number of minority shareholders, the two largest being Novator, which is a global investor, and Teha Investments S.A.R.L., which is a wholly owned subsidiary of Teha Holdings, LLC, a wholly owned subsidiary of General Catalyst Partners V, one of a number of funds managed by General Catalyst Partners LLC, a US based venture capital firm with over USD 2 billion under management. The management holds a substantial share of the Verne, according to information submitted by the Icelandic authorities.

The objective of Verne is to develop data centres in optimised geographic areas that offer the best total cost of ownership (TCO) and 100% renewable power without a price premium.³

2.3. Description of the project

According to the notification Verne intends to construct, in three phases over a seven year period, a campus of high-reliability, high power density wholesale data centre in the municipality of Reykjanesbær, which is in the south-western part of Iceland.

Upon completion, the project is expected to consist of up to four main computer buildings (two of them being two old warehouses purchased from the State and two of them being planned new buildings) and several (new) support buildings, encompassing over 20 000 square meters of technical space and delivering 80MW to 140MW of utility load to power

² For the purpose of this Decision Verne Holding ehf. and Verne Real Estate ehf. will be referred to collectively as Verne.

³ Information from the Internet site of Verne Global: www.verneglobal.com.

and cool the servers in the data centre. The buildings will house commercial grade electrical, mechanical and IT systems to run computing gear.

Verne intends to offer its customers a suite of mission critical computing infrastructure services including power, cooling, computer room space, security, and in-building connectivity to operate their servers. These services will typically be sold on a long-term basis via ten year service contracts or leases and, in more exceptional case, service contracts or leases of five years. Verne's customers will include any large-scale user of data centre services, including, but not limited to, customers from the financial services, internet/media, life sciences, oil and gas, and academic and research high performance computing sectors. Additionally, Verne's target customer base includes global IT integrators. Verne will however not offer IT management services as part of its core suite of services. Verne intends to employ Icelandic IT service providers to manage those functions, where required by its customers.

Upon completion of the first building Verne will be able to offer customers modular critical environment suites in either 375 or 750 square-meter sizes. Depending on density requirements, the suites will offer the flexibility of being powered from 1.6 kilowatts per square meter to 3.2 kilowatts per square meter. The small suite will accommodate up to 1.2 megawatts of fully redundant, UPS-protected power and the large suite accommodates up to 2.4 megawatts of redundant UPS power.

On 26 February 2008, Verne purchased buildings on the site in question made up of two large warehouses (11 064 m² and 16 606 m²) built in 1954 and 1955 and three smaller support buildings from the Icelandic Treasury. These buildings had been the property of the US military, and had not been used since the departure of the military from Iceland in 2006. The purchase price was USD 14.5 million and the delivery date 26 March 2008⁴. Transfer of title was signed on 9 May 2008. It appears from the information provided by the Icelandic authorities that Verne has, through 2008 and 2009, been refurbishing the two warehouses as part of the planned multi-building campus⁵.

On 9 May 2008, Verne signed a ground lease agreement with the Icelandic Treasury for the 9.6 hectares site⁶ for a period of 99 years⁷. The total rent for the site is USD 0.8 (80 US cents) per m². The lease is not adjusted to any index. The lease agreement includes a three years exclusivity clause, under which the State is prevented from "...enter[ing] into other sale or lease agreements or similar agreements with any other competitive multi-use data center operators, without the express written consent of [Verne]. [...] The 36 month exclusivity period will be maintained provided that [Verne] has made a minimum of \$30.000.000 (US dollars) investment within a 24 month period since May 9th 2008".

⁴ A document entitled "Exhibit C" attached to the purchase agreement reads: "Phase 1 – Renovation of Building 868 into data center, including up to 1,000 m2 new construction. Renovation of Building 869 into data center, including up to 4,000 m2 new construction. Construction of a new generator building of up to 4,000 m2. Construction of two substation building of up to 1,000 m2 each. Construction of a medium voltage UPS building of up to 3,000 m2. Construction of an admin building of up to 4,000 m2."

⁵ The demolition, engineering, design, project management and other site preparation work carried out over the period through October 2008 totaled [...], according to information submitted to the Authority, and amounted to a further [...] in the period November 2008 through December 2009, including physical construction and purchase of electrical and mechanical gear.

⁶ A document entitled "Exhibit B" attached to the lease agreement reads: "Master Plan. Construction of up to 40,000 m2 of new data center buildings. Construction of up to 4 additional generator buildings of up to 4,000 m2 each".

⁷ The site is located at the address Valhallarbraut 868, Reykjanesebær.

The first phase encompasses making the first building operational, costing approximately [...] according to the notification. The building, with 4 800 square meters of technical space, is expected to be ready for use in 2011. It will use 20 MW of utility power.

The second phase encompasses bringing the first building to full occupancy by the end of 2012. This will require an additional [...] of capital, according to information submitted by the Icelandic authorities.

The third and final phase entails making all four buildings operational by the end of 2016.

The total investment cost for the whole project, “*as currently planned*”, is estimated at USD 726 million according to the notification⁸.

2.4. The state intervention under the Verne Act, the Investment Agreement and the Agreement on Licensing and Charges

Since late in 2008, representatives of Verne have been in contact with the Ministry of Industry to discuss the conclusion of a potential Investment Agreement⁹. According to the Icelandic authorities the final draft version of the MoU for the Investment Agreement was reached in April 2009, even though it was not signed¹⁰. However, in May 2009 the Icelandic authorities questioned certain aspects of the MoU and during the summer and autumn of 2009, Verne and the Icelandic authorities continued to negotiate an investment agreement. The agreement was initialled by the managing director of Verne Real Estate ehf. and an official of the Ministry of Industry on 23 October 2009. This document entails, amongst other, several deviations from statutory rules on taxes and fees. The agreement was however not signed. The initialled draft agreement, which has been submitted as part of the notification, will be referred to as “the Investment Agreement” in this decision.

On 4 November 2009, Verne and the municipality of Reykjanesbær signed an agreement (“the Agreement on Licensing and Charges”) on exemptions from, amongst other, statutory rules on municipal property tax and municipal street construction tax.

On 12 December 2009 a Bill authorising the Icelandic authorities to enter into an Investment Agreement was submitted before the Icelandic Parliament.

Act No 57/2010 (“the Verne Act”) adopted by the Icelandic Parliament on 7 June 2010 authorises the Ministry of Industry to enter into an investment agreement on behalf of the Icelandic authorities with Verne Holdings ehf. and Verne Real Estate ehf.¹¹ for the purposes, amongst other, of awarding various tax and fee concessions in relation to the construction of a data centre. The Verne Act provides *inter alia* for various derogations from Icelandic statutory tax and fee legislation in favour of Verne, as will be explained below. The derogations are foreseen to enter into force at the date of signature of a final

⁸ In the preamble to the Investment Agreement this commitment reads as follows: “...over the first five years of its investment, Verne and the Investors estimate that the potential level of investment for the project envisaged above could exceed USD 700 million, and that the power consumption of the Data Center could exceed 140MW”.

