


EFTA SURVEILLANCE AUTHORITY

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EFTA SURVEILLANCE AUTHORITY DECISION

of 4 June 1999

on temporary repayment of costs of films produced in Iceland
(Iceland)

THE EFTA SURVEILLANCE AUTHORITY,

Having regard to the Agreement on the European Economic Area¹, in particular to Articles 61 to 63 of the Agreement,

Having regard to the Agreement between the EFTA States on the establishment of a Surveillance Authority and a Court of Justice², in particular to Article 24 and Article 1 of Protocol 3 thereof,

WHEREAS:

I. FACTS

1. Notification

By letter from the Ministry of Industry and Commerce dated 10 March 1999, received and registered by the Authority on 7 April 1999 (Doc. No. 99-2531-A), the Icelandic authorities notified, pursuant to Article 1(3) of Protocol 3 to the Surveillance and Court Agreement, certain measures in favour of film production taking place in Iceland. The letter stated that the Icelandic authorities were unsure whether or not State aid to cultural activities, such as the production of motion pictures, called for a notification. Attached to the letter was a bill of law on temporary repayment of costs of films produced in Iceland.

The Authority has subsequently learned that a law bill on the same subject was adopted by the Icelandic Parliament on 11 March 1999 (Act No. 43/1999).

¹ Hereinafter referred to as the EEA Agreement.

² Hereinafter referred to as the Surveillance and Court Agreement.

2. General description of the measures

According to the first Article of the new Icelandic law, the objective of the measures is to attract foreign parties to produce films and television programmes in Iceland through repayment of a certain percentage of production costs incurred in Iceland. The law is temporary in nature, as there will be no support for films whose production starts after the year 2005.

The term 'production costs' in the Icelandic law means all business expenses and allowance deductible from income on the basis of the law on corporate income tax. However, it is a condition that the costs are incurred in Iceland and that salaries and payments to sub-contractors are subject to taxation in Iceland.

Applications for repayment shall be submitted to the Ministry of Industry prior to the project being initiated. The Minister of Industry is to appoint a committee for processing applications and proposing the amount of support in each case.

In order to qualify, an application must meet the following conditions:

- a. a company must be established in Iceland for the production of the film,
- b. a detailed plan of production costs and financing must be made,
- c. the minimum production costs of qualifying films must as a general rule be at least IKR 80 million.
- d. once the film has been completed the production costs must be verified by an auditor,
- e. the production of the film must be completed within three years from the time the repayment was made.

If the above conditions are not met, repayment can be rejected.

The repayment of production costs shall be as follows:

In the years 1999-2002	12%
In the years 2003-2005	9%

If the production costs are in the range IKR 80 - 100 million, the repayment percentage shall be reduced by half. For films whose production costs are in the range IKR 101 - 120 million, the above percentages shall be reduced by a quarter. This implies that the full rate is only reached for films whose production costs reach IKR 121 million, and that for films whose production costs are below IKR 80 million, no repayment is given.

The Minister of Industry takes decisions on repayment. They shall be based on audited production costs. The percentage rate is determined on the basis of the year when production was started.

Repayment will not take place until when production has been completed and when the company established for the production of the film has been dissolved. Any unpaid taxes and fees to the State or municipalities shall be deducted.

If the applicant has received a grant from the Icelandic Film Fund ('*Kvikmyndasjóður Íslands*') for the production of the same film, he will not receive repayment on the basis of these measures.

The Minister of Industry is authorised to issue a regulation on the implementation of the law.

In the Ministry's letter notifying the aid scheme, it is stated that their objective is to increase the diversity and production of motion pictures and television series in Iceland. It is also underlined in that letter that the draft bill assumes neither nationality nor language requirements.

In the explanatory notes to the law bill it is *inter alia* stated that while reimbursements would take place only after films have been completed, the Ministry would, prior to the project taking place, determine on the basis of application whether the film is eligible for repayment. In such cases it would issue a pledge to the producer that a certain percentage of production costs incurred in Iceland would be reimbursed when production was completed.

II. APPRECIATION

1. The concept and presence of State aid

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

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

This implies that in order for a measure to constitute State aid, four cumulative criteria must all be fulfilled. The measure must: (1) represent a financial advantage to a firm or firms, (2) be granted by the State or through State resources, (3) be specific in nature, and (4) be capable of distorting competition and affecting intra-EEA trade.

It shall firstly be noted that film production is an industry fully covered by the EEA Agreement and unaffected by the limitation on the scope of the Agreement set out in Article 8.

A measure subsidising the production costs of certain films on the basis of applications from film producers operating in Iceland represents a financial advantage to certain firms and is also specific in nature. The measure, representing direct subsidies from the State, is also evidently granted by the State. The first three conditions are therefore fulfilled.

In general, measures of support will affect competition and trade between the EEA Contracting Parties, provided that the recipient firm carries on an economic activity involving trade between Contracting Parties and that the aid strengthens the firm's position compared with that of competing firms. This rule applies not only to firms engaged in exports, but also to import-competing companies. Furthermore, due to the interdependence of EEA markets, the same rule is also likely to apply to recipients of support intending to export virtually all of their production to markets outside the EEA.

The effects on trade of support measures in favour of film production and the production of television series depend *inter alia* on the types of films supported and the audience at which the films concerned are aiming. In the present case, the support measures do not in any way restrict or delimit the types of films and television series eligible for support on the basis of any such criteria.

