

Case No: 57697
Event No: 365856
Dec. No: 227/06/COL

EFTA SURVEILLANCE AUTHORITY DECISION
of 19 July 2006
with regard to state aid in favour of Farice hf.

(Iceland)

THE EFTA SURVEILLANCE AUTHORITY¹,

Having regard to the Agreement on the European Economic Area², in particular to Articles 61 to 63 and Protocol 26 thereof,

Having regard to the Agreement between the EFTA States on the establishment of a Surveillance Authority and a Court of Justice³, in particular to Article 24 thereof,

Having regard to Article 1(2) in Part I and Articles 4(4), 6, 7(3) and 10 in Part II of Protocol 3 to the Surveillance and Court Agreement,

Having regard to the Authority's Guidelines⁴ on the application and interpretation of Articles 61 and 62 of the EEA Agreement, and in particular Chapter 17 on State Guarantees and Chapter 19 on public authorities holdings,

Having regard to the Authority's Decision No. 125/05/COL to initiate the formal investigation procedure with regard to state aid in favour of Farice hf. calling on interested parties to submit their comments thereon⁵,

Whereas:

¹ Hereinafter referred to as the Authority.

² Hereinafter referred to as the EEA Agreement.

³ Hereinafter referred to as the Surveillance and Court Agreement.

⁴ Guidelines on the application and interpretation of Articles 61 and 62 of the EEA Agreement and Article 1 of Protocol 3 to the Surveillance and Court Agreement, adopted and issued by the EFTA Surveillance Authority on 19 January 1994, published in OJ 1994 L 231, EEA Supplements 03.09.94 No 32. The Guidelines were last amended on 29 March 2006. Hereinafter referred to as the State Aid Guidelines.

⁵ Authority's Decision No. 125/05/COL, OJ C 277, 10.11.2005 and the EEA Supplement to the Official Journal of the EU No 56, 10.11.2005, p.14.

I. FACTS

1. Procedure

By letter dated 27 February 2004 of the Icelandic Mission to the European Union, forwarding a letter from the Ministry of Finance dated 26 February 2004, the Icelandic authorities notified the Authority of a state guarantee in favour of a submarine cable project in Iceland, i.e. the Farice project. The letter was received and registered on 1 March 2004 (Event No. 257593).

Supplementary information was submitted by letter from the Icelandic Mission dated 14 May 2004, forwarding a letter by the Icelandic Ministry of Finance dated 13 May 2004. The letter was received and registered by the Authority on 14 May 2004 (Event No. 281472).

After various exchanges of correspondence⁶, the Authority informed the Icelandic authorities by letter dated 26 May 2006 that it had decided to initiate the formal investigation procedure laid down in Article 1(2) in Part I of Protocol 3 to the Surveillance and Court Agreement with regard to state aid in favour of Farice hf. (Event No. 319257).

The Authority's Decision No. 125/05/COL to initiate the formal investigation procedure was published in the Official Journal of the European Union and the EEA Supplement thereto⁷. The Authority called on interested parties to submit their comments thereon. The Authority received no comments from interested parties.

The Icelandic authorities submitted their comments to Decision No. 125/05/COL by letter dated 28 June 2005 (Event No. 324236).

As mentioned in the decision to open the formal investigation procedure, under separate competition proceedings, the Authority had expressed certain competition concerns by letter to Farice hf. dated 31 January 2003. The Authority had also requested information concerning the Farice project which was relevant for the assessment of the project's competitive impact. By letter dated 6 May 2004 the Authority addressed a formal request for information to Farice hf.⁸ Farice hf.'s reply was received by the Authority on 21 October 2004. The separate competition proceedings have been closed by letter of the Authority dated 2 June 2006 (Event No. 365856).

2. Description of the measures

2.1 *Description of the Farice project*

The Farice project concerns the construction and management of an undersea telecommunications cable connecting Iceland and the Faeroe Islands with Scotland.

Since 1994, Iceland and the Faeroe Islands have been internationally connected with the undersea telecommunication cable CANTAT-3. CANTAT-3 was set up as a consortium

⁶ For more detailed information on the various correspondence between the Authority and the Authority, reference is made to the Authority's Decision to open the formal investigation procedure, Decision No. 125/05/COL, published in the OJ C 277 of 10.11.2005, p.14.

⁷ Official Journal of the European Union C 277 of 10.11.2005 and EEA Supplement to the Official Journal of the EU No. 56 of 10.11.2005, p.14.

⁸ In accordance with the provisions of Protocol 21 to the EEA Agreement and Article 11 of Chapter II, Protocol 4 to the Surveillance and Court Agreement.

cable. Access to CANTAT-3 was secured via membership of the consortium⁹, by defeasible rights of use and by leasing capacity from the consortium member Teleglobe. CANTAT-3 has connection points in Canada, Iceland, the Faeroe Islands, Denmark, the United Kingdom and Germany. With the build-up of trans-Atlantic cable systems competing with CANTAT-3, the founders of CANTAT-3 had access to other, more economical connections. The Icelandic and the Faeroe parties, however, still had to rely on the CANTAT-3 connection. This was one consideration for these parties to take into account during the development of a new connectivity. In addition, the CANTAT-3 cable had certain technical limitations, as it is an older generation cable which has limited capacity and is not always reliable. The Icelandic authorities submitted an overview of several failures of the CANTAT-3 connection during 1995-2003. No other single international fibre network project has reached these two countries since 1994, despite a general capacity growth of international and inter-regional telecommunications routes. According to information by the Icelandic authorities, the geographically isolated location of the two countries and the limited market size prevented this.

Costs of satellite connections, which serve as a second connectivity, are expected to rise and are, in any event, not considered appropriate for transmitting delay-sensitive internet traffic. In order to handle the increased telecommunication traffic, an alternative had to be developed.

The Farice project came about from an initiative by the (at the time) almost 100% state owned Icelandic telecom operator Landssími Íslands hf (hereinafter Síminn¹⁰) and the incumbent telecom operator in the Faeroe Islands, Føroya Tele, which were considering the development of a submarine cable linking Reykjavík, Tórshavn and Edinburgh. However, in 2002 it became clear that the Farice project seemed unable to gain momentum as a purely commercial business case¹¹. A feasibility study conducted in March 2002 concluded that it would not be possible to fund the project through conventional project financing. A broad alliance behind the project was sought in order to secure its realisation. This resulted in two decisions:

Firstly, the communication authorities of Iceland and the Faeroe Islands became involved in the preparation of the project. In particular, the largest sponsors, Síminn and Føroya Tele, made it clear that they were not interested in providing the necessary loan guarantees on behalf of the whole telecom market¹². The Icelandic State would therefore have to participate and contribute actively in the project.

Secondly, it was considered important that Og Vodafone, a major player in the Icelandic telecom market, should participate actively in the project. It was decided that besides the establishment of Farice hf, for the purpose of constructing and operating the new transmission system, a holding company *Eignarhaldsfélagið Farice ehf.* (hereinafter 'E-Farice')¹³ should be established. This company, while holding all the Icelandic shares in

⁹ The consortium included *inter alia* the Icelandic telecom operator Landssími Íslands hf., Teleglobe and Deutsche Telekom.