⁹ According to an internal memorandum dated 23.10.2008 prepared by the Ministry of Industry, Verne had approached the Ministry shortly before, requesting various measures to reduce the risk and initial cost of the company’s data centre investment; infrastructure, direct grants, tax concessions, incl. VAT remission, and interventions as state guarantee and subsidized electricity prices at the start of operation.

¹⁰ The version of the draft MoU that the Icelandic authorities have referred to as having been concluded in April 2009 will be referred to as “the MoU” in this Decision, if not otherwise stated.

¹¹ Hereinafter collectively referred to as Verne.

investment agreement and remain in force for 13 years from the date of signature. However, the derogations will only apply for a maximum period of ten years from the time that the taxable income is earned, that is in excess of deductible expenses¹².

2.5. Description of the proposed tax and fee concessions

The Verne Act, the Investment Agreement and the Agreement on Licenses and Charges provide for an *ad hoc* aid in the form of various derogations from general legislation¹³. In principle, Verne shall be subject to taxes and other public charges generally levied in Iceland and in line with statutory regulation applicable from time to time, except otherwise provided in the Verne Act.

The tax and fee derogations are mainly listed in Article 4 of the Verne Act. However, Article 3(5) and Article 6 also provide for derogations from taxes and charges dealt with in this decision. The remaining provisions of the Verne Act do not, to the Authority's knowledge, entail granting of state aid.

The aid measures are notified by the Icelandic authorities¹⁴ and identified as entailing state aid within the meaning of the EEA Agreement. These derogations are furthermore stipulated in the Investment Agreement, and in the Agreement on Licensing and Charges as regards the municipality taxes.

The derogations covered by this decision are listed and further described in the following.

2.5.1. Corporate income tax rate

Verne will pay a maximum corporate income tax rate of 15% for the first five years¹⁵. Should the general tax rate become lower than 15%, such lower income tax rate shall also apply to Verne. After the first five years the maximum corporate income tax rate shall be 18% for the next five years (years 5-10) and maximum 25% after ten years.

The current tax rate for limited liability companies according to Act No 90/2003 on income tax is now 18%. At the date of initialling of the Investment Agreement and the Verne Bill was submitted to the Parliament, the tax rate was 15%, but was raised to 18% on 1 January 2010.

2.5.2. Depreciation rules

Verne will be entitled to depreciate equipment used at the data centre to zero residual value, in lieu of the statutory 10% under Act No 90/2003 on income tax¹⁶. Equipment will include, but shall not be limited to, electrical, mechanical, IT and communications gear necessary to support the operations of the data centre.

¹² See Article 1 of the Verne Act.

¹³ However, the Verne Act and the Investment Agreement also include various provisions which merely refer to general tax treatment (such as Article 4(1)(2) of the Verne Act), provisions on equal treatment as regards tax and charges imposed in the future and provisions outside the state aid regime and the scope of this decision.

¹⁴ Except for the exemption from municipal Street Construction tax envisaged in Article 3(5) of the Verne Act and Section 2.3 of the Investment Agreement, to which the Icelandic authorities have not referred in their notification. The Authority will address this derogation under section 2.5.11. below.

¹⁵ According to Article 4(1)(1) of the Verne Act and Section 4 of the Investment Agreement.

¹⁶ According to Article 4(1)(3) of the Verne Act and Section 4.3 of the Investment Agreement.

2.5.3. Industrial- and market charges

Verne will be exempt from industrial charge under Act No 134/1993 on Industrial Charge¹⁷ (0.08% of the turnover) and market charge (0.05% of the labour costs) under Act No 160/2002 on Export Assistance¹⁸, and any present and future similar charges¹⁹.

2.5.4. Stamp duties

Verne will pay reduced stamp duties; 0.15% on all documents issued or entered into by Verne in connection with the construction of the data centre²⁰.

According to Act No 36/1978 on Stamp Duties, stamp duties are payable when various types of legal documents are signed, *inter alia* bonds (1.5% stamp duty on bonds with interest and collateral or guarantee, 0.5% on other bonds) and agreements on lease of real estate (2% of the rental charge).

2.5.5. Zoning fee

Verne will pay a fixed zoning fee of USD 100 000 on new buildings²¹ in respect of the construction of the data centre in lieu of the statutory zoning fee described below.

According to Icelandic legislation, zoning fee is a one-off fee on all new constructions to cover the costs of the Icelandic National Planning Agency. Article 35 of the Planning and Building Act No 73/1997 provides that the fee shall be fixed at 0.3% of either the fire insurance value or initial investments costs of the construction. According to Article 35(3) of the Planning and Building Act, the fee only falls due once the Icelandic Property Registry has appraised the constructions according to Act No 48/1994 on Fire Insurance.

2.5.6. Import duties

Verne is exempt from Icelandic customs/excise duties under Act no 97/1987 on Excise Duties, on import or domestic purchase by the company of construction materials, machinery, equipment and other capital goods and spare parts and related facilities²². Moreover, customs duties and excise duties on goods or services purchased by Verne within the country with respect to the construction of the data centre may be waived or refunded.

Section 5.3 of the Investment Agreement (which is based on an authorisation set out in Article 6 of the Verne Act) exempts Verne from excise duties or customs duties on the import or domestic purchase of raw materials and production supplies required for the operation of the data centre.

2.5.7. Deferral from payment of VAT on imports and electricity

In Iceland VAT on imports is payable under Act No 50/1988 on Value Added Tax. Section 5.2 of the Investment Agreement provides for a deferral (custom credit) for VAT on imports until payment of the refund for the respective clearing period is due. VAT on

¹⁷ Act No 134/1993 is repealed as of 1.1.2011 according to Act No 124/2010 adopted on 22.9.2010, following the Judgment of the European Court of Human Rights on 27.4.2010 which stated that the industrial charge under Act No 134/1993 violated Article 11 of the European Convention on Human Rights.

¹⁸ On 6.5.2010 Act No 160/2002 was repealed and replaced by Act No 38/2010 on the Promote Iceland Agency.

¹⁹ According to Article 4(1)(4) of the Verne Act and Section 2.3 of the Investment Agreement.

²⁰ According to Article 4(1)(5) of the Verne Act and Section 6.1 of the Investment Agreement.

²¹ According to Article 4(1)(7) of the Verne Act and Section 6.2 of the Investment Agreement.

²² According to Article 6 of the Verne Act and Section 5.1 of the Investment Agreement.

the purchase of electricity shall be deferred to the same effect. This is in line with existing statutory rules. However, according to the notification, the Icelandic authorities intend to guarantee Verne against future changes in the legislation in this regard even though not explicitly referred to in the Investment Agreement or provided for in the Verne Act²³.

2.5.8. *Safety control fee for electricity production*

Verne is exempted from paying charges to the Consumer Agency according to Article 14(1)(1-5) of Act No 146/1996 on the Safety of Electrical Installations, Consumer Utilities and Electrical Equipment, and any present and future similar charges²⁴.

2.5.9. *Net worth tax*

Even though not explicitly referred to in the Icelandic authorities' notification, Article 4(1)(9) of the Verne Act and Section 4.4 of the Investment Agreement provides Verne with a five year guarantee against net worth tax that may be introduced after the entry into force of an investment agreement.

