Case No: 55093
Event No: 465443
Decision No: 302/09/COL

EFTA SURVEILLANCE AUTHORITY DECISION
of 8 July 2009
to propose appropriate measures with regard to state aid granted to Landsvirkjun and Orkuveita Reykjavíkur

(Iceland)

THE EFTA SURVEILLANCE AUTHORITY[1],

Having regard to the Agreement on the European Economic Area[2], 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 Justice[3], in particular to Article 24 thereof,

Having regard to Article 1 of Part I and Article 18 of Part II of Protocol 3 to the Surveillance and Court Agreement[4],

Having regard to the Authority's State Aid Guidelines on the application and interpretation of Articles 61 and 62 of the EEA Agreement[5], and in particular the Chapter on state guarantees.

Whereas:

I. FACTS

1 Procedure

By letter dated 13 May 2002 (Doc No. 02-3998-A) a complaint was lodged with the Authority alleging that the Icelandic National Power Company, Landsvirkjun, received state aid within the meaning of Article 61(1) of the EEA Agreement.

[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] Hereinafter referred to as Protocol 3.

[5] 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 Authority on 19 January 1994, published in the Official Journal of the European Union (hereinafter referred to as the OJ) L 231 of 03.09.1994, p. 1 and EEA Supplement No 32 of 03.09.1994, p. 1. Hereinafter referred to as the State Aid Guidelines. The updated version of the State Aid Guidelines is published on the Authority's website: http://www.eftasurv.int/fieldsofwork/fieldstateaid/guidelines/

By way of a letter dated 20 June 2002 (Doc No. 02-4668-D), the Authority forwarded the complaint to the Icelandic authorities and requested further information relating to the functioning of the electricity market in Iceland. The Authority thereby initiated the review on existing aid measures referred to in Article 17(1) of Part II of Protocol 3.

On 16 June 2004, the Authority sent a letter to the Icelandic authorities informing them about the extension of the scope of the preliminary investigation to cover all publicly owned electricity undertakings active in Iceland and requesting further information on other operators (Event No. 280835). The Icelandic authorities replied by letter dated 21 September 2004 (Event No. 293427).

After further exchange of correspondence, the Authority sent a letter to the Icelandic authorities in accordance with Article 17 of Protocol 3 on 26 September 2006 informing them of the preliminary view of the Authority that certain measures in favour of electricity utilities constituted existing aid which was no longer compatible with the functioning of the EEA Agreement (Event No. 280834).

The Icelandic authorities commented on the preliminary assessment by letter dated 27 March 2007 (Event No. 415630).

On 16 May 2007 (Event No. 418612), the Authority requested further information regarding the amendment of the state aid guarantee enjoyed by some utilities. The Icelandic authorities replied by letter dated 17 October 2007 (Event No. 447449) explaining that they would submit further information on this issue at a later stage. The Authority sent a reminder to provide this information on 19 December 2007 (Event No. 457792) to which the Icelandic authorities replied on 31 January 2008 (Event No. 462827). The case was further discussed at the Package Meeting held in Reykjavík in October 2008 and during a meeting in Brussels in March 2009.

2 Description of the aid measure

This decision concerns the state guarantee provided by the Icelandic State to the publicly owned electricity companies Landsvirkjun and Orkuveita Reykjavíkur.

2.1 Landsvirkjun

2.1.1 The company

The company was established as an enterprise, jointly owned by the State Treasury and the City of Reykjavík in equal parts, on the basis of Act 59/1965 on Landsvirkjun, by a Partnership Agreement of 1 July 1965 between the Government of Iceland and the City Council of Reykjavík.

Laxárvirkjun, a power company jointly owned by the Town of Akureyri and the State Treasury, was merged with Landsvirkjun with effect from 1 July 1983. Thereafter, the company was governed by the provisions of Act 42/1983, the Act on Landsvirkjun. The Icelandic authorities have explained that the legal form of the company is a partnership according to Art 1(1) of the Act on Landsvirkjun. The Authority will use the term ”jointly owned enterprise” for the purpose of this decision.

On 1 November 2006, the Government of Iceland purchased the stake belonging to the City of Reykjavík and the Town of Akureyri. At the same time, Act 42/1983 was amended by Act 154/2006 in accordance with the change of ownership of the company, which remained a jointly owned enterprise. Since 1 January 2007, Landsvirkjun is jointly owned

by the State Treasury (99.9 %) and Eignarhlutir ehf. (0.1 %). The latter is a limited liability company wholly owned by the State Treasury.

2.1.2 Description of the state guarantee

Article 1 of Act 42/1983 reads after the amendments by Act 154/2006:

"Landsvirkjun is a jointly owned enterprise of the State Treasury and Eignarhlutir ehf. […] Each owner shall be liable as guarantor of collection for all the obligations of the Company, while the division of liability among the owners shall be in proportion with their respective shares of ownership."[6]

The wording as regards the description of the liability of the owners is the same as before the amendments by Act 154/2006.[7] Landsvirkjun, as a jointly owned enterprise, enjoys the unlimited liability of the State Treasury for all the company's obligations, cf. paragraph 2 of Article 1 of Act 42/1983 which sets up a several and joint liability for the owners of Landsvirkjun. Joint and several liability means that with respect to a claimant, the parties are jointly liable, i.e. they are each liable up to the full amount of the relevant obligation. However, as between guarantors themselves, the liabilities are several, i.e. they are only liable for their respective obligations. Joint and several liability therefore implies that the lender or the creditor can recover the whole debt from any of the guarantors.

