

Case No: 56694
Event No: 383627
Dec. No: 367/06/COL

EFTA SURVEILLANCE AUTHORITY DECISION
of 29 November 2006
on the taking over by the Icelandic State of pension-related liabilities of
Sementsverksmiðjan 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) of Part I and Articles 4(4), and 6 of 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,

Having regard to the Authority's Decision of 14 July 2004 on the implementing provisions referred to under Article 27 of Part II of Protocol 3 to the Surveillance and Court Agreement,

Having regard to the Authority's Decision No 421/04/COL on the sale of the Icelandic State's shares in Sementsverksmiðjan hf. and having called on interested parties to submit their comments pursuant to those provisions⁵

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 25 October 2006. Hereinafter referred to as the State Aid Guidelines.

⁵ Published in the OJ C 117 of 19.05.2005, page 17 and following as well as in the EEA Supplement to the Official Journal of the EU No 24 of 19.05.2005.

Whereas:

I. FACTS

1. Procedure

By letter of 19 August 2003 from the Icelandic Mission to the European Union forwarding a letter from the Ministry of Finance dated 19 August 2003, both received and registered by the Authority on the same date (Doc No 03-5685 A), the Icelandic authorities notified the sale of the State's shares in Sementsverksmiðjan hf., pursuant to Article 1(3) of Part I of Protocol 3 to the Surveillance and Court Agreement.

On 17 December 2003, the company Aalborg Portland Íslandi ehf. lodged a complaint with the Authority against the terms and conditions of the sale by the Icelandic State of its shares in Sementsverksmiðjan hf. The Authority received and registered this letter on 23 December 2003 (Doc No 03-9059 A). The complainant requested this complaint to be processed simultaneously to the notification of the sale made by the Government.

After various exchanges of correspondence⁶, by letter dated 21 December 2004 the Authority informed the Icelandic authorities that it had decided to initiate the procedure laid down in Article 1(2) of Part I of Protocol 3 to the Surveillance and Court Agreement in respect of the sale by the Icelandic State of its shares in Sementsverksmiðjan hf. (Event No 296878). The Authority raised doubts regarding the market value of Sementsverksmiðjan hf. at the time the State's shares were sold, the market value of the assets repurchased by the State, the right of Sementsverksmiðjan hf. to use some of the assets located in Reykjavik sold to the National Treasury without any payment as well as its right to reacquire certain properties and ground rights in Reykjavik for an already predetermined price.

The Authority's Decision No 421/04/COL to initiate the 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 Icelandic authorities submitted comments on this Decision by letter dated 24 February 2005 (Event No 311243). On 20 June 2005, the Authority received comments from Íslenskt sement ehf., the purchaser of Sementsverksmiðjan hf. (Event No 323552). On 2 September 2005, Aalborg Portland Íslandi ehf. submitted further comments (Event No 333018).

The Authority requested the assistance of an independent expert to find out whether the sale of the State's shares in Sementsverksmiðjan hf. was done in accordance with the market investor principle. Based on the independent expert's first assessment of the information on the sale available to the Authority, an information request was sent to the Icelandic authorities on 12 July 2005 (Event No 326295). The Icelandic authorities replied by letter from the Icelandic Mission to the EU forwarding a letter of the Ministry of Finance dated 30 and 31 August 2005 respectively. This letter was received and registered by the Authority on 1 September 2005 (Event No 332274).

⁶ For more detailed information on the various correspondence between the Authority and the Icelandic authorities, reference is made to the Authority's Decision to open the formal investigation procedure, Decision No 421/04/COL, published in the OJ C 117 of 19.05.2005, page 17 and following.

⁷ Published in the OJ C 117 of 19.05.2005, page 17 and following as well as in the EEA Supplement to the Official Journal of the EA No 24 of 19.05.2005.

A second information request was sent to the Icelandic authorities in the framework of the formal investigation procedure on 28 October 2005 (Event No 347691). This request was followed by a meeting in Brussels on 23 November 2005 between representatives of the Authority, the Icelandic authorities, the company and one of the investors participating in the consortium which acquired Sementsverksmiðjan hf. The independent expert engaged by the Authority attended this meeting as well.

By letter dated 6 December 2005, received and registered by the Authority on 7 December 2005 (Event No 353483), the Icelandic Mission to the EU forwarded a letter from the Ministry of Finance dated 2 December 2005, replying to the above-mentioned information request as well as to some pending issues raised during the meeting.

On 31 January 2006, the independent expert presented to the Authority his final report on whether the sale by the Icelandic State of its shares in Sementsverksmiðjan hf. had been accomplished on market terms (Event No 360438).

On 16 February, 9 March and 4 August 2006, the Authority sent letters to the Icelandic authorities requesting further information and clarifications on still unclear points (Event No 363213, 365145 and 383227). The Icelandic authorities replied with letters dated 20 February, 19 April and 26 September 2006 respectively (Event No 363608, 370425 and 390092).