2.5.10. *Municipal property tax*

Article 3 of Act No 4/1995 on Sources of Municipal Revenue provides that municipal property tax is levied on an annual basis on real estate (land and buildings, including industrial real estate) evaluated (for property tax purposes) on 31 December the previous year. According to Article 3(2) of the Act the tax rates are fixed each year by the individual municipalities and may be as low as zero but at a maximum 1.65% of the official value of the property. The current tax rate in Reykjanesbær is 1.65%.

According to Article 27 of Act No 6/2001 on Property Registry and Assessment the tax base is the official market value of the property or a cost-based estimate evaluated by the Icelandic Property Registry.

The Verne Act, the Investment Agreement and the Agreement on Licensing and Charges provide Verne with three different derogation from these statutory rules.

Firstly, Verne is guaranteed to pay a property tax of 1.65% (as currently generally levied by Reykjanesbær) on all buildings, premises and facilities owned or leased by Verne also for the future in the event that the tax rate would be increased²⁵.

Secondly, the tax base in respect of Verne's present real-estate assets is fixed at ISK 1.030.600²⁶ and for the future buildings constructed on the site will be the lesser of (i) the costs of the build-out of the exterior shells and (ii) 85 500 ISK per square meter, indexed to the Icelandic Building Cost Index beginning in the month in which Verne commences customer operations/the building becomes operational (pro-rata according to occupancy rate)²⁷.

²³ For the sake of completeness Article 4(3) of the Verne Act clarifies that Icelandic statutory rules and municipal legislation on settlement procedures in respect of income tax and VAT (such as tax returns, due dates, assessment, collection) apply to the company.

²⁴ According to Article 4(1)(6) of the Verne Act and Section 6.6 of the Investment Agreement.

²⁵ According to Article 4(1)(8) of the Verne Act and Section 6.3 of the Investment Agreement.

²⁶ The real-estate official valuation at the time of submitting the Verne Bill and initialling of the Investment Agreement in 2009, excluding the assessed value of the three smaller buildings purchased (see 2.3 above), which were intended for demolition.

²⁷ The municipality tax derogations also form a part of the Agreement on Licensing and Charges between the municipality of Reykjanesbær and Verne signed 4 November 2009, discussed in the following section of this decision.

Thirdly, Verne will pay the property tax only as of 1 January 2011.

2.5.11. Municipal street construction tax

Verne will be exempt from paying street construction fee under Act No 154/2006 on Street Construction tax, and any present and future similar charges, to the extent agreed between Verne and the municipality of Reykjanesbær²⁸.

Street construction fee is a one-off fee payable to the municipality and governed by Act No 154/2006. Under the act, municipalities have an obligation to levy the street construction fee in urban areas. The fee is defined as a tax according to the Act, rather than a service charge. The tax base is the construction planned on the relevant site. The fee shall be further determined and collected by the municipality and the Act provides for the general and specific derogation permitted.

In the pre-notification phase, the Authority received a copy of the Agreement on Licensing and Charges entered into between Verne and the municipality of Reykjanesbær, even though not referred to in the notification²⁹. According to the agreement, the municipality grants Verne a special 75% reduction on street construction tax for all new buildings, provided Verne will in the future at its own expense undertake street construction within the site.

2.6. Eligible costs and aid intensity

The Icelandic authorities have submitted that the cost estimate for the total investment is as follows:

Table 1 Total investment costs

Electrical infrastructure	[...]
Structural work	[...]
Mechanical (cooling) infrastructure	[...]
Exterior finishing	[...]
Interior finishing	[...]
Design	[...]
Civil works	[...]
Total investment cost	USD 726 million³⁰

The Icelandic authorities have submitted that the eligible investment costs (by reference to paragraph 39 of the Regional Aid Guidelines under which eligible expenditure is land, buildings and plant/machinery) are the total investment costs referred to above *i.e.* USD 726 million, or EUR 552 million using the applicable exchange rate on 11 August 2010. Accordingly, the project is a large investment project under Section 4.3 of the Regional Aid Guidelines.

²⁸ According to Article 3(5) of the Verne Act and Section 2.4 of the Investment Agreement.

²⁹ According to the Icelandic authorities the terms of the Agreement on Licensing and Charges were originally negotiated between Verne and the municipality of Reykjanesbær in May 2009 even though not signed until 4.11.2009.

³⁰ The Icelandic authorities have not submitted more detailed breakdown of costs. Thus, it is not clear whether *i.e.* the purchase price of the buildings, USD 14.5 million, is included in table 1 or how the breakdown is as regards each of the three phases.

The Icelandic authorities have submitted that regional investment aid for large investment projects are subject to adjusted regional aid ceilings by reference to paragraph 56 of the Regional Aid Guidelines, as demonstrated in table 2.

Table 2 Adjusted regional aid scale

Eligible expenditure	Adjusted aid ceiling
Up to EUR 50 million	100% of regional ceiling (ICE 15%)
For the part between EUR 50 million and EUR 100 million	50% of regional ceiling (ICE 7.5%)
For the part exceeding EUR 100 million	34% of regional ceiling (ICE 5.1%)

The breakdown of EUR 551 million eligible investment costs, according to the Icelandic authorities, is therefore as follows:

(i)	Up to EUR 50 million (15% of EUR 50 million)	EUR 7.5 million
(ii)	EUR 50-100 million (7.5% of EUR 50 million)	EUR 3.75 million
(iii)	+ EUR 100 million (5.1% of EUR 451 million)	EUR 23 million
	Total aid ceiling	EUR 34.25 million

Based on a total aid ceiling of EUR 34.25 million and total eligible costs of EUR 551 million, the Icelandic authorities submit that the allowable aid intensity in the case of Verne Data Centre is 6.22%³¹.

The Icelandic authorities have provided a calculation of the estimated amount of state aid resulting from the aid measures they identify in their notification during the 13 year period of the Investment Agreement, under the current tax system (e.g. 18% corporate income tax) on one hand and the exemptions provided for in Investment Agreement and the Agreement on Licences and Charges on the other hand, applying 8% discount factor to calculate the net present value, see table 3.

Table 3 Taxes and duties – calculation of the aid amount

NPV over 13 years, r=	8%	Assumptions:		Results:		MUSD
		Icelandic Tax System	Verne Contract	Icelandic Tax System	Verne Contract	NPV
MUSD				A	B	Difference A-B:
Industrial Fee (of Revenue)		0.08%	0%	0.8	0.0	0.8
Market Fee (of Labour Cost)		0.05%	0%	0.02	0.0	0.02
Property Tax Basis MUSD		16.4	8.4	2.1	1.1	1.1
EI Safety Tax of EI Purchase		0.8%	0%	1.5	0.0	1.5
EI Safety Tax of EI Equipment		0.15%	0%	0.1	0.0	0.1
Income Tax (roofs, deprec)		18%	15%	61.0	60.4	0.5
Zoning Fee (of Insurance Value)		0.3%	100KUSD	0.14	0.10	0.04
Building Licence Fee				0.0	0.0	0.0
Stamp Duties Shares		0.00%	0.00%	0.0	0.0	0.0
Stamp Duties Loans		0.00%	0.00%	0.0	0.0	0.0
Street Connection Fee				0.0	0.0	0.0
Water & Sewage Duties				0.0	0.0	0.0
Fire Insurance				0.0	0.0	0.0
Catastrophic Insurance				0.0	0.0	0.0
Net Worth Tax				0.0	0.0	0.0
Import Duties				0.0	0.0	0.0

³¹ The Icelandic authorities have based their calculations on the methodology used in the Authority's Decisions Nos. 187/05/COL and 344/09/COL.