Thus, the owners of Landsvirkjun [8] are liable for all the obligations of the company. The main guarantor, the State Treasury, is not subject to bankruptcy. Therefore, Landsvirkjun will never be excluded from the market by means of an insolvency procedure, since the State guarantees all its liabilities and accordingly assures the continuation of the company in the market.

2.2 Orkuveita Reykjavíkur

2.2.1 The company

Orkuveita Reykjavíkur is a utilities company currently owned by the City of Reykjavík, the Town of Akranes, and the municipality of Borgarbyggð. Orkuveita Reykjavíkur has been in operation as a jointly owned enterprise since 1 January 2002. It was created following the merger of various municipality utilities, which by virtue of paragraph 1 of Article 73 of the Local Government Act enjoyed unlimited state guarantee and existed prior to the entry into force of the EEA Agreement. According to the information provided by the Icelandic authorities, the Local Government Act 45/1998 repealed the former Local Government Act 8/1986, which was in force at the time of entry into force of the EEA Agreement. Regarding the municipal guarantee, Article 73 of Act 45/1998 and Article 89 of Act 8/1986 both provided for a guarantee for the obligations of utilities operated by the municipalities.

The company has the legal form of a jointly owned enterprise operated on the basis of Act No 139/2001. The current partnership agreement is dated 29 January 2004.

[6] As translated by the Authority.

[7] However, as the ownership was changed, Temporary Provision II of Act 154/2006, amending Act 42/1983, provides that the former owners of Landsvirkjun, City of Reykjavík and the Town of Akureyri, remain jointly and severally liable as guarantors of collection for all the obligations of the company entered into before the end of the year 2006.

[8] Formerly the State Treasury, the City of Reykjavík and the Town of Akureyri and now the State Treasury and Eignarhlutir ehf.

2.2.2 Description of the state guarantee

Article 1(2) of Act 139/2001 establishes joint and several liability for the owners of Orkuveita Reykjavíkur with respect to all obligations of the company. The three owners of Orkuveita Reykjavíkur, the City of Reykjavík, Town of Akranes and municipality of Borgarbyggð, are all individually liable for all the company's obligations. They provide an unlimited guarantee for the company's obligations. This is so even if, as explained above under Section 2.1.2, each owner is ultimately only responsible for all liabilities in proportion to the share of ownership.

By virtue of paragraph 4 of Article 73 of the Local Government Act, the guarantors are not subject to bankruptcy. Therefore, Orkuveita Reykjavíkur will never be excluded from the market by means of an insolvency procedure since all its liabilities are guaranteed by the municipalities. The same explanations provided above under Section 2.1 regarding the state guarantee in favour of Landsvirkjun are applicable to the guarantee in favour of Orkuveita Reykjavíkur.

3 Comments by the Icelandic authorities

In a letter dated 27 March 2007 (Event No 415630) the Icelandic authorities agreed with the Authority's assessment as laid down in the letter sent on 26 September 2006 in accordance with Article 17(2) in Part I of Protocol 3. The Icelandic authorities agreed that Landsvirkjun benefits from an unlimited state guarantee and that it constitutes incompatible state aid within the meaning of the EEA Agreement. They also agreed that the state guarantee qualifies as existing aid. Regarding Orkuveita Reykjavíkur, the Icelandic authorities simply forwarded the opinion of the company without making statements themselves.

II. ASSESSMENT

1 The 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.*"

Consequently, the Authority will assess whether the guarantee that Landsvirkjun and Orkuveita Reykjavíkur enjoy constitutes state aid within the meaning of Article 61(1) of the EEA Agreement on the basis of the following criteria:

- Is the aid granted by the State or through state resources?

- Does the aid favour certain undertakings or the production of certain goods?

- Is the aid capable of distorting competition and affecting trade between the Contracting Parties to the EEA Agreement?

1.1 Presence of state resources

According to Article 61(1) of the EEA Agreement, a measure must be granted by the State or through state resources in order to constitute state aid. State resources within the meaning of Article 61(1) of the EEA Agreement are not limited to direct grants via the budget of the State. An explicit state guarantee without adequate market premium paid, or an implicit guarantee where the legal form of an undertaking rules out bankruptcy proceedings or where the State would have to cover losses, amounts to consumption of state resources as well[9]. The risk associated with the guarantee is carried by the State and should normally be counter-balanced by the payment of an appropriate premium. Where the State foregoes such a premium, there is a drain on the resources of the State. The guarantees described above therefore are granted with state resources.

In accordance with the provisions of the Chapter on state guarantees, state aid exists even if no payments are made by the State under the guarantee. Aid is granted at the moment the guarantee is given[10]. Landsvirkjun and the companies that merged into Orkuveita Reykjavíkur were given this guarantee at the establishment of the companies by the State and the relevant municipalities.