On 12 October 2006 in the annual State Aid Package Meeting in Reykjavik, this case was discussed. As a follow-up to this discussion, the Icelandic authorities sent a letter to the Authority on 2 November 2006 (Event No 396476).

2. Description of the measure under assessment

With an agreement dated 23 October 2003 between the Ministry of Finance and the Pension Fund of State Employees, on behalf of the State Treasury, the Ministry of Finance took over the pension obligations of Sementsverksmiðjan hf. taken over by the company with a special agreement from 1997, and those regarding the annual compensation settlement for employees affiliated to the B-Section of the Pension Fund of State Employees.

a) Introduction: the affiliation of employees of Sementsverksmiðjan hf. to the Pension Fund of State Employees

In a letter dated 18 April 2006, the Icelandic authorities explained that white-collar employees of Sementsverksmiðjan hf. had access to the Pension Fund of State Employees. For their part, blue-collar employees were affiliated to the private pension fund system, i.e. the pension funds of their trade unions. According to the explanations of the Icelandic authorities, at the time of the incorporation of the company in 1993, 6 employees were affiliated to the Pension Fund of State Employees and 93 to private pension funds. Although after the incorporation of the company in 1993, new white-collar employees could still affiliate to the Pension Fund of State Employees, after the sale of the State's shares in Sementsverksmiðjan hf. carried out in 2003, all new employees have to affiliate to a private pension fund.

b) General information on the functioning of the Pension Fund of State Employees

The Pension Fund of State Employees was originally governed by the provisions of Act No 29/1963. In 1997, given that the premiums to the Pension Fund of State Employees seemed insufficient to cover its pension payments, the State decided to reform the system and adopted Act No 1/1997 “The Government Employees Pension Fund Act”. The Pension Fund of State Employees was divided into two Sections: a new Section A was created and the existing pension fund changed into Section B. All new employees were to join Section A whereas existing employees could choose between membership in Section A or retaining their right to membership in Section B, closed henceforth to new members. According to the Icelandic authorities, with the splitting of the former Pension Fund of State Employees into Section A and B, the fund was made self-sustaining and would no longer cumulate a negative balance between premiums and commitments which would eventually have to be made up by the National Treasury.

The main differences between Section A and B of the Pension Fund of State Employees are:

- Premiums to Section A of the Pension Fund of State Employees are paid on the basis of the total income of the affiliated employees who earn retirement rights on the basis of total premiums paid. The pension rights are linked to the consumer price index. The rights of the affiliated employees to a pension are bound by law and employers must periodically adjust their premiums to ensure that the Fund’s premium income matches its commitments.
- In contrast, premiums to Section B of the Pension Fund of State Employees are only paid on the basis of the basic salary of the affiliated employees, not on their total pay. The affiliated employees acquire pension rights in a way that at retirement they receive a certain percentage of the basic pay for the post from which they retired. Thereafter, the pension is linked to the average rise in the pay of government employees. As a result of the provisions for Section B, there is normally a deficit which has to be covered on a regular basis. By virtue of Article 32 of Act No 1/1997, the Treasury guarantees the payment of a pension according to the Act. Notwithstanding this guarantee of the State on the paying-out of pensions to affiliates to the Fund, it is the employer of the members of Section B of the Pension Fund of State Employees who must cover this difference on the basis of Article 33 Act No 1/1997.

c) The establishment of a debt from Sementsverksmiðjan hf. towards the Pension Fund of State Employees

Article 33 of Act No 1/1997 provides that “*in the case where a previously determined [...] pension increases due to a general increase in the salary of public employees, the Treasury and other employers who insure their employees in the Fund refund⁸ the increase which thus takes place in pension payments. [...] The board of the Fund may [...] accept a debenture in payment of accrued commitments. [...] The commitment thus settled shall be based on an actuarial assessment as at the settlement date. An employer who has settled his/her commitment with the issue of a debenture in accordance with this*

⁸ Emphasis added by the Authority.

paragraph shall have no further responsibility for the Fund's commitments [...] in respect of the period and those employees to which the settlement applies”.

On 8 October 1997, the Ministry of Finance signed an Agreement with the Civil Servants' Pension Fund on payment of National Treasury obligations pursuant to Article 33 of Act No 1/1997 on the Civil Servants' Pension Fund with respect to employees of the Iceland State Cement Works to year-end 1996. These obligations corresponded to the accrued unpaid pension obligation for Sementsverksmiðjan hf.'s employees minus the share of the company in the Fund's assets.