¹⁰ The Icelandic State's stake in Síminn was sold to Skipti ehf. effective August 2005.

¹¹ See Summary Report, provided as annex 1 to the notification.

¹² See also the following comment by the Icelandic authorities: "Although the designated universal service provider, and as such required to provide secure long-distance communication, Síminn felt that increasing the capacity to meet demand, as well as providing an alternative route for emergencies, was a financially risky undertaking, providing little return on investment. In order to facilitate the necessary upgrade in capacity, particularly in view of the short time frame available until capacity would be outstripped by demand, the government stepped in."

¹³ In 2003, E-Farice ehf held 80% of the shares in Farice hf, with the 20% remaining shares held by Føroya Tele (19.93%) and other Faeroe parties (together 0,6%).

Farice, should buy Og Vodafone's capacity in CANTAT-3. A similar offer was made to Síminn which, according to the IBM report¹⁴ submitted by the Icelandic authorities, resulted in E-Farice handling all international connectivity for Iceland. As stated in the notification, CANTAT-3 capacity was consequently supposed to be operated and sold by E-Farice¹⁵.

In 2002 the new limited company, Farice hf, was established with the purpose of preparing, constructing and operating a submarine communication cable system to transfer telecommunications and internet traffic between Iceland, the Faeroe Islands and the UK. According to the information provided by the Icelandic authorities, the shareholders of this company were Síminn (47,33%), Og Vodafone (1,33%), the Government of Iceland (27,33%), three other Icelandic operators which held together 3,99%, Føroya Tele (17,33%), and two other Faeroe telecom operators, which each held 1,33%¹⁶. The new Farice cable includes an Iceland backhaul¹⁷ (Seyðisfjörður to Reykjavík), a submarine section (Seyðisfjörður to Dunnet Bay), a Faeroese backhaul (from Funningsfjörður to Tórshavn) and a UK backhaul (Dunnet Bay to Edinburgh). No public tender was carried out to decide on the management of the cable, which was granted to Farice hf. According to the business plan, the estimated total investment costs of the Farice project were EUR 48,9 million.

A shareholders' agreement dated 12 September 2002 provided that the pricing policy of Farice should be based on the principles of cost orientation, transparency and non-discrimination.

The Icelandic authorities have further pointed out that the use of the Farice cable is open to foreign and domestic operators alike, on equal terms and prices. The shareholders' agreement is also open to new shareholders. It stipulates, however, that the existing shareholders will always be offered the possibility of maintaining their equity position in the company if the share capital is increased (section 7 of the Shareholders Agreement).

The formal opening of the Farice submarine transmission cable was in February 2004.

2.2 Description of the Icelandic State support

a. The loan guarantee

The object of the notification concerns the grant by the State of a guarantee for a loan of EUR 9,4 million in favour of Farice (hereinafter: the A Term Loan). This loan forms part of a broader long-term loan package for a maximum amount of EUR 34,5 million.

¹⁴ The IBM report is a report submitted by the Icelandic authorities, which gives a summary on the background and current status of the Farice project. It describes the project idea, the business plan and the network structure as well as the need for a new cable.

¹⁵ The IBM report stresses the business possibility that E-Farice's purchase of CANTAT-3 connectivity provides the possibility to ring-connect the two cable systems in such a way that Farice hf. can offer its customers secured connectivity. The report further describes negotiations of E-Farice with Teleglobe to lease additional CANTAT-3 capacity. It has been discussed whether Farice hf. or E-Farice should lease *all* available capacity to Iceland and the Faeroe Islands.

¹⁶ Initial capital contributions, which were later changed. The holding company E-Farice holds all the shares of the Icelandic parties in Farice hf.

¹⁷ The term backhaul often refers to transmitting from a remote site or network to a central or main site. The original definition of backhaul was to transmit a telephone call or data beyond its normal destination point and then back again in order to utilize available personnel (operators, agents, etc.) or network equipment that is not located at the destination location. The term has evolved into a more generic meaning. It typically implies a high-capacity line.

According to the information provided by the Icelandic authorities, in particular as can be seen from the Agreement of 27 February 2004 (hereinafter: the loan agreement) between Farice hf, Íslandsbanki hf, other financial institutions and other guarantors, the signed loans for a maximum amount of EUR 34,5 million, break down as follows:

Loan	Million Euro	Lender	Interest rate ¹⁸	Interest periods	Repayment		Gua-rantor
					Number of instalments	Start of repayment	
A	9,4	The Nordic Investment Bank	Euribor + 0,18 % p.a.	6 months	8 semi-annually payments	Sept. 2011	Government of Iceland
B	4,7	The Nordic Investment Bank	Euribor + 0,80 % p.a.	6 months	5 semi-annually payments	Sept. 2009	Landssími Íslands hf (Síminn)
	4,7	Íslandsbanki hf					
C	4,7	Føroya banki	Euribor + 1,00 % p.a.	3 months	10 quarterly payments	Sept. 2009	Telefon verkið P/F
D	11,0	Íslandsbanki hf	Euribor + 1,50 % p.a.	1 month	48 monthly payments	Sept. 2005	None

The state guarantee for the A Term Loan is a guarantee of collection, i.e. Farice hf. will be fully liable for payment of the loan and the creditor will need to exhaust the recourses for collection from the company before the state guarantee can take effect. Farice hf. was charged with an annual premium of 0,5% (established by the Icelandic National Debt Management) which was paid upfront when the loan agreement and the state guarantee were issued. The upfront payment amounted to EUR 438 839, i.e. 4,7% of the loan amount. In addition, a guarantee fee of 120 000 ISK was charged.

An earlier guarantee of collection was signed in July 2003 in relation to a bridge loan of EUR 16 million. The guarantee of collection covered EUR 6,4 million, i.e. 40% of that loan. The bridge loan was paid up upon the release of the long-term loans of EUR 34,5 million and the guarantee of collection for the bridge loan ceased to exist the same day. Farice hf. paid a 0,50% guarantee fee and a guarantee charge of ISK 120 000 for that guarantee.

b. The Icelandic Government's increase in share capital

At the beginning of January 2003, the state participation in Farice hf. increased from an initial share of 27,33 % to 46,5 %. Following the explanation given by the Icelandic authorities in their reply of June 2004,

“[a]s the business plan evolved, the funding needs of the company became clearer and it was decided to increase the company's share capital. All operators in Iceland and Faeroe

¹⁸ Although in the letter accompanying the notification reference is made to Libor as the basis for establishing the rate of interest to the loan for each tranche, clause 7.1 of the Loan Agreement refers to Euribor. For this reason, the Authority considers the Euribor rate to be the valid reference for the determination of the rate of interest applicable to the loan for each interest period.

Islands were invited to buy shares in the share capital increase. As Síminn made it clear that the company would not want to provide more than 33,33 % of the share capital, Telefonverkið would provide necessary share capital from the Faroese site (19,93 %), the Icelandic government had to provide 46,53 % of the necessary share capital as other operators in Iceland did not have the financial capacity to buy more than 1,2 % of the share capital.”