As mentioned above, the objective of the law is to attract foreign parties to produce films and television programmes in Iceland. According to the opinion of the Ministry of Finance printed as an annex to the law bill, it appears most likely that that objective will in fact be achieved. The Ministry of Finance estimates that the annual budgetary costs of the bill will be in the region of IKR 100 - 300 million, of which only IKR 20 - 30 million would be granted for domestic films. The Authority therefore concludes that the measures will distort competition and have significant effects on trade between the Contracting Parties to the EEA Agreement. Accordingly, the measures constitute State aid within the meaning of Article 61(1) of the EEA Agreement.

2. Procedural obligations

Article 1(3) of Protocol 3 to the Surveillance and Court Agreement provides that the EFTA States are obliged to notify to the Authority any plans to grant or alter aid in sufficient time to allow the Authority to decide on the case, and not to put the proposed measures into effect until the procedure before the EFTA Surveillance Authority has resulted in a final decision. According to provisions on time limits in Part II of the Authority's State Aid Guidelines, which in turn are based on established case law, "sufficient time" in this context means two months as from the date when the Authority has received a complete notification.

The measures at issue were notified by letter from the Ministry of Industry and Commerce dated 10 March 1999 and received by the Authority on 7 April 1999. However, according to information available to the Authority, it appears that the law bill attached to the notification was adopted by the Icelandic Parliament on 11 March 1999, i.e. only a day after the letter was dated and before it arrived at the EFTA Surveillance Authority. The law authorises the Minister of Industry to apply it without any further implementing measures being necessary. The Authority therefore concludes that the Icelandic authorities, by notifying the measures late and implementing them without awaiting a decision of the EFTA Surveillance Authority, have failed to respect the procedural obligations. The measures are therefore unlawful on procedural grounds.



3. Application of the relevant State aid rules

The aid measures implemented by the law favour a certain sector and also represent operating aid. The Authority has reservations in principle to operating aid and approves it only in exceptional circumstances. However, it must be acknowledged that the European Commission has been sympathetic to aid for the film industry, even when involving operating aid, provided that the aid is necessary for the promotion of culture and preservation of heritage and provided also that the aid respects certain fundamental rules of the EC Treaty, such as the absence of any discrimination on grounds of nationality and secures the free flow of goods, services, people and capital across the EEA.

It shall be noted that the substantive rules of the EEA Agreement in this area are not identical to those of the EC Treaty. This is due to the fact that as a part of the Maastricht Treaty a new exemption clause, Article 92(3)(d), was added to the EC Treaty, allowing for the possibility of supporting "aid to promote culture and heritage conservation, where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest". This exemption has not been included in the EEA Agreement. The Authority can therefore only base itself on exemptions provided for in the EEA Agreement, in particular Article 61(3)(c). However, it does not appear that the Commission's decisions in this field have so far implied any great shift in policy. The Authority considers that it can in its decisions take account of decisions taken by the Commission prior to the introduction of the exemption, i.e. based on Article 92(3)(c) EC, as well as of subsequent decisions based on Article 92(3)(d), which do not deviate from the earlier policy and could have been approved under the c-indent.

Neither the EC Commission nor the EFTA Surveillance Authority have so far issued any guidelines on aid to the film industry. Such aid must therefore be assessed only by reference to the primary State aid rules, case law and decision practice of the two surveillance bodies.

In case of support for a local television programme or for films recorded in a small language, such as Icelandic, not widely spoken outside the country borders, and the theme of such films also being relatively "narrow" in scope and mainly of interest for the local people, such support is normally likely to have only limited trade effects, and the financing of such films is likely to be difficult on market terms only. This tends to justify aid for such films. On the other hand, support for films recorded in a world language and covering themes of wide interest irrespective of the nationality of the viewers is likely to affect trade between the Contracting Parties in a similar way as any other subsidies in trade sensitive sectors.

It is again noted that the Icelandic law under scrutiny does not in any way restrict or delimit the types of films eligible for support, e.g. by the themes of eligible films, the markets or audience aimed at, etc. This is in line with the objective set out in Article 1, i.e. to attract foreign film producers to Iceland. The law is in fact in no way limited to supporting films and television programs of any particular cultural value and could equally be used to support films of a purely entertainment character. The market for such films is global in nature. Aid for such films is generally not necessary for the films to be made, but more likely to determine where the production takes place.



The Authority therefore has serious doubts that State aid to the film industry of the kind covered by the Icelandic law at issue could qualify for an exemption in Article 61(2) or (3) of the EEA Agreement. It is therefore obliged to initiate the procedure laid down in Article 1(2) of Protocol 3 to the Surveillance and Court Agreement. It shall be noted, however, that this position is without prejudice to the Authority's final position on the matter. The purpose of proceedings under Article 1(2) of Protocol 3 to the Surveillance and Court Agreement is to ensure a comprehensive examination of the case giving all parties concerned the right to be heard.

HAS ADOPTED THIS DECISION:

1. The procedure provided for in Article 1(2) of Protocol 3 to the Surveillance and Court Agreement is opened with regard to the measures notified by Iceland on 7 April 1999 concerning temporary repayment of costs of films produced in Iceland.
2. The Icelandic Government shall be requested to refrain from applying the aid scheme and suspend any payment of aid until the Authority has taken a final decision in the matter.
3. The Icelandic Government shall be informed by means of a letter containing a copy of this decision, whereby it is invited to submit its comments and any other information relevant to the assessment of the case, within a period of one month from the receipt of the letter.
4. The EC Commission shall be informed, in accordance with Protocol 27(d), by a copy of this decision.
5. Other EFTA States, EC Member States, and interested parties shall be informed by the publishing of the attached notice in the EEA Section of the Official Journal of the European Communities and the EEA Supplement thereto, inviting them to submit comments within one month from the date of the publication.
6. This decision is authentic in the English language.

Done at Brussels, 4 June 1999

For the EFTA Surveillance Authority

Knut Almestad
President

Bernd Hammermann
College Member