Article 3 of this Agreement reads as follows: *“Using an imputed interest rate of 3.5 %, the present value of the LSR⁹'s accrued obligations with respect to employees of the Iceland State Cement Works at year-end 1996 was assessed as ISK 494.816.380. LSR's assets for payment of obligations are considered to be 19 % of the Fund's accrued unsettled obligations. The State's obligations on behalf of Iceland Cement Ltd. is thus ISK 400.801.268.”*

According to Article 4 of the same agreement *“The National Treasury will make payment to LSR of its obligation pursuant to Article 2 by presenting it with Iceland Cement Ltd. bonds for a total amount of ISK 326.488.714 [...]. This will take the form of five bonds, each in the amount of ISK 50.000.000, and one bond in the amount of ISK 76.488.714. the bonds are to be paid in 49 equal instalments of the principal and interest, with the first instalment due 1 March 1998 and the remainder at six-month intervals after that. The bonds are inflation-indexed to the Consumer Price Index (CPI) with the base index 178.6. Annual interest is 5.5 % (2.75 % for half-year) and shall be calculated as of 1 January 1997. Interest for the period 1 January 1997 to 30 August 1997 shall be paid separately on 1 November 1997. The present value of the bonds as of 1 September 1997, at 3.5 % imputed interest, is ISK 400.801.268. The National Treasury shall guarantee LSR of payment of instalments and interest of these bonds. With these bonds the National Treasury has fully settled its obligations towards LSR with respect to pension supplements pursuant to Article 33 of Act No 1/1997 on the Civil Servants' Pension Fund, arising from membership of employees of the Iceland State Cement Works to LSR until the end of 1996”.*

Therefore, following the application of Article 33 last paragraph of Act No 1/1997, once Sementsverksmiðjan hf. settled its commitment with the issue of bonds for the amount determined in the Agreement of 8 October 1997, the company would have no further responsibility for the Fund's commitments regarding the period until end of 1996 for the employees to which the settlement applied. These bonds are thus simply a postponement of the payment of the debt.

On 30 March 1999, Sementsverksmiðjan hf. and the Pension Fund of State Employees signed a second agreement pursuant to Article 33 of Act No 1/1997. On the basis of this agreement, the Fund would assess yearly the accrued pension obligation arisen during the year with respect to the employees of the company affiliated to Section B of the Fund remaining at the time. According to this Agreement, the company would settle the accrued obligations arisen during the year with respect to the employees still affiliated to Section B at the end of each year, after deducting all contributions already paid by the employees and the company with respect to the rights earned during the year. According

⁹ Acronym in Icelandic for Pension Fund of State Employees.

to the information provided by the Icelandic authorities, in 2003, five employees of Sementsverksmiðjan hf. were still affiliated to Section B of the Pension Fund of State Employees.

d) *The taking over by the State of Sementsverksmiðjan hf.'s pension liabilities*

With an agreement dated 23 October 2003 between the Ministry of Finance and the Pension Fund of State Employees, on behalf of the State Treasury, fulfilling the obligation laid down in Article 4 of the Share Purchase Agreement between the Ministry of Industry and Íslenskt sement ehf., the Ministry of Finance took over the remainder of the bonds issued to pay the accrued obligations of Sementsverksmiðjan hf. as settled in the agreement of 1997.

The agreement signed in October 2003 also refers to the agreement dated 30 March 1999 between the Pension Fund of State Employees and Sementsverksmiðjan hf. in which it was stated that obligations regarding employees of Sementsverksmiðjan hf. were to be paid and settled annually. With the agreement of October 2003, the Ministry of Finance also took over the obligations of Sementsverksmiðjan hf. according to the referred agreement of March 1999.

With this Agreement, the Ministry of Finance fulfilled the obligation entered into under Article 4 of the Share Purchase Agreement signed on 2 October 2003 with the investors group, Íslenskt sement ehf., according to which “[t]he Seller shall take over the pension debts and obligations of the Company, which carry Government guarantee, and were taken over by the Company in 1997 with a special agreement. The Seller shall as well take over all existing and future obligations regarding the annual compensation settlement for the individuals who are now paying in the B-Section of the Pension Fund of State Employees as long as they are employees of the Company.”

Even if the Ministry of Finance engaged itself into taking over these debts and obligations of Sementsverksmiðjan hf. in the Share Purchase Agreement with the investors group Íslenskt sement ehf., it is on the basis of a distinct legal act, namely the agreement between the Ministry of Finance and the Pension Fund of State Employees, that Sementsverksmiðjan hf. is relieved of these obligations.

According to the information provided by the Icelandic authorities in their letter dated 12 November 2003, the pension obligations for employees already retired were estimated at ISK 412 million in 2003. As far as the future obligations for the employees of Sementsverksmiðjan hf. still affiliated to Section B of the Pension Fund of State Employees are concerned, they were estimated to amount to ISK 10-15 million, depending on the time the employees will remain in the company.

3. *Comments to the Authority's Decision No 421/04/COL relevant to the present decision*

a) *The Icelandic authorities*

In their letter dated 18 April 2006, the Icelandic authorities explained that the Ministry of Finance and the Pension Fund of State Employees signed an agreement on 8 October 1997 on the basis of which the pension obligations of Sementsverksmiðjan hf. regarding all its employees were settled as they stood at the end of year 1996.