As stated by the Icelandic authorities, the total share capital of Farice hf was increased from EUR 327 000 to more than EUR 14 million. Details on the share capital contribution of the different shareholders can be seen in the table below¹⁹:

Share capital of Farice hf. (amounts in ‘000s)

	Preparation phase			Jan-03			Jun-03		
	ISK	EUR 20	Share	ISK	EUR	Share	ISK	EUR	Share
Eignarhaldsfélagið Farice ehf.				947944	11242	79,90%	947944	11242	79,90%
Government of Iceland	8200	90	27,33%	552067	6547	46,53%	491737	5831	41,45%
Síminn	14200	155	47,33%	395477	4690	33,33%	352259	4177	29,69%
Og Vodafone	400	4	1,33%	400	5	0,03%	103949	1232	8,76%
Lína.Net	400	4	1,33%	400	5	0,03%	400	5	0,03%
Fjarski ehf.	400	4	1,33%	400	5	0,03%	400	5	0,03%
RH-net	400	4	1,33%	400	5	0,03%	400	5	0,03%
Telefonverkið	5200	57	17,33%	236486	2804	19,93%	236486	2804	19,93%
Kall	400	4	1,33%	400	5	0,03%	400	5	0,03%
SPF spf.	400	4	1,33%	400	5	0,03%	400	5	0,03%
Total	30000	327	100,00%	1186430	14070	100,00%	1186430	14070	100,00%

3. Opening of the formal investigation procedure

In its Decision No. 125/05/COL to open the formal investigation procedure, the Authority came to the preliminary conclusion that the state guarantee and the share capital increase by the Icelandic State in Farice hf. constituted state aid within the meaning of Article 61(1) of the EEA Agreement.

The Authority had doubts whether the Icelandic State’s support measures could be declared compatible with the functioning of the EEA Agreement. In its Decision to open the formal investigation procedure the Authority raised doubts as to whether the aid measures - in order to be compatible with the rules of the EEA Agreement – were proportionate to their objectives and did not distort competition to an extent contrary to the common interest. These doubts concerned in particular the question whether there would be non-discriminatory access to the network. Further, as the original idea was to channel also CANTAT-3 capacity via the E-Farice hf., there were concerns that the competition in connectivity to Iceland would be eliminated, as only one supplier would remain in the market.

4. Comments by the Icelandic authorities

¹⁹ See letter of the Icelandic authorities dated 8 June 2004, page 7.

²⁰ As the Icelandic authorities did not use the same conversion rate throughout the table, the Authority has modified the table submitted by the Icelandic authorities, as far as the Euro figures are concerned. It calculated the Euro figures in the table according to its conversion rates published on its webpage <http://www.eftasurv.int/fieldsofwork/fieldstateaid/dbaFile791.html>. For the preparation phase it used the 2002 conversion rate of 91,58. For the 2003 figures, it used the 2003 conversion rate of 84,32.

In their comments to Decision No. 125/05/COL dated 28 June 2005, the Icelandic authorities restate their opinion that there is no state aid involved in the Farice project. According to the Icelandic authorities, the loan guarantee and the increase of the Government's share capital are in line with the state aid provisions. Furthermore, the Farice project constitutes infrastructure within the meaning of the state aid rules. However, as stated in a previous letter dated 21 January 2005, the Icelandic authorities are of the opinion that any state aid would be compatible with Article 61(3)(b) and (c) of the EEA Agreement.

The Icelandic authorities justify the necessity of the measures in question based on the consideration that telecom connectivity and broadband access are a necessary step for the modernisation of the EU society and economy and are a crucial aspect of the Lisbon agenda as well as a pre-requisite for the development of the e-Europe Action Plan.

Given its geographic location, Iceland is particularly dependent on having access to economic and reliable telecom connectivity. The connectivity currently in place is neither satisfactory nor reliable or acceptable for the telecom-dependent Icelandic and Faroese economies due to the technical limitations of CANTAT-3.

Under these circumstances, the participation of the State resulted from the need to make the project viable. Without the state participation the project would either have been delayed or not undertaken at all.

The Icelandic authorities are of the opinion that the advantages in terms of guaranteeing a reliable provision of telecom services in Iceland outweighs the disadvantages of a certain distortion of competition for other competitors.

Prior to the establishment of Farice, introductory meetings were held with Icelandic operators whereby only three of the "smaller" operators agreed to buy shares in the company. In the opinion of the Icelandic authorities, considerable effort was put into the search for founding parties, setting no lower limit on share capital contributions. Therefore, the Icelandic authorities argue that there was widespread participation given the specific circumstances of the project.

The Icelandic authorities underline that section 7 of the Shareholders Agreement contains a pre-emptive right of the founding companies of Farice hf. This right is equivalent to Article 34 of the Icelandic Act No 2/1995 on Public Limited Companies, according to which shareholders are entitled to subscribe to new shares in direct proportion to their holdings. This right is transferable and, furthermore, each shareholder can always decide not to use this pre-emptive right. Furthermore, section 7(2) of the Shareholders Agreement, provides that the shareholders will endeavour to ensure that new parties can participate in the increase of capital, notwithstanding the pre-emptive rights.

The shareholders agreement provides for a non-discriminatory, transparent pricing on market terms. The pricing policy of the company shall be based on the principles of cost orientation, transparency and non-discrimination. The Icelandic authorities compare the Farice project with the situation addressed in Commission's Decision N307/2004, concerning a broadband infrastructure project in the UK to provide mass market broadband services to businesses and citizens in remote and rural Scotland. According to their information, the prices for capacity on the Farice system are probably the highest ones for similar services across the North-Atlantic. This is one of the reasons why the volume sold in 2005 corresponds to less than 5% of the currently installed capacity on Farice.

Concerning the question of open access, the Icelandic authorities stress that access to the infrastructure is open, transparent and non-discriminatory.

Finally, the Icelandic authorities consider that if it were to be established that state aid was involved, the total amount of aid is limited. In particular regarding the loan guarantee, such a limited amount cannot be considered contrary to the common interest with regard to Article 61(3)(c) of the EEA Agreement. As to the Icelandic State's share increase, the Icelandic authorities argued that *“the initial purpose for the establishment of Farice hf in September 2002 was solely the preparation for the construction and operation of the submarine communication cable system. At this point, the financial need of the whole project had not been finally decided nor had the final shareholding [...] No company would be in the position to undertake the actual construction and operation of the cable [...] The first share increase in January 2003 was therefore not a normal 'share increase' of a company but in fact similar to the establishment of a new company with a new purpose.”* The fact that private operators have been holding the majority of the shares at all stages and contributing substantially to the company at the same time as the Icelandic State, shows that any eventual state aid would be very limited.

Regarding the competition concerns (see section II.3.2 of Decision No. 125/05/COL), the Icelandic authorities state that presently neither Farice hf. nor E-Farice ehf. have any plans to purchase or lease more CANTAT-3 capacity and that the discussions with Teleglobe at the time never led to any agreements. It has also been shown that due to the high prices of Farice, customers have increasingly used CANTAT-3 capacity, which is able to compete with Farice hf.

II. APPRECIATION

1. The presence of 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.”

1.1. The loan guarantee by the Icelandic State

In general, a state guarantee enables its beneficiary to obtain better financial terms for a loan than those normally available on the financial markets. Therefore, guarantees given by the State may fall within the scope of Article 61(1) of the EEA Agreement.