Post & Tele Admin Power Intensive Industries Tarif		0.0	0.0	0.0
		0.0	0.0	0.0
		65.7	61.6	4.1
Total				

Based on these calculations the Icelandic authorities submit that the net present value of total tax payments under the Investment Agreement is USD 61.6 million compared to USD 65.7 million under the current tax system. The total state aid to Verne would therefore amount to USD 4.1 million. The Icelandic authorities have furthermore provided sensitivity calculation, demonstrating that the 6.22% aid intensity would be reached between 27% and 30% corporate income tax.

Table 4 Corporate income tax - sensitivity calculation

Sensitivity w.r.t. Income Tax Rate

Rate	State Aid	
18%	5.4	0.7%
21%	12.3	1.7%
24%	19.2	2.6%
27%	32.1	4.4%
30%	48.2	6.6%
33%	64.2	8.8%
36%	80.3	11.1%

The Icelandic authorities have, with reference to the calculations in table 3 above submitted, that the total state aid intensity in the case of Verne Data Centre is 0.56% (total state aid as calculated above, USD 4.1 million / total investment cost USD 726 million). On this basis the Icelandic authorities have submitted that the estimated total state aid intensity is well below the 6.22% aid intensity ceiling.

The Icelandic authorities have undertaken the commitment that the total value of aid will not exceed 34.25 million Euro expressed in 2010 prices, covering the entire contract period of thirteen years, discounted to a net present value as of 2010 with a discount factor of 8%.

3. Other agreements

As already mentioned under Section 2.3 above, Verne has negotiated a series of agreements in addition to the Investment Agreement and the Agreement on Licensing and Charges, including a Ground Lease Agreement, a Real Estate Purchase Agreement and a Power Contract in connection with the project. These agreements were submitted to the Authority together with the notification.

The Ground Lease Agreement is between the Company and the Icelandic State, signed on 9 May 2008. Pursuant to this agreement, Verne leases 9.6 hectares land together with all fixtures, fittings and improvements located thereon. The property, Valhallarbraut 868, Reykjanesbær, is situated on and located within the boundaries of the Keflavik Air Base with the Icelandic Land Registry number 214 247.

The Real Estate Purchase Agreement, whereby Verne buys five buildings from the Icelandic State, was signed on 26 February 2008. The purchase price was USD 14.5

million, divided into a deposit, paid on 26 February 2008, and the closing payment, paid on 26 March 2008.

The Power Contract between Verne and Landsvirkjun (the national power company, wholly state owned) was signed on 22 October 2009. Landsvirkjun is licensed by the Minister of Industry to engage in trade in electricity by wholesale distribution of power to suppliers and to power intensive industries in Iceland. Landsvirkjun will supply the energy necessary to meet the power requirements of the data centre. Landsvirkjun commits to provide Verne with the necessary regular power supply of up to approximately 25MW (mean per hour) and up to 210 GWh annually. The Power Contract is valid for 20 years, subject to an extension for another 10 years.

Moreover, during the pre-notification phase, the Authority was provided with a draft Memorandum of Understanding from 15 December 2008 (Event No 547201), which refers to “a *Master Services Agreement for Bandwidth Lease Services*” (“the Farice Agreement”) between Verne and Eignarhaldsfélagið Farice ehf. and Farice hf.³², signed on 26 February 2008. The Authority has not been provided with this agreement as a part of the notification.

4. Position of the Icelandic authorities

The Icelandic authorities have submitted that Reykjanesbær, where the data centre is to be located, is in an area eligible for regional investment aid based on the Authority’s Decision No 378/06/COL on the regional aid map of assisted areas for Iceland.³³ Projects undertaken within the municipalities eligible for regional aid can qualify for regional investment aid in accordance with the Regional Aid Guidelines.

The objective of the measures which the Icelandic authorities propose, through the Investment Agreement, is *inter alia* to strengthen economic activities in the south-western part of Iceland in a sustainable manner. The Icelandic authorities have submitted that the region in which the data centre will be located is not only the hardest hit by the economic recession but is also seeking to recover from the unique micro-economic downturn resulting from the closing down of the U.S. military base in the region in September 2006. According to the Icelandic authorities this region currently has among the highest unemployment rates in Iceland.

Verne expects to generate approximately 100 full time positions upon completion of the project, either directly or through Icelandic subcontractors³⁴. These are primarily skilled jobs in the electrical, mechanical and IT engineering fields, which require university or technical degrees, according to the notification. During the projected 7-year construction period, from start of work on the first building to the completion of all four buildings, Verne expects to require roughly 100 full-time construction workers on average. Additionally, indirect job creation is expected as a result of the development.

The Icelandic authorities further note that the potential benefits of the Investment Agreement are well below the State aid intensity caps and that the security that the Investment Agreement provides is designed to stimulate up-front investment, not to create an ongoing operating benefit.

³² Collectively referred to as “Farice” in this Decision.

³³ Reykjanesbær can be found on the list under the NUTS III region heading “South Electoral District”.

³⁴ The Icelandic authorities have, however, not provided a breakdown on how many direct jobs the three different phases are intended to create

The Icelandic authorities have submitted that the Government committed itself to the granting of aid through the various measures contained in the MoU from April 2009, and that the MoU generated the necessary incentive effect on Verne to renew its investment in the data centre and was intended by the Government to have that effect.

The Icelandic authorities have also submitted that any investments made by Verne subsequent to September 2008 through to April 2009 were merely “preparatory” in nature, in line with paragraph 30 of the Regional Aid Guidelines, and were made because of the desire of the company not to shut down the project altogether unless it became clear that the aid measures in question would not be granted.

Moreover, the Icelandic authorities have submitted that their approach is consistent with the “substantive test for an incentive effect adopted by the Court of Justice in the *Kronoply* case³⁵”. The Icelandic authorities argue that it would therefore be wrong for the Authority to opt for form over substance by asserting that the MoU did not have the requisite effect on market behaviour simply because the Parties did not sign it.

The Icelandic authorities have stated that in the absence of the Investment Agreement, “*Verne cannot proceed with the completion of the data center project as originally planned*”.

In addition to the Investment Agreement, the Icelandic authorities have submitted, with their notification, a Lease Agreement, a Real Estate Purchase Agreement and a Power Contract, all of which Verne has negotiated in connection to the data centre. These agreements have been referred to above. The Icelandic authorities have stated, as regards the estimated rate of return of the Power Contract, that the provisions to that effect reflect commercial terms negotiated at arms length. The Icelandic authorities therefore state that there is no element of discrimination, selectivity or advantage conferred upon Verne by the Power Contract. Accordingly, the Icelandic authorities are of that opinion that the Power Contract does not involve elements of state aid.