Article 4 of the Agreement states that the State shall be liable as guarantor of collection towards the Pension Fund of State Employees. A guarantee of collection implies that all legal remedies will have to be exhausted before the guarantee can be activated.

The Icelandic authorities clarified that *“[f]ollowing the Agreement, dated 8 October 1997, Sementsverksmiðjan hf. was liable for the pension fund obligations. On the basis of this Agreement the said liabilities were accounted for in the accounts of Sementsverksmiðjan hf. between 1997 and 2003. The legal liability of the State remained intact as a secondary liability to the Company’s as per art. 32 of Act No 1/1997 that defines the constitutional legal liability of the state.”*

As far as the Agreement between the Pension Fund of State Employees and Sementsverksmiðjan hf. of 30 March 1999 is concerned, the Icelandic authorities have explained that obligations regarding employees of Sementsverksmiðjan hf. will be paid and settled annually by the company.

According to the explanations of the Icelandic authorities, *“[o]ther corporations under state ownership were treated similarly in 1997 and bonds issued for a calculated future pension obligation pertaining to former and current employees of said corporations. When these corporations have been privatized the bonds have in most cases been taken over by the state or settled prior to the sale. The Icelandic government found that to be correct since the legal responsibility for the payments is always the state. [...] The obligation was in all cases to the greatest extent pertaining to rights earned by employees prior to the incorporation of the companies, granted them as state employees. It would be skewering the competition standing of these companies by burdening them with a bond for part pension obligations in most part accrued prior to their incorporation and in most part resulting from the fact that the state did not at that time collect pension premiums into a fund in [the Pension Fund of State Employees] resulting in the fact that there were no investments made for the premiums and no interest accrued to meet the future pension obligations.”*

In a letter dated 25 September 2006, the Icelandic authorities first made reference to the Authority’s Decision No 421/04/COL to open the formal investigation procedure which *“did not “set out any doubts as to its compatibility with the functioning of the EEA Agreement” concerning the pension obligations”*. Further, they argued that *“the Authority is not authorised by law to add new “doubts” which are not on the list of the doubts set out by the Authority in the decision to initiate the formal investigation procedure, after the decision has been published. This is clear from Article 6 of Part II to Protocol 3 to the Surveillance and Court Agreement.”*

In this letter, the Icelandic authorities explained in further detail the three pillar structure of the Icelandic pension system: pillar one corresponds to public pensions, pillar two to occupational pension funds and pillar three to voluntary private pension saving. The Pension Fund of State Employees is the biggest public sector pension fund in Iceland.

As far as the Agreement signed in 1997 regarding Sementsverksmiðjan hf.’s pension-related liabilities towards the Pension Fund of State Employees is concerned, the Icelandic authorities consider that the 1997 Agreement did not alter the obligation of the State. *“The legal liability of the State remained intact as a secondary liability. [...] The obligations of the State with regard to pensions are towards the individuals and not the company. The obligations are due to the previous ownership and structure of the*

company and would not have occurred if the State would not have owned the company. The obligations can thus only be towards the State”.

The Icelandic authorities finally pointed out that *“even if the conclusion would be that the pension obligations were the liability of the company, then this had to be taken into account in the experts assessment on the market value of the company. If the determined market value of the company shows that no state aid was involved then it would, in the opinion of the Icelandic authorities, be difficult to maintain the handling of the pension obligation contains state measures. The determination of the market value therefore has to be closely linked to the question of the pension liabilities.”*

b) Aalborg Portland Íslandi ehf.

In the complaint letter dated 17 December 2003, Aalborg Portland Íslandi ehf. referred to three points regarding the terms and conditions of the sale which had been disclosed to the public. One of these points was the take-over by the Icelandic State of Sementsverksmiðjan hf.’s pension obligations amounting to over ISK 400 million. The complainant considered that the terms of the sale of Sementsverksmiðjan hf. constituted a violation of the state aid rules of the EEA Agreement. In the opinion of Aalborg Portland Íslandi ehf. none of the compatibility grounds foreseen under Article 61(2) and (3) are applicable to the case at hand.

II. APPRECIATION

1. The scope of the initial formal investigation and the need to extend it

The Authority had not addressed the taking over by the State of Sementsverksmiðjan hf.’s pension-related liabilities in the decision to open the formal investigation procedure on the sale of the Icelandic State’s shares in Sementsverksmiðjan hf. (Decision No 421/04/COL) adopted in December 2004. In light of the comments made by the complainant and in light of the further information and clarifications made by the Icelandic authorities during the formal investigation procedure, the Authority considers it necessary to extend the formal investigation procedure opened with Decision No 421/04/COL to cover the take-over by the Icelandic State of pension-related liabilities of Sementsverksmiðjan hf. In Decision No 421/04/COL, the Authority identified two possible aid beneficiaries, Íslenskt sement ehf. and Sementsverksmiðjan hf. The potential beneficiary of state aid in the case of the sale of the State’s shares in Sementsverksmiðjan hf. would be Íslenskt sement ehf. In contrast, the potential beneficiary of any possible state aid granted in the context of the assets-liabilities restructuring of the company made by the State in connection to the sale of shares would be the cement producer itself, i.e. Sementsverksmiðjan hf. It is from the latter that the State purchased various assets and took over pension liabilities. The potential aid beneficiary with regard to the take-over by the Icelandic State of pension-related liabilities of Sementsverksmiðjan hf. would therefore be Sementsverksmiðjan hf.