However, in the provisions of Chapter 17.4(2) of the Authority's State Aid Guidelines on State Guarantees (hereinafter: the Guidelines), the Authority has laid down a situation in which an individual state guarantee does not constitute state aid under Article 61(1) of the EEA Agreement. To this end, the state guarantee must fulfil all the following conditions:

- a) The borrower is not in financial difficulty;
- b) the borrower would, in principle, be able to obtain a loan on market conditions from the financial markets without any intervention by the State;

- c) the guarantee is linked to a specific financial transaction, is for a fixed maximum amount, does not cover more than 80 % of the outstanding loan and is not open-ended;
- d) the market price for the guarantee is paid (which reflects, amongst other things, the amount and duration of the guarantee, the security given by the borrower, the borrower's financial position, the sector of activity and the prospects, the rates of default, and other economic conditions).

The Authority will, therefore, firstly assess whether the state guarantee in favour of Farice hf. for the A Term Loan fulfils the four conditions set out in the Guidelines which would exclude that state aid is involved. Only in the case of a negative finding in that regard will the Authority assess the individual conditions of Article 61(1) EEA Agreement.

1.1.1 Conditions excluding the existence of aid – Chapter 17.4(2) of the State Aid Guidelines

According to the information provided by the Icelandic authorities, the project could not gain momentum as a purely commercial business case and required the involvement of the State. Although Farice hf. was not technically in financial difficulty (first condition), it could only secure a EUR 11 million loan on market conditions (D loan). The fact that the banks did not only require a guarantee from the State for the A Term Loan but also from the two former state telecommunication monopolists (Síminn for the B Term Loan and Telefonverkið P/F for the C Term Loan), which were still owned by the respective States, shows that Farice was not in the position to obtain a loan on market conditions without any intervention by the State. The second condition is therefore not fulfilled.

As to the third condition, the Authority took the preliminary view in the decision to open the formal investigation that the state guarantee covers 100% of the guaranteed A Term Loan. The overall loan package is made up of four (or five²¹) different loan amounts with different borrowing conditions, different lenders and different guarantees. The Icelandic authorities argue that there is only one loan at stake, at EUR 34,5 million and that for that reason the state guarantee relating to the A Term loan does not cover more than 80% of the loan. However, as can be seen from the loan agreement, while granted for the same collateral, the four loans are granted by different banks which assume the responsibility for *their* loan amount only. None of the banks would give up its share of the security²² – in case of a failure of Farice hf. – in order to cover any of the other loans. The different loans do not only carry different interest rates but they also have different repayment periods, different number of instalments and different guarantors.

It should further be noted that the 80% rule should ensure that the creditor still has an incentive to reflect on the risk which he is willing to assume. Against this background, it does not seem correct to take into account – in relation to the business decision made by the Nordic Investment Bank and in order to establish the loan basis to which the 80% rule applies – that other loans are granted by Íslandsbanki and Føroya Banki. The Nordic Investment Bank has not assumed any responsibility for these loans.

For these reasons, the Authority considers that each part of the overall loan amount constitutes an independent loan as such. The combination of the loans in one joint document does not appear to be of significant relevance. For this reason, the Authority

²¹ As the B Term Loan is provided by two different lenders.

²² According to the Security Document of the Loan Agreement a first ranking security into land and assets is registered for the amount of EUR 34,5 million

considers that the guarantee of the State covers 100 % of the guaranteed A Term Loan for a maximum amount of EUR 9,4 million. Therefore, the third condition is not fulfilled.

Regarding the fourth condition, the Authority notes that the Icelandic State Guarantee Fund charged a guarantee premium of 0,5 % p.a. in relation to the A Term Loan. The premium was paid upfront at an amount of EUR 438 839. In addition a guarantee of ISK 120 000 was charged.

Only assuming that the State Guarantee Fund took into account, in the assessment of the premium, the concrete characteristics of the guaranteed loan, in particular the conditions for repayment²³ and that it followed for its assessment the so-called market investor principle, would the fourth condition laid down in Chapter 17.4(2) of the Guidelines be fulfilled. However, despite being invited to prove that the guarantee premium reflects the market rate, the Icelandic authorities have not substantiated this point, but mainly limited themselves to repeat the relevant provisions of the State Guarantee Fund Act. The Authority notes that while taking into account that the guarantee in question is a guarantee of collection with a lesser risk, the premium charged to Farice is at the very low end of the spectrum of such charges to be fixed by the National Debt Management Agency (from 0,5 to 4%²⁴), which has not been reasoned by the Icelandic authorities despite the comment of the Authority in the Decision to open the formal investigation procedure²⁵.

Further indication of the appropriate market rate can be derived from Chapter 17.3(2) of the Guidelines which identifies the amount of aid, i.e. the cash grant equivalent, for an individual guarantee, as the difference between the market rate and the rate obtained thanks to the state guarantee after any premiums have been deducted. This is based on the understanding that if the borrower profits from a favourable interest rate, which he would not have received without state intervention, the aid element is the amount which remains in comparison to the market rate and *after* the premium has been deducted. If the premium does not fully remove this advantage, the state guarantee would still benefit the recipient and thus distort the market. In such circumstances the advantage resulting from the guarantee has not been removed by the premium and would have to be classified as aid²⁶.

On the basis of the information available to it (the Authority has no information on credit ratings for Farice hf.), the Authority will try to establish an approximation of the value of the guarantee and the respective aid intensity by a comparison of the A Term Loan with the D Term Loan.

In its Decision to open the formal investigation procedure, the Authority expressed doubts as to whether the interest rate of the A Term Loan should be compared with the B or D Term Loans. The Authority considers that the interest rate of the A Term Loan could be compared with the D Term Loan²⁷, which is the only one not backed up by the State or a

²³ The provisions of the Loan Agreement foresee the possibility of prepaying the whole or part of the loan, except for the A term Loan, without any prepayment fee.

²⁴ See the letter of the Icelandic authorities dated 21 January 2005, page 9.

²⁵ See page 11 of the Authority's Decision No. 125/05/COL.

²⁶ The Icelandic authorities do not consider this aspect, but look at the adequacy of the market price as such. The result is that the fact that the state guarantee has led to better loan conditions than market conditions, is neither considered under the second condition (see above) nor under the fourth condition.