II. ASSESSMENT

1. The presence of state aid

1.1. State aid within the meaning of Article 61(1) EEA Agreement

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.”

This implies that a measure constitutes state aid within the meaning of Article 61(1) of the EEA Agreement if the following conditions are cumulatively fulfilled: the measure (i) is granted by the State or through state resources; (ii) confers an economic advantage to the

³⁵ The Icelandic authorities have made a reference to Case T-130/02, *Kronoply v. Commission* [2003] ECR II-4857. The Authority assumes that the reference is meant to be to the General Court’s judgment in Case T-162/06 *Kronoply v. Commission* [2009] ECR II-1, referred to below in the Authority’s assessment.

beneficiary; (iii) is selective; (iv) has an impact on trade between Contracting Parties and is liable to distort competition.³⁶

As regards the Ground Lease Agreement, the Real Estate Purchase Agreement and the Power Contract, referred to above, the Icelandic authorities have not submitted sufficient evidence to assess whether those agreements comply with the requirements of the market economy investor principle or whether, on the contrary, entail the grant of state aid. Moreover, the draft MoU from 15 December 2008, mentioned above, refers to an agreement between Verne and Farice on 26 February 2008³⁷. However the Authority has not been provided with this agreement. A second draft MoU from 26 January 2009 was furthermore submitted to the Authority during the pre-notification phase. This draft refers to “a Mutual Letter of Agreement signed by Verne and E-Farice on 11 December 2008.” This agreement has not been submitted to the Authority.

The Icelandic authorities are invited to provide the Authority with the necessary information and reasoning to allow the Authority to assess whether the above mentioned agreements entail state aid or not.

1.2. State resources

To be qualified as state aid, the advantage must be granted by the State or through state resources. For purposes of the state aid rules the term “State” covers also regional and local bodies.³⁸ A loss of tax revenue is equivalent to consumption of state resources in the form of fiscal expenditure. Besides, state support may be provided equally by tax provisions of a legislative, regulatory or administrative nature as through the practices of the tax authorities.³⁹ A reduction in the tax base or a total or partial reduction on the amount of tax, fees or charges, involves a loss of revenue and is therefore equivalent to the consumption of state resources in the form of fiscal expenditure.

Furthermore, should the Ground Lease Agreement, the Real Estate Purchase Agreement and the Farice Agreement have been concluded under conditions that would normally not have been accepted by a private market player in the sense that in particular the price paid for the real estate as well as the price paid for the lease and the conditions for review of this price would be below market price, state resources would be consumed within the meaning of Article 61(1) of the EEA Agreement, provided they were imputable to the State.

Verne will be buying power from the state owned power company, Landsvirkjun. The draft MoU from 15 December 2008 submitted in the pre-notification discussions includes Landsvirkjun as a party. The draft refers to a “*Landsvirkjun Agreement*”, a power contract entered into by Verne and Landsvirkjun on 26 February 2008. This agreement has not

³⁶ According to settled case-law, classification as aid requires that all the conditions set out in the provision should be fulfilled, see Case C-142/87 *Belgium v. Commission* (“*Tubemeuse*”) [1990] ECR I-959.

³⁷ The draft MoU from 15 December 2008 includes Farice as a party and states: ““Must take” arrangement will be eliminated and converted to a “pay-as-you go”, variable consumption model. Direct relationship between Farice and Verne customers will be established (or their carrier partners) and a data center carrier neutral model will be enabled. Competitive rates will be charged with other “last mile” carriers. Verne customers will be charged on proportional “cost plus” basis for the first 40 GB of carriage exclusive of any capital recovery charges. After the first 40 GB of carriage, Verne customers will be charged on a proportional “cost plus” basis inclusive of some capital recovery. Farice will structure its service agreements according to international carrier norms.”

³⁸ Case C-248/84 *Germany v. Commission* [1987] ECR 4013.

³⁹ See point 3 of the Authority’s Business Taxation Guidelines.

been submitted to the Authority, but only the Power Contract, signed on 22 October 2009, replacing a previous one, dated 29 January 2008⁴⁰.

The second draft MoU, from 26 January 2009, submitted to the Authority in the pre-notification phase, also includes Landsvirkjun as a party. In a footnote on the first page of this draft the following text is included: “*Participation of Reykjanes Municipality, Landsvirkjun, Landsnet, e-Farice and Farice in this Memorandum of Understanding, as opposed to separate agreements only, is to be further discussed*”⁴¹. The final version of the draft MoU, from April 2009, does not include Landsvirkjun as a party.

Actions of public undertakings may constitute state aid provided there is imputability of such actions to the State⁴². The Court of Justice held in *Stardust Marine*⁴³ that:

“...the mere fact that a public undertaking has been constituted in the form of a capital company under ordinary law cannot, having regard to the autonomy which that legal form is capable of conferring upon it, be regarded as sufficient to exclude the possibility of an aid measure taken by such a company being imputable to the State (Case C-305/89 Italy v Commission...paragraph 13). The existence of a situation of control and the real possibilities of exercising a dominant influence which that situation involves in practice makes it impossible to exclude from the outset any imputability to the State of a measure taken by such a company”

While as a general rule imputability cannot be presumed (even if the State is in a position to influence and control the operations of a public undertaking), specific, compelling evidence is not always essential and indeed the Court of Justice will assume in certain circumstances that it will not be available⁴⁴. As the Court stated in *Stardust Marine*⁴⁵:

“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”.

Apart from the Power Contract dated 22 October 2009 and the information mentioned above the Authority does not have additional information pertaining in particular to the contract price for the electricity to Verne. Should this price not be comparable to the price paid for electricity by other big consumers in Iceland, the Authority would have to assess whether the transaction is imputable to the State and state resources are involved.

⁴⁰ The draft MoU from 15.12.2008 contains this text as regards the 26.2.2008 “Landsvirkjun Agreement”: ““Must take” arrangement will be eliminated and converted to a “pay-as-you go” variable consumption model. The first 25MW of power to Verne for a 20 year term will be sold at whatever rate it takes to land Verne’s initial customers.”

⁴¹ The draft MoU from 26.1.2009 states: “Landsvirkjun undertakes to amend the Landsvirkjun Agreement as follows: “Must take” arrangement will be eliminated and converted to a “pay-as-you-go” variable consumption model. Preliminary pricing received from Landsvirkjun at a price level that is competitive with the most favourable energy markets. The Landsvirkjun Agreement shall be assignable by Verne, without further condition, delay or prior consent of any other party”

⁴² Case C482/99 *France v Commission (Stardust Marine)* [2002] ECR I-4397, paragraphs 50-59 and Article 1 of the Transparency Directive.

⁴³ Case 482/99 *France v Commission (Stardust Marine)*, cited above, paragraph 57.