2. State aid assessment

Article 61(1) of the EEA Agreement provides that:

“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.”

Thus, in order for a measure to be considered state aid, it must constitute an advantage in favour of certain undertakings, be granted through state resources, distort competition and affect trade between the Contracting Parties to the EEA Agreement.

In the following, the Authority will make a preliminary assessment of whether the taking over by the State of Sementsverksmiðjan hf.’s pension-related liabilities constitutes state aid.

a) Market economy investor principle

In accordance with established case law¹⁰, the Authority will firstly assess whether, in similar circumstances, a private investor operating in normal conditions of a market economy would have entered into the transaction in question on the same terms the State had and, if not, on which terms he might have done so. If the behaviour of the State complies with the market economy investor principle there is no state aid within the meaning of Article 61(1) of the EEA Agreement. The comparison between the conduct of public and private investors must be made by reference to the attitude which a private investor would have had at the time of the transaction in question, having regard to the available information and foreseeable developments at that time¹¹. Had the State acted as a private market investor, no state aid would have been granted by the State with the taking over of pension-related liabilities.

The behaviour of the State as owner of a company, supposed to act in accordance with market principles, should be distinguished from the behaviour of the State as public authority, which takes into account other considerations such as regional development, unemployment, etc. which are not strictly linked to the maximisation of profits a market investor would theoretically pursue. In the case at hand, a distinction can be made between the role of the State as owner of Sementsverksmiðjan hf., the State as guarantor of the Pension Fund of State Employees and the State as authority.

In principle, a private market investor whose company faced a difficult financial and operational situation like the one Sementsverksmiðjan hf. had experienced, would try to turn it around, stop losses of the undertaking and make it function in a way to obtain revenue. If it were to be unsuccessful, some legislations would leave it no option but to file for bankruptcy. Otherwise, it would seem reasonable to try to sell the company with the aim of obtaining a price over its liquidation value.

Had the owner of Sementsverksmiðjan hf. let the company go bankrupt, the State as guarantor of the Pension Fund of State Employees would have had to cover the missing payments from the former company in order to guarantee the payment of monthly pensions to the former affiliates of the Fund.

In this case, the State decided to take over pension liabilities amounting to ISK 422-427 million (ISK 412 + 10~15 million) and sold the company, now released from these obligations, for ISK 68 million. An outlay of more than ISK 400 million for a receipt of

¹⁰ Case T-16/96 *Cityflieger Express v Commission* [1998] ECR II-757, paragraph 51 and Case T-228/99 and T-233/99 *Westdeutsche Landesbank Girozentrale a.o. v Commission* [2003] ECR II-435, paragraph 245.

¹¹ Case T-16/96 *Cityflieger Express v Commission* [1998] ECR II-757, paragraph 76.

less than ISK 70 million does not appear to be in accordance with the market criteria. Therefore, the Authority has the preliminary view that it cannot be considered that the State acted in accordance with the private market investor principle.

In the following, the Authority will assess whether the conditions laid down under Article 61(1) of the EEA Agreement for a measure to constitute state aid have been fulfilled.

b) Selective advantage

The Authority preliminarily considers that the State granted a selective advantage to Sementsverksmiðjan hf. by taking over its pension-related liabilities with the Agreement signed in October 2003. Sementsverksmiðjan hf. obtained an advantage because the State relieved it from some of its debts corresponding to past pension-related liabilities. Moreover, by virtue of this agreement, Sementsverksmiðjan hf. has also been relieved of future, still undetermined, pension-related liabilities due in application of Article 33 of Act No 1/1997 with respect to its employees still affiliated to the Pension Fund of State Employees. The measure is selective because it is granted exclusively to Sementsverksmiðjan hf., due to the very specific circumstances of the company, by means of the Agreement signed in 2003 between the Ministry of Finance and the Pension Fund, a particular act from which no other undertaking could benefit.

The Icelandic authorities have argued that by taking over Sementsverksmiðjan hf.'s pension liabilities the Treasury acted as the guarantor of the Pension Fund of State Employees on the basis of Article 32 of Act No 1/1997, according to which “[t]he Treasury guarantees the payment of a pension according to this act and it shall be paid with 1/12 of the annual pension in advance each month.”

The preliminary opinion of the Authority is that the guarantee of the State laid down in Article 32 of Act No 1/1997 is directed towards the employees of companies affiliated to the Pension Fund and has the object of guaranteeing that these employees obtain their pensions even in the situation where their former employer does not pay its due contributions in full. In the Authority's opinion, this guarantee does not constitute a secondary guarantee for the payment of Sementsverksmiðjan hf.'s pension obligations to the fund. Therefore, the Authority has difficulties in understanding that the State acted as guarantor when taking over Sementsverksmiðjan hf.'s pension liabilities towards the Pension Fund.