²⁷ According to Clause 7.4 of the Loan Agreement, only the margin for the A Term Loan can be modified after signature of the agreement. Such an amendment may take place on 18 March 2011 and will be effective until the loan maturity. As this is depending on the future negotiations, the Authority is not in a position to assess whether such a modified margin would constitute state aid within the meaning of Article 61 (1) of the EEA Agreement or whether any possible aid could be authorised. However, the Icelandic authorities would be able to identify the existence of an aid element for any

state-owned company. The difference between the interest rate for these two loans is 1,32 percentage points. Deducting a guarantee premium of 0,50%, the difference amounts to 0,82 percentage points²⁸. That would result in an aid amount of some EUR 720 000²⁹. However, it should be taken into account that the D Term Loan has a longer repayment period (maturity) than the A Term Loan. Whereas the A Term Loan will only be paid back in 2015, i.e. 11 years after the conclusion of the loan agreement, the D Term Loan will be paid back in 2009 (see table in I 2.2. a. of this Decision). If the D Term Loan had the same long maturity as the A Term Loan (i.e. until 2015), there is reason to believe that Íslandsbanki hf. would have requested an interest rate, higher than Euribor + 1,50 %. Using Eurobond yield rate curves for 2004³⁰ the difference between a bond maturity of 5 years and of 11 years shows a difference in the yield rate of some 0.8 percentage points. In order not to understate the advantage of the guarantee and the respective aid intensity, this difference must be taken into account, which would for the D Term Loan lead to an interest rate of Euribor + 2.3% (1.5 % as the original rate plus the additional 0,8%), thereby increasing the aid intensity to 1,62 %³¹ or around EUR 1,4 million³². This figure should be taken rather as an illustration than as an exact calculation of what the aid amounts to. It cannot be taken for granted that a commercial lender for a non-guaranteed loan would have charged 2.12 percentage points³³ more than the rate for the A Term Loan, even if the maturity were the same. A required rate would depend on the lender's risk assessment, which not necessarily leads to the mark-up as calculated above.

Thus, three out of the four cumulative conditions laid down in the Guidelines for assessing whether or not an individual state guarantee constitutes state aid under Article 61(1) of the EEA Agreement are not fulfilled. Although the borrower, Farice hf., was technically not in financial difficulty, it was not able to obtain a loan from the financial markets on market conditions without any intervention by the State but needed the state guarantee for 100% of the outstanding A Term Loan. Furthermore, Farice hf. did not pay a market price for the guarantee, which would reflect the amount and duration of the guarantee and the security given by the borrower, as well as, in particular, the sector of activity and the prospects.

For these reasons, the Authority cannot conclude that the state guarantee in favour of Farice hf. for the A Term Loan excludes the involvement of state aid.

1.1.2 The conditions of Article 61(1) of the EEA Agreement

In order for a measure to be considered state aid within the meaning of Article 61(1) of the EEA Agreement, it must fulfil the following cumulative conditions: the aid constitutes a selective advantage in favour of certain undertakings, is granted through state resources, distorts or threatens to distort competition and affects trade between the Contracting Parties to the EEA Agreement.

The measure constitutes a selective advantage in favour of an undertaking

A measure which grants an advantage to certain specific beneficiaries and which is not a general measure constitutes aid.

future modification by applying the calculation parameters laid down in the previous paragraph and, in case of the existence of an aid element, would have to notify the aid measure to the Authority.

²⁸ Euribor + 1,50% p.a.-(Euribor+0,18% p.a.)-0,50% = 0,82 %.

²⁹ Based on the following calculation: EUR 438 839/0.5 x 0.82=EUR 719 695.

³⁰ http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/EYC/EN/eyc-EN.htm#historical

³¹ Euribor + 2,30% p.a.-(Euribor+0,18% p.a.)-0,50% = 1,62%

³² EUR 438 839/0.5x1,62= EUR 1 421 838.

³³ 2.30 – 0,18 (the interest rate of the A Term Loan)

The Icelandic authorities have argued that the support to the Farice project does not comprise any state aid, given that the submarine cable qualifies as infrastructure and support in its favour therefore constitutes a “general” and not a selective measure. As stated in the European Commission Communication COM (2001) 35 final, “Reinforcing quality service in sea ports: a key for European transport”³⁴, the criterion of selectivity is an important benchmark for deciding whether a concrete financing measure constitutes state aid.

In Commission practice, state funding for the construction or management of infrastructure is not to be regarded as aid if the infrastructure is directly managed by the State (which is not the case in the present project) or if there is a public tender for the selection of the manager and if access to the infrastructure is open to all potential users on a non-discriminatory basis³⁵.

As it pointed out in the decision to open the formal investigation procedure, while wide participation might have been sought within the project, neither the construction nor the management of the company was organised by a public tender. The government participation rather responded to a private initiative, started by the two incumbent telecommunication operators³⁶. Moreover, regarding non-discriminatory access, while the participation in the company according to the shareholders’ agreement is not restricted, the founding shareholders keep certain pre-emptive rights, which seems to place them in a better position than new shareholders.

Regardless of this, in line with Commission practice, a measure does not constitute a general measure, if the body managing the infrastructure is pursuing an economic activity, as this may provide a potential advantage to the beneficiary³⁷ in relation to competing operators. In this respect it suffices to note that the state support benefits Farice hf. which manages the cable and sells users’ rights to interested parties against remuneration. According to the case law of the European Court of First Instance, the management of infrastructure constitutes an economic activity within the meaning of Article 61(1) of the EEA Agreement³⁸. Farice hf. is able to profit from an infrastructure construction secured with a state guarantee and with government participation in a situation in which private parties were not willing to ensure the full financing of the project, whereas other operators might have to finance 100% of it on their own.

In addition, the participation in the company is mainly geared towards telecommunication operators. Connectivity via the Farice cable is currently only sold in large units to business operators who resell the service on the downstream market to end users. It were these business operators who took the initiative to which the State responded. The type of

³⁴ Communication of 13.02.2001, COM (2001) 35 final.

³⁵ Commission decision N 527/02 – Greece Financial support of a private company for the design, construction, testing and commissioning of the aviation fuel pipelines for supply of the new Athens International Airport.

³⁶ See Commission decision C 67-69/2003 concerning aid for the construction of a propylene pipeline between Rotterdam, Antwerp and the Ruhr-area, paragraph 48. The argument by the Icelandic authorities that Directive 2002/20/EC only requires a general authorisation (and not a tender) is valid, but not relevant for state aid purposes. Under the state aid provisions, the carrying out of a tender is one of the elements to assess whether a measure can be classified as infrastructure.

³⁷ See Commission decision N 527/02 Greece Financial support of a private company for the design, construction, testing and commissioning of the aviation fuel pipelines for supply of the new Athens International Airport. Also Commission decision N 860/01 – Austria on the ski resort Mutterer Alm where the running of ski lifts was considered to be an economic activity benefiting the operator of the ski lift and therefore not constituting an infrastructure measure. See Commission decision C 67-69/2003, paragraph 48.

³⁸ See Case T-128/98 *Aéroports de Paris v European Commission* [2000] ECR II-3929.

service is therefore targeted at commercial operators and not at the general public. The Authority therefore considers that the project should be looked at as being a dedicated facility for undertakings, which is within the scope of state aid control, and not as a general infrastructure³⁹.

In order to determine 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 market conditions.

As stated in Chapter 17.2.1, paragraph 1, of the Guidelines, a State guarantee enables the borrower to obtain better financial terms for a loan than those normally available on the financial markets. Typically, with the benefit of the State guarantee, the borrower would not, without a State guarantee, find a financial institution prepared to lend on any terms.

As stated above (in section II.1.1.1 of this Decision), the fact that the banks did not only require a guarantee from the State for the A Term Loan but also from the two former state telecommunication monopolists (Síminn for the B Term Loan and Telefonverkið P/F for the C Term Loan), which were still owned by the respective States, shows that Farice was not in the position to obtain a loan on market conditions without any intervention by the State.