⁴⁴ Case 482/99 *France v Commission (Stardust Marine)*, cited above, paragraph 54. The difficulties of proving collusive behavior between public authorities and public undertakings would render the state aid rules of the EEA Agreement ineffective by such condition. For this reason the case law of the Court of Justice holds that in the presence of certain indicators, aid measures taken by public undertakings may be inferred as being imputable to the State.

⁴⁵ Case C-482/99 *France v Commission (Stardust Marine)*, cited above, paragraph 53.

1.3. Favouring certain undertakings or the production of certain goods

Verne is an undertaking within the meaning of the state aid rules of the EEA Agreement. The tax and fee derogations set out in the Verne Act, the Investment Agreement and the Agreement on Licensing and Charges do not apply to all economic operators, but are granted in favour of Verne only. Consequently, they cannot be considered to be general measures of tax or economic policy and are therefore selective.

The definition of aid is more general than that of subsidy, because it includes not only positive benefits, such as subsidies themselves, but also state measures which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which thus, without being subsidies in the strict sense of the word, are similar in character and have the same effect.⁴⁶ According to settled case law, a measure by which the public authorities grant to certain undertakings a tax exemption which, although not involving a transfer of state resources, places those to whom the tax exemption applies in a more favourable financial situation than other taxpayers constitutes aid granted by the state or through state resources.⁴⁷

Such an advantage may be conferred by various reductions in the undertaking's tax burden, including a reduction in the tax base or total or partial reduction in the amount of tax or a deferment, cancellation or even by special re-scheduling of tax debt.⁴⁸ The Authority observes that a guarantee against future legislative changes in itself constitutes state aid within the meaning of Article 61(1) of the EEA Agreement.

On this basis the Authority concludes that the tax and fee derogations allow Verne to be relieved of part of the costs which the company would normally have to bear itself in its course of business.

The same reasoning applies to the Ground Lease Agreement, the Real Estate Purchase Agreement, the Farice Agreement and the Power Contract. In case the price agreed under these agreements was below market price and the decisions are imputable to the State, Verne would get an advantage that would reduce the costs for the company.

Thus, the measures favour certain undertakings and the production of certain goods within the meaning of Article 61(1) of the EEA Agreement.

1.4. Distortion of competition and effect on trade between Contracting Parties

In the present case, the measures will strengthen the competitive situation of Verne with respect to other competitors, *i.e.* other data centres, established in Iceland.

Moreover, Verne intends to operate a global wholesale data centre where the service will be available to customers within the EEA and the world market.

For these reasons, the Authority concludes that the Investment Agreement is liable to distort competition and to affect trade between the Contracting Parties to the EEA Agreement.

⁴⁶ See, in particular, Case C-143/99 *Adria-Wien Pipeline and Wietersdorfer & Peggauer Zementwerke* [2001] ECR I-8365, paragraph 38; Case C-501/00 *Spain v Commission* [2004] ECR I-6717, paragraph 90; and Case C-66/02 *Italy v Commission* [2005] ECR I-10901, paragraph 77.

⁴⁷ See to that effect Case C-387/92 *Banco Exterior de España* [1994] ECR I-877, paragraph 14; and Case C-222/04 *Cassa di Risparmio di Firenze and Others* [2006] ECR I-289, paragraph 132.

⁴⁸ See point 2 of the Authority's Business Taxation Guidelines.

1.5. Conclusion

Based on the above findings, the Authority comes to the conclusion that the above mentioned measures constitute state aid within the meaning of Article 61(1) of the EEA Agreement.

2. Procedural requirements

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”*.

The Icelandic authorities submitted the notification in the present case on 1 September 2010.

The Parliament adopted the Verne Act authorising the Icelandic authorities to enter into an Investment Agreement with Verne on 7 June 2010 and the Investment Agreement was initialled on 23 October 2009. The Icelandic authorities have, however, assured the Authority that the Investment Agreement will not be signed and derogations will not be put into effect until the Authority has approved the aid measures. In these circumstances, the Authority considers that, by submitting the notification on 1 September 2010, the Icelandic authorities have complied with the notification requirement as regards the tax and fee concessions in the Investment Agreement.

The Agreement on Licences and Charges was signed on behalf of the municipality of Reykjanesbær. It contains a clause stipulating that the entry into effect of the agreement is contingent upon the conclusion of the Investment Agreement. Should the street construction tax have been levied on new constructions in line with statutory rules and should municipality property tax have been levied in 2010 the Authority regards the Icelandic authorities to have complied with the standstill obligation. In so far as the state aid elements identified in Section I have been put into effect, the Authority will have to conclude that the standstill obligation was not respected.

In so far as the Power Contract, the Ground Lease Agreement, the Purchase Agreement and the Farice Agreement contain state aid elements already put into effect, the Authority will have to conclude that the standstill obligation was not respected.

The Authority therefore concludes that the Icelandic authorities have partly respected their obligation pursuant to Article 1(3) of Part I of Protocol 3.

3. Compatibility of the aid

Support measures caught by Article 61(1) of the EEA Agreement are generally incompatible with the functioning of the EEA Agreement, unless they qualify for a derogation under Article 61(2) or (3) of the EEA Agreement.

Under the Regional Aid Guidelines, measures may qualify as compatible aid under Article 61(3)(c) if aimed to *“assist the development of the most disadvantaged regions by supporting investment and job creation”*. The Authority notes that the data centre will be located at Reykjanesbær, which is an area eligible for regional investment aid based on the Authority’s Decision No 378/06/COL on the regional aid map of assisted areas for Iceland.

3.1. Necessity of the aid and the incentive effect

Whether the proposed aid is necessary to produce a real incentive effect to undertake investment which would not otherwise be made in the assisted areas is a crucial element in a regional aid assessment. Thus, it has to be verified whether the aid is necessary to provide an incentive effect for the investment, *i.e.* whether the aid actually contributes to changing the behaviour of the beneficiary so that it undertakes investment in the assisted region concerned and not somewhere else. Therefore, regional aid may be compatible with Article 61(3)(c) only if it has triggered the investment in the given regional aid area.⁴⁹

The rules on incentive effect are stated in paragraph 30 of the Regional Aid Guidelines which first states that in general:

“It is important to ensure that regional aid produces real incentive effect to undertake investments which would not otherwise be made in the assisted areas”;

and:

“In the case of ad hoc aid, the competent authority must have issued a letter of intent, conditional on the Authority’s approval of the measure, to award aid before work starts on the project. If work begins before the conditions laid down in this paragraph are fulfilled, the whole project will not be eligible for aid.”

The Regional Aid Guidelines defines the term “start of work” as “*start of construction work or first firm commitment to order equipment, excluding preliminary feasibility studies.*”⁵⁰

In line with European Commission decision practice, a letter of intent within the meaning of the Regional Aid Guidelines can be described as a: “*document that may be considered as explicitly granting aid to [the company] for the investment.*”⁵¹

The aim of paragraph 30 of the Regional Aid Guidelines is to make it possible for the Authority to ascertain the existence of incentive effect without unduly delaying the investment by carrying out a full analysis of the economic circumstances of the recipient’s investment decision⁵². Thus, as confirmed by the General Court in the *Kronoply* judgement, the Authority may base its assessment of the incentive effect by reference to a circumstance of a chronological nature⁵³.