Article 33 of Act No 1/1997 determines the obligation of employers to refund the Pension Fund of State Employees in case the pension payments done in the past by the company and the employees themselves do not suffice to cover the full payment of pensions. As mentioned above, according to Article 33 of Act No 1/1997, “[i]n the case where a previously determined old age, disability or spouse's pension increases due to a general increase in the salary of the public employees, the Treasury and other employers who insure their employees in the Fund refund the increase which thus takes place in pension payments.[...] An employer who has settled his/her commitment with the issue of a debenture [...] should have no further responsibility for the Fund's commitments [...]”.

In the view of the Authority, this places an obligation on employers, in the case at hand, on Sementsverksmiðjan hf. Thus, by taking over these various liabilities on the basis of the Agreement signed in October 2003, the Ministry of Finance, on behalf of the Treasury, did not act as the guarantor of the individual pension payment to pensioners affiliated to the Pension Fund of State Employees. The Ministry of Finance relieved the

undertaking of debts and obligations it had towards the Fund and accordingly granted it a selective advantage.

The Icelandic authorities have claimed in their letter dated 18 April 2006 that other corporations under state ownership were treated similarly in 1997 and that the Pension Fund for State Employees accepted a debenture in the payment by means of a bond. According to the Icelandic authorities, when these corporations were privatised, in most cases, the State took over similar bonds. Even if this is the case, it does not modify the selective nature of the measure at hand. In this case, the Authority is not addressing the lawfulness of issuing in 1997 a bond as a debenture for the payment of due contributions to the Pension Fund of State Employees but the taking over by the State in 2003 of the remainder of the bonds issued to cover the debt assessed in 1997 (as well as other past and future pension-related liabilities).

Some case law from the European Courts as well as from the practice of the European Commission has concluded that, under certain conditions, a financial contribution from the State to cover its obligations towards civil servants does not constitute state aid in as far as these obligations do not constitute a “normal” burden of a company¹². At this stage of the procedure, the Authority doubts that this approach can be applicable to the case at hand.

c) State resources

Secondly, in order to constitute state aid within the meaning of Article 61(1) of the EEA Agreement, the advantage must be granted by the State or through state resources.

On the basis of the Agreement between the Ministry of Finance and the Pension Fund of State Employees signed in October 2003, the Treasury will pay, on behalf of Sementsverksmiðjan hf., to the Pension Fund, the amounts due by the company. Thus, by so doing, resources from the State budget will be expended. At this point, the Authority would like to ask the Icelandic authorities for a clarification on the figures of ISK 412 million and ISK 10-15 million. It is not clear from the information provided, what kind of pension obligations are covered under each of these estimates, i.e. what are the obligations already estimated and what corresponds to future obligations.

Alternatively, if Sementsverksmiðjan hf. had paid a market price to the State for the take-over of these debts, it could be considered that no state resources would have been involved¹³. No such market price was paid.

Therefore, the Authority takes the preliminary view that there were state resources involved in the taking over of pension-related liabilities of Sementsverksmiðjan hf. by the State.

d) Distortion of competition

Thirdly, in order for Article 61(1) of the EEA Agreement to be applicable, the measure must distort competition. Undertakings benefiting from an economic advantage granted

¹² Case T-175/01 *Danske Busvognmaend v Commission* ECR [2004] II-917, Commission’s decision of 12 October 2006 on the reform of the mode of financing of civil servants’ pensions attached to La Poste.

¹³ Commission Decision of 21 January 2004 on the transfer to the Belgian State of pension obligations of Belgacom pertaining to the “first pillar” (Case N 567/2003).

by the State which reduces their normal burden of costs, are placed in a better competitive position than those who cannot enjoy this advantage.

There is competition in the market for cement within the EEA. Currently there are two companies active in the Icelandic market of cement: Sementsverksmiðjan hf. and Aalborg Portland Íslandi ehf. Any advantage granted to Sementsverksmiðjan hf. which reduces the costs it should normally incur, places this undertaking in a better competitive position *vis à vis* the other market player in the Icelandic cement market which does not receive this advantage. Thus, the support granted by the State to Sementsverksmiðjan hf. has the effect of distorting competition since the other competitor neither had access to nor obtain such support from the State.

e) Effect on trade

Fourthly, for Article 61(1) of the EEA Agreement to be applicable, the notified measure must have an effect on trade between the Contracting Parties to the EEA Agreement.

The direct competitor of Sementsverksmiðjan hf. in the Icelandic market is a subsidiary of an undertaking located in another State party to the EEA Agreement which does not produce cement in Iceland, but imports it from other EEA countries into Iceland.