Furthermore, the carrying of a risk by the State should normally be remunerated by an appropriate premium. As it has been shown above (in section II.1.1.1 of this Decision), the premium charged to Farice hf. is on the very low end of the spectrum and might not represent an adequate remuneration. The Icelandic authorities have not provided any information in their comments to the concerns on that point raised in the Decision to open the formal investigation procedure, on which basis the Authority could assess that the premium paid was adequate. This has to be seen in particular with regard to the fact that the premium did not fully removed the advantage which Farice hf. obtained from gaining a lower interest rate for the A Term Loan from the banks. As can be seen from Chapter 17.2.1, paragraph 2 of the Guidelines, where the State foregoes an adequate premium, there is a benefit for the undertaking.

Thus, the Authority considers that Farice hf. has received an economic advantage which it would not have obtained under normal market conditions.

State resources

In order to be considered state aid within the meaning of Article 61(1) of the EEA Agreement, the economic advantage must be granted by the State or through state resources. The Icelandic State provided a guarantee for a loan of EUR 9,4 million in favour of Farice, i.e. the State guarantee involves state resources.

Furthermore, as stated in Chapter 17.2.1, paragraph 2, of the Guidelines, where the State foregoes an adequate premium, this constitutes a drain on state resources. As it has been shown above, the premium charged to Farice hf. is on the very low end of the spectrum and might not represent an adequate remuneration, in particular with regard to the lower interest rate obtained. Since the Icelandic State could have required a higher premium to be paid, and consequently has forgone higher revenues, state resources are involved.

The State also did not act as a private market investor, which would exclude the application of Article 61(1) of the EEA Agreement. The discussion of the above two

³⁹ See Commission decision N 213/2003 – Project Atlas, broadband infrastructure for business parks.

criteria shows that the project did not gain any momentum on commercial grounds. The State's participation in the project, *inter alia* by guaranteeing the A Term Loan, became necessary in a situation where private market investors would have – if they had granted the guarantee – asked for a higher premium. This shows that the Icelandic State, when assuming the guarantee, did not act according to the private market investor principle.

Distortion of competition and effect on trade between the Contracting Parties

In order for Article 61(1) of the EEA Agreement to be applicable, the measure must distort competition and affect trade between the Contracting Parties. Undertakings benefiting from an economic advantage granted by the State which reduces their normal burden of costs, are placed in a better competitive position than those who cannot enjoy this advantage.

The intervention of the State strengthens the position of Farice hf. in securing the project financing versus competitors who do not profit from such a guarantee and would have to make the investment solely on market terms, as for example other providers of cables for internet connectivity (such as the CANTAT-3 network). The consortium which operates the CANTAT-3 network includes, *inter alia*, the Icelandic telecom operator Landssími Íslands hf., Teleglobe and Deutsche Telekom. CANTAT-3 has connection points in Canada, Iceland, the Faeroe Islands, Denmark, the United Kingdom and Germany.

Furthermore, the guarantee is given for a project which is carried out by multinational business operators and constitutes an activity which is subject to trade between the Contracting Parties.

Hence, the measure distorts competition and affects trade between the Contracting Parties.

Conclusion

For the above mentioned reasons, the Authority concludes that the state guarantee granted in favour of Farice hf. for the A Term Loan constitutes state aid within the meaning of Article 61(1) of the EEA Agreement.

1.2 The increase in the participation of the State as shareholder of Farice hf.

Between the time of the establishment of the company in September 2002 and the time of the notification at the beginning of 2004, the state participation in Farice hf. increased from an initial share of 27,33 % up to 46,5 %. Following the explanation given by the Icelandic authorities in their reply of June 2004, Síminn made it clear that it did not intend to provide more than 33,33% of the share capital⁴⁰.

For state aid purposes, it has to be established whether the capital increase at Farice hf. undertaken by the State is in conformity with the market economy investor principle. Chapter 19 of the Guidelines establishes the general approach of the Authority with regard to the acquisition of share holdings by public authorities.

According to Chapter 19.6(b) of the Guidelines, no state aid is involved where fresh capital is contributed to an undertaking in circumstances that would be acceptable to a private investor operating under normal market economy conditions. This can apply when public holdings in a company are to be increased, provided that the capital injected is proportionate to the number of shares held by the authorities and goes together with the

⁴⁰ See section I 2.2.b of this Decision.

injection of capital by a private shareholder. The private investor's holding must have real economic significance.

On the other hand, there is state aid where fresh capital is contributed in circumstances that would not be acceptable to a private investor operating under normal market economy conditions. Following Chapter 19.6(c) of the Guidelines, this is, amongst others, the case where the injection of capital into companies whose capital is divided between private and public shareholders makes the public holding reach a significantly higher level than it was originally and the relative disengagement of private shareholders is largely due to the companies' poor profit outlook.

The Icelandic authorities argue that the Icelandic State's share capital increase should not be looked at as an injection of fresh capital, but rather as the initial setting up of the company. The Icelandic authorities state that Farice hf., with the share capital of 30 million ISK was not, in September 2002, in the position to take on the project of construction or operation of a submarine communication cable system. Instead of creating – as discussed - a new company, the first share increase in January 2003 took place, which was in the view of the Icelandic authorities, therefore not a normal “share increase” of a company, but in fact similar to the establishment of a new company with a new purpose. The Authority points out that the State Aid Guidelines consider the share capital increase, regardless of at what point in time it takes place, as a subcategory of the injection of fresh capital. As the Guidelines reflect the general principle of private market investor behaviour, the share capital increase must be analysed on its merits. Even if the Government had assumed the higher share already during the preparation phase, this still would have made the capital participation of the Icelandic State subject to an analysis under the state aid provisions. For that assessment it is therefore only relevant whether the share capital increase reflects the rationale of a private market investor.

The Authority does not deny that in real terms the private operators' increased holdings occurred at the same time as the capital increase by the State. However, in the Authority's opinion, the share increase of the private operators was not proportionate to the share capital increase by the State.

As can be seen from the table above (see section I.2.2.b) of this Decision) Farice hf.'s capital rose from EUR 327 000 to EUR 14 070 000 in January 2003. The share of the Icelandic State grew from 27,33 % (EUR 90 000) to 46,53% (EUR 6 547 000), i.e. by almost 20 percentage points. While it is correctly stated by the Icelandic authorities that the share of Síminn grew from EUR 155 000 to EUR 4 690 000, in relative terms the share of Síminn fell from 47,33% to 33,33 % (14 percentage points). Except for Telefonverkið, the shares of all other participants also fell (from 1,33% to 0,33%), which shows that in relative terms the commercial operators disengaged from the project.

This is likely to result from the poor outlook of the company's profit. In their letter of September 2004, the Icelandic authorities have submitted that:

“Síminn felt that increasing the capacity to meet foreseeable demand, as well as providing an alternate route for emergencies, was a financially risky undertaking, providing little return on investment (especially for a limited company in line for privatisation). In order to facilitate the necessary upgrade in capacity, particularly in view of the short time frame available until capacity would be outstripped by the demand, the Government stepped in.”

The Icelandic authorities further state that the *market's reluctance* towards the project was indicated in the preparatory phase when Síminn and Telefonverkið engaged IBM Consulting to advise them on the economic viability of the project and its financing

possibilities. The findings strongly suggested that the funding could not be done via traditional means⁴¹.