⁴⁹ Case T-162/06 *Kronoply v. Commission* [2009] ECR II-1, paragraph 27. See also Case C-34/2009 *Petrogal* where the Commission stated that in a case of an *ad hoc* aid the competent authority shall issue a letter of intent to award aid before the start of work on the project and Case C-390/06 *Nuova Agricast Srl* paragraph 69. Case T-212/00 *Nuove Industrie Molisane Srl v Commission* [2002] ECR II-347 confirms the same principle.

⁵⁰ See the Regional Aid Guidelines, footnote 32.

⁵¹ Case N-357/2008 *Fri-El Acerra S.r.l. (Italy)* [2009] OJ C 95/20, paragraph 40. See also Commission decision as of 15.9.2010, C 8/2009 *Fri-El Acerra*, not yet published.

⁵² See Case T-162/06 *Kronoply v. Commission* [2009] ECR II-1, paragraph 81: “As stated in recital 30 of the Decision, the aim of applying the criterion set out in point 4.2 of the Guidelines is to ascertain the existence of incentive effect without unduly delaying the investment by carrying out a full analysis of the economic circumstances of the recipient’s investment decision, which might prove very difficult or time-consuming. The latter concern explains why the finding that the aid application was made before the start of the investment project is enough in itself, according to the Commission, to raise the presumption that an incentive effect exists.”

⁵³ See Case T-162/06 *Kronoply v. Commission* [2009] ECR II-1, paragraph 80. “It should be observed that that provision refers to a circumstance of a chronological nature and therefore points to an examination *ratione temporis*, which is perfectly suitable for determining whether an incentive effect exists. That examination must be made by reference to the decision to invest taken by the undertaking concerned, which marks the beginning of the dynamic process that an operating investment such as that undertaken

As already described, Verne purchased the buildings for the data centre in February 2008. It is the Authority's understanding that Verne subsequently started working on the demolition, project management, design, development work and infrastructure. It is therefore the Authority's preliminary view that the start of work in this case, with reference to the Regional Aid Guidelines, was in February 2008. This appears to be consistent with the description given by the Icelandic authorities in their notification: "*Verne commenced its building of a data center campus in the Ásbrú development on the Reykjanesbær peninsula in February 2008. To this end, the Company purchased two large warehouses from the KADECO Redevelopment Authority⁵⁴ and began retrofitting them as part of a planned multi-building campus.⁵⁵*"

According to the information provided by the Icelandic authorities, Verne subsequently approached the Icelandic authorities to discuss a potential Investment Agreement in October 2008, following worsened financial conditions in Iceland⁵⁶. Subsequent discussions delivered the MoU, mentioned above, in April 2009 and in October 2009, the Investment Agreement was initialled and in November 2009 the Agreement on Licensing and Charges was signed. Accordingly, no letter of intent was issued before February 2008 when start of work on the project, within the meaning of the Regional Aid Guidelines, commenced.

These circumstances seem to demonstrate, in the Authority's preliminary view, that regional aid did not trigger the data centre investment in the Reykjanes area. To the contrary the work on the project was initiated without any request to or commitment from the Icelandic authorities to grant regional aid. As mentioned above, it follows from paragraph 30 of the Regional Aid Guidelines that "*If work begins before the conditions laid down in this paragraph are fulfilled, the whole project will not be eligible for aid.*"

However, in the notification the Icelandic authorities have submitted that the severe financial crisis in October 2008 entailed that regional state aid was necessary for Verne.

The Icelandic authorities claim that, when the Verne project started in mid-2007, debt and equity financing for a new data centre was widely available on attractive terms. Furthermore, the Icelandic authorities submit, that late 2008, the investment climate had turned around almost completely, and that it has been very difficult to attract investment capital into Iceland since that time. In the view of the Icelandic authorities, the challenge Verne faced in raising financing in such a situation was further compounded by the fact that in 2007, Iceland was viewed as a safe and highly desirable location to do business. The Icelandic authorities are of the view that only through the provisions set forth in the Investment Agreement can Verne work with the Icelandic Government to minimise many of the risk concerns maintained by potential data centre customers and investors.

by Kronoply necessarily constitutes". See also Case C-8/2009 *Fri-El Acerra S.r.l. v. Commission* [2010] OJ C 95/20, paragraph 91 and Case C-12/2007 *Glunz&Jensen v. Commission* (Slovakia) [2008] OJ L 178/38 concerning the lack of incentive effect.

⁵⁴ The Authority notes that the seller according to the Real Estate Purchase Agreement is the Icelandic Treasury ("*Ríkissjóður Íslands*").

⁵⁵ Page 6 of the notification letter (Event 568140).

⁵⁶ According to an internal memorandum dated 23.10.2008 prepared by the Ministry of Industry, Verne had approached the Icelandic authorities shortly before, requesting various concessions to reduce the risk and initial cost of the company's data centre investment. Infrastructure, direct grants, tax concessions, incl. VAT remission, and interventions as state guarantee and subsidized electricity prices at the start of operation.

As a result of the above, Verne was no longer able to raise the capital required in order to begin the next stages of the project. The Icelandic authorities have submitted that Verne is not able to finalize the exterior and interior fit-out of the initial building, and the procurement of critical long lead capital items, without additional funding becoming available.

The Authority has been provided with a letter dated 25 January 2010 from a new investor, Wellcome Trust⁵⁷, [...].

The Icelandic authorities submit that Verne had relied upon the profitability model set forth in an annex to the notification (Annex 6A) demonstrating the impact on returns to equity investors under a scenario of rising corporate income taxes, which the Investment Agreement is designed to protect Verne against. According to this document, under a scenario where corporate taxes rise from their current 18% to 30%, dividends to investors as well as their equity returns upon a sale or initial public offering will be reduced. The model demonstrates that the total reduction of returns would be between USD 190 million and USD 299 million under different return scenarios.

On this basis, the Icelandic authorities have stated that in the absence of the Investment Agreement, “*Verne cannot proceed with the completion of the data center project as originally planned*”.

Thus, although regional aid did not trigger the initial data centre investment in Reykjanes it has been submitted that regional aid later became necessary in order for the data centre project to be completed. In such circumstances, the Authority is of the view that the necessity of the aid has to be verified on the basis of a full analysis of the economic circumstances of the recipient’s investment decision. Such an analysis should only be made on the basis of the aid recipient’s original business plans and other documents submitted to investment committees in order to obtain approval to commit resources to the investment activity; profitability calculations for the project with and without aid⁵⁸; project finance analysis; risk assessments; and a detailed account of how circumstances following the onset of the financial crisis in October 2008 influenced on the business plan and required rate of return of the investment. The Authority has not been provided with any information allowing it to carry out the counterfactual analysis required for such an economic analysis. Thus, the Authority is not in the position to verify the necessity of the aid.