Accordingly, the measure affects trade between the Contracting Parties to the EEA Agreement within the meaning of Article 61(1) of the EEA Agreement.

f) Conclusion

For the above mentioned reasons, the Authority preliminarily considers that the take-over by the State of pension-related liabilities of Sementsverksmiðjan hf. constitutes state aid within the meaning of Article 61(1) of the EEA Agreement.

3. Procedural requirements

Pursuant to Article 1(3) of Part I of Protocol 3 to the Surveillance and Court Agreement, “[t]he 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 notified to the Authority the sale of the Icelandic State’s shares in Sementsverksmiðjan hf. with a letter dated August 2003. The take-over by the State of Sementsverksmiðjan hf.’s pension-related liabilities was agreed in Article 4 of the Share Purchase Agreement between the Ministry of Finance and the investors group Íslenskt sement ehf. for the sale of the State’s shares.

This notwithstanding, the Icelandic authorities put the measure into effect in October 2003 before the state aid procedure had resulted in a final decision. The Icelandic authorities did not respect the standstill obligation further laid down under Article 3 of Part II of Protocol 3 to the Surveillance and Court Agreement according to which “[a]id notifiable [...] shall not be put into effect before the [...] Authority has taken, or is deemed to have taken, a decision authorising such aid.” Hence, the Authority takes the preliminary view that the State’s take-over of Sementsverksmiðjan hf.’s pension-related liabilities would constitute unlawful aid within the meaning of Article 1(f) of Part II of

Protocol 3 to the Surveillance and Court Agreement and, thus, possible subject to recovery. According to Article 13 in Part II of Protocol 3 to the Surveillance and Court Agreement, in cases of possible unlawful aid the Authority shall not be bound by the time-limits set out in Articles 4(5), 7(6) and (7).

4. Compatibility of the aid

In the Authority's preliminary view, a distinction has to be made between the take-over by the State of the old pension-related liabilities of Sementsverksmiðjan hf. which constitutes a so-called one-off measure, and the take-over of future pension-related liabilities in application of Article 33 of Act No 1/1997 regarding the affiliated to the Pension Fund of State Employees still employed at Sementsverksmiðjan hf. The Authority further considers, that the take-over (yearly or periodically) of future pension-related liabilities of Sementsverksmiðjan hf. will entail a reduction in the running costs of an undertaking. This constitutes operating aid, which is in principle prohibited. The assessment of the compatibility of these measures with the rules of the EEA Agreement may therefore differ.

The Authority is of the opinion that none of the derogations mentioned in Article 61(2) of the EEA Agreement can be applied to the case at hand.

These measures cannot be considered within the framework of Article 61(3)(a) of the EEA Agreement since none of the Icelandic regions qualify for this provision which requires an abnormally low standard of living or serious underemployment.

The take-over by the State of pension liabilities of a given undertaking does not seem to promote the execution of an important project of common European interest or remedy a serious disturbance in the economy of a State, as it is requested for compatibility on the basis of Article 61(3)(b) of the EEA Agreement.

According to Article 61(3)(c) of the EEA Agreement, aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest, may be considered compatible. Regional aid or rescue and restructuring aid can be considered compatible on the basis of this provision.

Concerning Article 61(3)(c) of the EEA Agreement, the site of Sementsverksmiðjan hf. is located in Akranes, an area covered by the regional aid map of Iceland. However, this financial support does not seem to be linked to any investment and, in particular as far as the refund for future pension obligations is concerned, it seems to cover a running cost. The Regional Aid Guidelines applicable at the time of the sale did not foresee the possibility to grant operating aid. For this reason, the Authority has doubts that the measures can be considered compatible on the basis of the Regional Aid Guidelines.

The Authority preliminarily considers that it can only be assessed whether the take-over by the State of pension-related liabilities of Sementsverksmiðjan hf. can be considered compatible with the state aid rules of the EEA Agreement on the basis of the provisions of Chapter 16 of the State Aid Guidelines on Rescue and Restructuring Aid.

The Icelandic authorities took over Sementsverksmiðjan hf.'s pension-related liabilities on the basis of an agreement signed between the Ministry of Finance and the Pension Fund of State Employees in October 2003. According to Point 16.6.5 of Chapter 16 of the

Authority's State Aid Guidelines as adopted on 16 December 1999, "[t]he EFTA Surveillance Authority will examine the compatibility with the functioning of the EEA Agreement of any rescue or restructuring aid granted without its authorisation and therefore in breach of Article 1(3) of Protocol 3 to the Surveillance and Court Agreement [...] on the basis of the Guidelines in force at the time the aid is granted [...]". For this reason, although new guidelines were adopted on 1 December 2004, the Authority considers that the 1999 Guidelines are the applicable rules in the case at hand.

As far as the application of the provisions of Chapter 16 of the State Aid Guidelines "Rescue and Restructuring Guidelines" is concerned, it is questionable whether the information provided in the restructuring plan presented by the Icelandic authorities as it stands now fulfils the necessary requirements.