It seems from this that the initial lack of engagement from private investors was the reason for the subscription of the necessary capital increase by the Government in early 2003⁴², which raised the state participation in Farice hf.

The increase in the Icelandic State's share of Farice was further accompanied by the grant of a state guarantee to cover the A Term Loan of EUR 9,4 million, assessed above in this Decision. According to Chapter 19.6 (d) of the Guidelines, there is a presumption that there is state aid where the authorities' intervention takes the form of acquisition of a holding combined with other types of interventions which need to be notified pursuant to Article 1(3) in Part I of Protocol 3 to the Surveillance and Court Agreement.

The increase in the share capital in a situation in which no private investor was increasing its share capital in the same proportion, thus presented an advantage to an individual company, Farice hf. and a drain on state resources.

The intervention of the State strengthens the position of Farice hf. in securing the project financing versus competitors who do not profit from such a state participation (e.g the CANTAT 3 network) in a situation in which private operators are not willing to raise additional funds. The consortium which operates the CANTAT-3 network includes, *inter alia*, the Icelandic telecom operator Landssími Íslands hf., Teleglobe and Deutsche Telekom. CANTAT-3 has connection points in Canada, Iceland, the Faeroe Islands, Denmark, the United Kingdom and Germany.

Furthermore, the share increase concerns a project which is carried out by multinational business operators and constitutes an activity which is subject to trade between the Contracting Parties.

Hence, the measure distorts competition and affects trade between the Contracting Parties.

1.3 Conclusion

For the above-mentioned reasons, the Authority concludes that the state guarantee for the A Term Loan and the capital share increase by the Icelandic State constitute state aid within the meaning of Article 61(1) of the EEA Agreement.

2. Procedural requirements

Pursuant to Article 1(3) in Part I of Protocol 3 to the Surveillance and Court Agreement, "*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.*" According to Article 2(1) read together with Article 3 in Part II of Protocol 3 to the *Surveillance and Court Agreement*, "*any plans to grant new aid shall be notified to the Authority in sufficient time by the EFTA State concerned and shall not be put into effect before the Authority has taken, or is deemed to have taken, a decision authorising such aid.*"

⁴¹ See letter by the Icelandic authorities dated 25 June 2004, page 3.

⁴² The Authority is aware of the reference of the Icelandic authorities to the speech of the chairman of Farice hf. board on 24 January 2004. However, this speech only states that there is a '*modestly profitable business case*' and that the private operators also provided securities. The latter point has never been denied by the Authority; the question whether the share increase by the State is proportionate is, however, not answered.

Farice hf. was established in 2002 and the construction work started already in June 2003. The cable was officially opened in February 2004⁴³. The share capital increase took place in January 2003 and the guarantee of collection by the Icelandic authorities dates to 27 February 2004, i.e. before the Authority had a chance to express a view on the notification of the measures on 27 February 2004. Thus, the Icelandic authorities put the measures into effect before the Authority had taken a final decision on it.

The Authority therefore notes that the Icelandic authorities did not respect the stand-still obligation laid down in Article 3 in Part II of Protocol 3 to the Surveillance and Court Agreement.

3. Compatibility

In the Authority's view, the aid measures do not comply with any of the exemptions provided for under Article 59(2)⁴⁴ and Article 61(2) or (3)(a) and (d) of the EEA Agreement.

As stated in the decision to open the formal investigation procedure, in the Authority's view, the state support cannot be justified under Article 61(3)(b) of the EEA Agreement. Admittedly, the existence of reliable international connectivity could be considered of general interest under certain circumstances. While the project is trans-national, that does not suffice for accepting the project to fall under the exemption of Article 61 (3)(b) of the EEA Agreement. The aid in question presents itself in the form of sector aid, benefiting an individual company (Farice hf.) and brought about as a result of a private initiative of a group of business operators rather than achieving wider positive results for the European economy or creating important spill-overs for the general society. The project does not profit the European Economic Area as a whole⁴⁵ and is also outside any framework of any Community action in this field⁴⁶.

It needs to be assessed whether the aid could be justified under Article 61(3)(c) of the EEA Agreement. Under this provision aid may be declared compatible if "*it facilitates the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest*".

The Authority considers that the compatibility assessment is to be based directly on Article 61(3)(c) of the EEA Agreement. To be considered compatible under this provision, the state aid measure must be necessary and proportionate to the objective it pursues.

3.1 The necessity of the aid measures

The Authority notes that the project intends to secure internet connectivity to Iceland by having a reliable transmission method to which the former CANTAT-3 connection will serve as a back-up. Because of its geographic location, Iceland is particularly dependent on having access to economic and reliable telecom connectivity. As can be seen from section I.2 of this Decision, alternatives in the form of the existing CANTAT-3 cable or satellites were no durable options, either because of their technical limitations or

⁴³ Press release of 3 February 2004.

⁴⁴ The Icelandic authorities have not provided information which enables the Authority to make an assessment under that provision.

⁴⁵ See e.g. State aid N 576/98 United Kingdom concerning the Channel Tunnel Rail Link, where the high speed rail link was a link of EU wide importance, rather than being relevant for one or a few Member States.

⁴⁶ For this criterion, see e.g. Commission Decision concerning fiscal aid given to German airlines in the form of a depreciation facility, OJ L 146, 20.6.1996, p. 42.

dependencies on other consortium shareholders (CANTAT-3⁴⁷) or their rising costs (satellites). The new submarine cable, which is to become the primary transmission connection to Iceland, has greater capacities, is more reliable and - together with the backup by CANTAT-3 – is able to secure the provision of telecommunication services to Iceland. The availability of broadband⁴⁸ has been acknowledged in Commission policy and state aid decisions⁴⁹ as a legitimate objective and type of service which is by its nature capable of positively affecting the productivity and growth of a large number of sectors and activities.

As can be seen from its history (in particular the feasibility study of March 2002), the Farice project was not able to emerge as a purely private initiative. Both, the grant of a state guarantee and the share capital increase resulted from the need of a greater state participation to make the project economically viable. Without state participation, the project would either have been delayed or not undertaken at all. For these reasons, the Authority considers that the state support was necessary within the meaning of 61(3)(c) of the EEA Agreement.

3.2 The proportionality of the aid measures

In order for the aid measures to be compatible with Article 61(3)(c) of the EEA Agreement, it must also be proportionate to the objective and not distort competition to an extent contrary to the common interest. The trade-off between the advantages in terms of guaranteeing a reliable provision of telecommunication services to Iceland must be weighed against the disadvantages of the distortion of competition in comparison to competitors, which do not have access to public funding when realising similar projects.

Neither the construction nor the management of the cable were given to Farice hf. after an open tender. In the opinion of the Authority, the widespread information on this project as claimed by the Icelandic authorities cannot replace a formal tender procedure, in particular as this participation was limited to Icelandic and Faeroe parties⁵⁰. The open tender has been considered a positive, although not necessarily mandatory, element for the approval of broadband projects in Commission practice⁵¹. In these decisions it has been, in particular, stressed that the tendering out of the management of the cable to an independent asset manager secured the neutrality of the infrastructure manager better than in a situation in which the service provider has control over the infrastructure, as is the case here.