Therefore, based on the information at hand, after a first preliminary assessment, the Authority has doubts as to the necessity and the incentive effect of the measures, *i.e.* whether the aid actually contributes to changing the behaviour of the beneficiary so that it undertakes investment in the assisted region concerned. The Authority is under the duty to carry out all the requisite consultations and, therefore, to initiate the procedure under Article 4(4) of Part II of Protocol 3, if initial investigation does not enable the Authority to overcome all the difficulties involved in determining whether the aid is compatible with the functioning of the EEA Agreement.

3.2. Other considerations regarding the application of the Regional Aid Guidelines in conjunction with the Business Taxation Guidelines.

⁵⁷ Wellcome Trust is a London-based charitable organization (www.wellcome.ac.uk).

⁵⁸ Judgment of the General Court of 8 July 2010, Case T-396/08, *Freistaat Sachsen v Commission*, not yet published in the ECR, paragraphs 46 and 47.

The Authority observes, that the Investment Agreement does not contain any explicit commitment on behalf of Verne to complete the construction of the whole project. Moreover, the Investment Agreement does not contain any explicit obligation as for the time limits for the construction. The project, as planned, is divided into three phases to be executed over a period of seven years, where first and second phase appear to become operational irrespective of whether the subsequent phase(s) will be constructed. It is the Authority's understanding that the situation could in fact arise, where Verne would decide not to construct phase two and/or phase three of the envisaged project. This would indeed be the case if Verne would not be able to attract customers for more than the first phase or the first two phases. This would, according to the information provided by the Icelandic authorities, lead to a considerably less investment than the whole project ([...] million USD for the first phase and additional [...] million USD for the second phase, in lieu of the 726 million USD envisaged for all three phases according to the notification)⁵⁹. The Icelandic authorities have not provided the Authority with an assurance of which mechanism will be put in place to guarantee whether and how the applicable aid intensities would be ensured in this case.

It is the Authority's understanding that the Power Contract only provides Verne with the necessary power for the first phase of the project. Furthermore, the Ground Lease Agreement merely covers 9.6 hectares, which include the two old warehouses purchased, but does not appear to cover the additional land necessary to construct both additional main buildings to be built to complete the third phase of the project. Thus, there appear to be various uncertainties as regards the completion of the whole project. As mentioned above, the Icelandic authorities have not provided the Authority with a detailed breakdown of the eligible costs as regards each of the three individual phases.

In light of the above, the Authority has doubts as to whether the necessary transparency under the Authority's Business Taxation Guidelines⁶⁰ is provided, allowing the tax measures to be qualified as investment aid under the Regional Aid Guidelines and not operating aid.

Moreover, as regards the calculation provided by the Icelandic authorities, see table 3 above, the Authority finds it questionable to apply the discount factor of 8% to calculate the net present value of the aid measures in the current case. The Icelandic authorities have not provided any justification for applying this discount rate in times when the cost of capital for the Icelandic State was much lower⁶¹. In this respect, the Authority recites its doubts as to whether the maximum allowable aid intensities under the Regional Aid Guidelines will be ensured.

Furthermore, the Authority observes that in the case Verne merely completes the first phase or the first two phases of the investment project, bringing only the first out of the four buildings into operation, the contribution to the development of the region can be

⁵⁹ According to various sources, the total investment was at different point in time estimated to be considerably less than the USD 726 million stated in the notification. See <http://www.samgonguraduneyti.is/frettir/nr/1548>, a press release from the Icelandic Ministry of Transport on 26.2.2008 where the total investment cost of ISK 20 billion is mentioned, equivalent of approximately USD 300 million using the exchange rate on 26.2.2008. Another source, from 9.3.2009, mentioned USD 306 million investment costs, see <http://www.bizjournals.com/boston/stories/2009/03/09/story10.html> a media article in Boston Business Journal.

⁶⁰ See paragraphs 4(3) and 4(4) of the Authority's Guidelines on the application of state aid rules to measures relating to direct business taxation available at <http://www.eftasurv.int/state-aid/legal-framework/state-aid-guidelines/>

⁶¹ <http://www.sedlabanki.is/lisalib/getfile.aspx?itemid=2496>.

questioned, since this would *e.g.* in all likelihood encompass a considerably less than the 100 jobs envisaged if all three phases would be completed in the future⁶².

As an additional point, the Authority notes that the *ad hoc* aid does not appear to be made conditional, through conditions attached to the aid or the method of payment, on the maintenance of the investment in the region for a minimum of five years after its completion, as required under paragraph 32 of the Regional Aid Guidelines.

4. Conclusion

Based on the information submitted by the Icelandic authorities, the Authority cannot exclude the possibility that the agreements mentioned in this decision constitute state aid within the meaning of Article 61(1) of the EEA Agreement, provided they are imputable to the Icelandic State.

Moreover, the Authority has doubts as to whether the state aid granted in connection with the construction of Verne Data Centre, comply with Article 61(3) of the EEA Agreement, in conjunction with the requirements laid down in the Authority's Regional Aid Guidelines and the Business Taxation Guidelines. The Authority, therefore, has doubts as to whether the above measures are compatible with the functioning of the EEA Agreement.

Consequently, and in accordance with Article 4(4) of Part II of Protocol 3, the Authority is obliged to open the formal investigation procedure provided for in Article 1(2) of Part I of Protocol 3. The decision to open a formal investigation procedure is without prejudice to the final decision of the Authority, which may conclude that the measures in question are compatible with the functioning of the EEA Agreement.

In light of the foregoing considerations, the Authority, acting under the procedure laid down in Article 1(2) of Part I of Protocol 3, invites the Icelandic authorities to submit their comments within one month of the date of receipt of this Decision.

In light of the foregoing considerations, within one month of receipt of this decision, the Authority requests the Icelandic authorities to provide all documents, information and data needed for the assessment of the compatibility of the regional aid.

The Authority requests the Icelandic authorities to forward a copy of this decision to the potential aid recipient of the aid immediately.

Finally, the Authority reminds the Icelandic authorities that, according to the provisions of Protocol 3 to the Surveillance and Court Agreement, any incompatible aid unlawfully put at the disposal of the beneficiaries will have to be recovered with interest, unless this recovery would be contrary to the general principal of law.

HAS ADOPTED THIS DECISION:

Article 1

⁶² See also a press article on 29.10.2009 which indicates that the total direct jobs created will be 25-30, http://www.mbl.is/mm/frettir/innlent/2009/09/29/bedid_eftir_fjarfestingarsamningi/.

The formal investigation procedure provided for in Article 1(2) of Part I of Protocol 3 is opened into the state aid concerning construction of a data centre in the municipality of Reykjanesbær, implemented by the Icelandic authorities.

Article 2

The Icelandic authorities are invited, pursuant to Article 6(1) of Part II of Protocol 3, to submit their comments on the opening of the formal investigation procedure within one month from the notification of this Decision.

Article 3

The Icelandic authorities are requested to provide within one month from notification of this decision, all documents, information and data needed for assessment of the compatibility of the aid measure.

Article 4

This Decision is addressed to the Republic of Iceland.

Article 5

Only the English language version of this decision is authentic.

Decision made in Brussels, on 3 November 2010.

For the EFTA Surveillance Authority

Per Sanderud
President

Sverrir Haukur Gunnlaugsson
College Member