This is so even if reference is made to the recitals of the Guidelines according to which, "[s]tate aid for rescuing firms in difficulty from bankruptcy and helping them to restructure may be regarded as legitimate only under certain conditions. It may be justified [...] exceptionally by the desirability of maintaining a competitive market structure when the disappearance of firms could lead to a monopoly or tight oligopoly situation."¹⁴

The grant of restructuring aid is conditional on the implementation of a restructuring plan, the duration of which must be as short as possible and which must restore the long-term viability of the firm within a reasonable timescale and on the basis of realistic assumptions as to future operating conditions. According to Point 16.3.2.2 of the Guidelines, this plan must be submitted in all relevant detail and include a market survey.

Amongst the restructuring measures implemented, the Icelandic authorities have referred to the financial restructuring of the company consisting of the reduction of debts through sale of assets and renegotiation of long term debts, the restructuring of workforce consisting of the laying off of 22 employees, the restructuring of production costs with the renegotiation of prices of raw materials and changes in the composition of cement to reduce energy costs, and finally to the search for an alternative revenue source from burning waste.

Despite this general description of the adopted measures, the Authority has doubts whether the restructuring plan submitted by the Icelandic authorities complies with the requirements of the guidelines since it neither foresees a timetable for the return to viability nor makes a direct link between restructuring costs and aid amount. According to Point 16.3.2.2.(b) of Chapter 16 of the State Aid Guidelines, "*The restructuring plan, the duration of which must be as short as possible, must restore the long-term viability of the firm within a reasonable timescale and on the basis of realistic assumptions as to future operating conditions. Restructuring aid must therefore be linked to a viable restructuring plan to which the EFTA State concerned commits itself. The plan must be submitted in all relevant detail to the EFTA Surveillance Authority and include, in particular, a market survey.*"

Moreover, the Authority needs more detailed information on all the restructuring measures adopted to make the return to viability of Sementsverksmiðjan hf. possible.

¹⁴ See also Commission Decision of 13 July 1996 concerning aid granted by the Austrian Government to Head Tyrolia Mares in form of capital injections (C60/95 (ex NN169/95)) and Case T-110/97 *Kneissl Dachstein Sportartikel AG v Commission*, ECT [1999] II-2881.

This should also include the sale to the State of financial assets in other companies, as well as the sale of those assets which were not necessary to the operation of cement production. Therefore, the Authority will deal together with the remaining aspects of the formal investigation.

For these reasons, the Authority has doubts that the taking over by the State of Sementsverksmiðjan hf.'s liabilities can be considered compatible with the state aid rules of the EEA Agreement.

5. Conclusion

Based on the information submitted by the Icelandic authorities, the Authority preliminarily concludes that the take-over by the Icelandic State of Sementsverksmiðjan hf.'s pension-related liabilities constitutes state aid within the meaning of Article 61(1) of the EEA Agreement. The Authority has doubts whether any of the exceptions to the general prohibition of state aid under Article 61(1) of the EEA Agreement foreseen under Article 61(2) or (3) of the EEA Agreement apply to the case at hand.

Furthermore, even if the Icelandic authorities notified the Authority of the take-over by the State of Sementsverksmiðjan hf.'s pension-related liabilities as part of the sale of the Icelandic State's shares with a letter dated August 2003, it was put into effect in contravention of Article 1(3) of Part I of Protocol 3 to the Surveillance and Court Agreement. Therefore, should this investigation lead the Authority to the conclusion that the measures under assessment constitute state aid within the meaning of Article 61(1) of the EEA Agreement, the aid would be considered unlawful and may be subject to possible recovery, should the aid not be deemed compatible with the EEA Agreement.

Consequently, and in accordance with Articles 13(1) and 4(4) of Part II of Protocol 3 to the Surveillance and Court Agreement, the Authority is obliged to open the procedure provided for in Article 1(2) of Part I of Protocol 3 to the Surveillance and Court Agreement. The decision to open proceedings is without prejudice to the final decision of the Authority.

In the light of the foregoing considerations, the Authority, acting under the procedure laid down in Article 1(2) of Part I of Protocol 3 to the Surveillance and Court Agreement, requests Iceland to submit its comments and to provide all documents, information and data needed for the assessment of the compatibility of the taking over by the Icelandic State of Sementsverksmiðjan hf.'s pension-related liabilities.

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

HAS ADOPTED THIS DECISION

Article 1

The EFTA Surveillance Authority has decided to open the formal investigation procedure provided for in Article 1(2) of Part I of Protocol 3 to the Surveillance and Court Agreement against Iceland regarding the taking over by the State of Sementsverksmiðjan hf.'s pension-related liabilities.

Article 2

The Icelandic authorities are requested, pursuant to Article 6(1) of Part II of Protocol 3 to the Surveillance and Court Agreement, 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 required 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 version is authentic.

Done at Brussels, 29 November 2006

For the EFTA Surveillance Authority,

Bjørn T. Grydeland
President

Kristján A. Stefánsson
College Member