The Authority notes positively that the Shareholders Agreement provides for a non-discriminatory, transparent pricing on market terms. The pricing policy seems transparent, the schedule is published on Farice hf.'s website and includes the formula used to calculate prices.

⁴⁷ As stated in the summary report submitted by the Icelandic authorities in the notification dated 27 February 2004, the consortium member Teleglobe, in particular, was faced with business difficulties.

⁴⁸ Data transmission in which a single medium can carry several channels at once. The term is also used to compare frequency bandwidth greater than 3 MHz narrowband frequencies. Broadband can transmit more data at a higher speed.

⁴⁹ See e-Europe 2004 Action Plan, Communication from the Commission, An information society for all, 28.5.2002, COM (2002), 263 final, see Commission Decision N 213/2003 Project Atlas – broadband infrastructure for business parks and N 307/2004 Broadband in Scotland – remote and rural areas.

⁵⁰ The Icelandic authorities state: “Widespread participation was sought in Iceland and the Faeroe Islands for shareholders in the Farice project and all telecoms operators were invited to participate in the foundation of the company.”

⁵¹ Commission Decision N 307/2004, N 199/2004 and N 213/2003.

Furthermore, the shareholders' agreement is in principle open to new entrants. In the Decision to open the formal investigation procedure the Authority raised some doubts on the position of new entrants in relation to the founding parties. These doubts were mainly founded in section 7 of the Shareholders Agreement which protects the founders' position by giving them the possibility to maintain their equity position. In their comments to the Authority's Decision⁵², however, the Icelandic authorities have dispelled the doubts of the Authority and stressed the distinction between access to ownership of the company and access to the telecommunication cable. As stated in the previous paragraph, the Shareholders Agreement provides for a non-discriminatory and transparent pricing on market terms and therefore grants adequate access to the telecommunication cable.

The tentatively calculated aid with regard to the state guarantee (1,62%⁵³ or some EUR 1,4 million) is rather limited, when compared to the total investment costs of EUR 48,9 million, as it amounts to 2.9%. As to the Icelandic State's share increase, in June 2003 the State's share capital has already decreased to 41%, whereas the equity share of other private operators such as Og Vodafone had increased. The Icelandic authorities have pointed out that despite the openness of the current shareholders to newcomers no company has showed interest in the project⁵⁴. A calculation of the amount of state aid involved as a result of the increase in the Icelandic State's share capital is not straightforward. However, even if in the extreme one considered the whole capital increase as state aid and even if one considered the whole A Term Loan as state aid⁵⁵, the overall amount of the involvement of the Icelandic State would be some EUR 15,5 million. This is about 32% of the investment costs for the Farice project.⁵⁶

The European Court of Justice has established that a compatibility assessment under the state aid provisions should not produce a result which is contrary to other treaty provisions. Consequently, for the assessment under the state aid provisions, it is also relevant whether state support is given to a project which might raise competition concerns under the application of Article 53 and/or 54 of the EEA Agreement⁵⁷. In this regard, the Authority *inter alia* noted in the decision to open the formal investigation procedure that although the existing infrastructure CANTAT-3 still remains in place,⁵⁸ there was – among other issues - a concern that in the future, all CANTAT-3 connectivity to Iceland will be channelled through E-Farice hf, which holds the majority of shares in Farice hf.⁵⁹ Hence, the Authority was concerned that competition in connectivity to Iceland would be eliminated, as only one supplier would remain on the market. These concerns have now been dispelled.

⁵² See letter of the Icelandic authorities dated 28 June 2006, page 5.

⁵³ See above fn. 31 of this Decision.

⁵⁴ See letter of the Icelandic authorities dated 28 June 2006, page 5.

⁵⁵ See point 17.3 of Chapter 17 of the Authority's State Aid Guidelines, which states that in certain situations the value of the guarantee might be as high as the amount effectively covered by that guarantee.

⁵⁶ Aid intensities of 35% of total investment costs have e.g. been authorised by the European Commission in State aid N 188/2006- Latvia, for a broadband project in rural areas.

⁵⁷ Cf. Case C-225/91 *Matra SA v Commission* [1993] ECR-3203, paragraph 41, EFTA Court judgment in Case E-09/04 *The Bankers' and Securities' Dealers Association of Iceland v EFTA Surveillance Authority*, not yet published, paragraph 82.

⁵⁸ On the co-existence of existing infrastructure, see Commission Decision N 307/2004, paragraph 45, where it is positively outlined that this minimises the risk of unnecessary duplication and limits the economic impact for operators that already have infrastructure in place. See also Commission Decision N 199/2004, paragraph 41, N 213/2003, paragraph 47.

⁵⁹ See fn. 13 of this Decision.

The Farice project is pro-competitive in creating a new channel for international connectivity where previously there has only been the CANTAT-3 offer.

Moreover, as a result of Farice hf.'s prices, which are high in comparison to international prices, buyers of wholesale capacity in Iceland, other than Farice's founders, have tended to use CANTAT-3 capacity, which Teleglobe offers at lower prices. This shows that Farice does not appear to be able to control prices or supply in the market for international connectivity from/to Iceland under the present market conditions. The Icelandic authorities estimate that currently Teleglobe is selling capacity to Icelandic customers that amounts to about 50% of the volume channelled through Farice. It does not appear that Farice hf.'s pricing policy undercuts CANTAT-3 prices and is able to drive that competitor out of the market. Wholesale customers that are not affiliated with Farice hf.'s founders are able to bypass the Farice cable and have in fact done so.

The Icelandic authorities also reacted to the concerns voiced in the decision to open the formal investigation procedure that Farice hf. originally had plans for joint purchase/lease of increased bandwidth in CANTAT-3 in order to ring-connect the two systems. Such comprehensive purchases of available capacity would effectively have removed Teleglobe as a competitor to Farice. The Icelandic authorities stated that Farice hf. or E-Farice ehf. do not currently have any plans to purchase or lease more CANTAT-3 capacity and that discussions held with Teleglobe⁶⁰ years ago never led to any agreement. The situation of today is that both Farice and CANTAT-3 capacity is available to and from Iceland. In addition, there are other operators, such as TDC and T-Systems which provide capacity on CANTAT-3 to Iceland, although on a smaller scale.

Therefore, in the current situation, there are no grounds for the Authority to be concerned about the competition aspects and the corresponding competition proceedings have been closed.

4. Conclusion

On the basis of the foregoing assessment, the Authority considers that the support in favour of Farice hf. is compatible with the EEA Agreement. Notwithstanding this, the Authority regrets that the measures were implemented before Iceland had notified the Authority of the state guarantee and before the Authority had reached a final decision on the state aid assessment of the measures.

⁶⁰ Teleglobe has survived the earlier Chapter 11 proceedings and is currently a NASDAQ trading company.

HAS ADOPTED THIS DECISION:

Article 1

The support in favour of Farice hf. in form of a state guarantee for a loan and a capital increase constitute state aid which is compatible with the functioning of the EEA Agreement within the meaning of Article 61(3)(c) of the EEA Agreement.

Article 2

This Decision is addressed to the Republic of Iceland.

Article 3

Only the English version is authentic.

Done at Brussels, 19 July 2006

For the EFTA Surveillance Authority,

Bjørn T. Grydeland
President

Kristján A. Stefánsson
College Member