1.2 Favouring certain undertakings or the production of certain goods

1.2.1 The existence of an advantage

In order to be caught by Article 61(1) of the EEA Agreement, the measure must confer on certain undertakings an advantage that reduces costs or relieves them of charges that would normally be borne by their budgets. This is the case, for example, when a state guarantee enables a borrower to raise money on more favourable terms in the market than what would have been the case without the guarantee.

The state guarantee in favour of the undertakings addressed in this decision constitutes an advantage within the meaning of the state aid rules. The security which a state guarantee represents improves the creditworthiness of the companies, thereby enabling the undertakings in question to obtain a more favourable credit rating. This in turn entails that the undertakings benefit from more favourable funding terms than they otherwise would have obtained.

As mentioned above, the State carries the risk associated with the guarantee. This risk should normally be counter-balanced by the payment of an appropriate premium. Where the State foregoes such a premium, there is not only a drain on the resources of the State but also a benefit for the undertaking, which puts up with less costs than it would have carried in the normal course of business.

Even if no payments are ever made by the State under a guarantee, there is nevertheless state aid within the meaning of Article 61(1) of the EEA Agreement. This is because the aid is granted at the moment when the guarantee is given, and not the moment at which the guarantee is invoked or payments are made under its terms[11].

1.2.2 Is the advantage selective?

Secondly, in order to be caught by Article 61(1) of the EEA Agreement, the measure must be specific or selective in that it must favour certain undertakings or the production of certain goods. The Court of Justice of the European Communities, (hereinafter “Court of

[9] See Chapter on State Guarantees, paragraph 2.1.2, 2.1.3 and 2.1.4 in the State Aid Guidelines, Part V.

[10] See Chapter on State Guarantees, paragraph 2.1.2 in the State Aid Guidelines, Part V.

[11] See Chapter on State Guarantees, paragraph 2.1.2 in the State Aid Guidelines, Part V.

Justice") has held that any measure intended partially or wholly to exempt firms in a particular sector from the charges arising from the normal application of the general system, without there being any justification for this exemption on the basis of the nature and logic of the general scheme of this system, constitutes state aid[12]. The state guarantee in favour of the undertakings addressed in this decision constitutes a selective advantage within the meaning of the state aid rules.

In this respect, the fact that an aid measure may concern, or as it is the case for electricity utilities in Iceland, may have concerned a whole economic sector, does not prevent it from being covered by Article 61(1) of the EEA Agreement. On the contrary, the fact that some utilities were transformed into limited liability companies and do thus no longer benefit from an unlimited state guarantee, stresses the advantage that Landsvirkjun and Orkuveita Reykjavíkur, the biggest two utilities in Iceland at the moment, receive.

1.3 Distortion of competition and effect on trade between Contracting Parties

The measure must distort competition and affect trade between the Contracting Parties to the EEA Agreement to be considered state aid within the meaning of Article 61(1) of the EEA Agreement.

According to the case law of the Court of Justice and the EFTA Court[13], whenever state aid strengthens the position of an undertaking compared with other undertakings competing in intra-EEA trade, the latter must be regarded as affected by that aid.

There is no threshold or percentage below which it may be considered that trade between the Contracting Parties is not affected.[14] According to settled case law, aid may also affect trade within the EEA even if the recipient undertaking does not itself participate in cross-border activities.[15] The character of the aid does not depend on the local or regional character of the services supplied or on the scale of the field of activity concerned.[16] The local character of the activities of the beneficiaries of a measure constitutes one of the features to be taken into account in the assessment of whether there is an effect on trade but it is not sufficient to prevent the aid from having an effect on trade.[17] This is because the granting of state support to an undertaking may lead to the internal supply being maintained or increased, with the consequence that the opportunities for other undertakings to penetrate the market of the EEA State concerned are reduced.[18]

In an EEA-wide liberalised electricity sector, measures foreclosing a national market from competitors have an effect on trade. Not only because new entrants cannot access the

[12] Case 173/73 *Italy* v *Commission* ECR [1974] 709, paragraph 13 ff.

[13] Case E-6/98 *The Government of Norway* v *EFTA Surveillance Authority* [1999] Report of the EFTA Court page 76, paragraph 59; Case 730/79 *Philip Morris* v *Commission* ECR [1980] 2671, paragraph 11.

[14] Case C-280/00 *Altmark Trans and Regierungspräsidium Magdeburg* ECR [2003] I-7747, paragraph 81, Case C-172/03 *Wolfgang Heiser* v *Finanzamt Innsbruck* ECR [2005] I-1627, paragraph 32.

[15] Case T-55/99 *CETM* v *Commission* ECR [2000] II-3207, paragraph 86.

[16] Case C-280/00 *Altmark Trans and Regierungspräsidium Magdeburg* ECR [2003] I-7747, paragraph 77; Case C-172/03 *Wolfgang Heiser* v *Finanzamt Innsbruck* ECR [2005] I-1627, paragraph 33; Case C-71/04 *Administración del Estado* v *Xunta de Galicia* ECR [2005] not yet reported, paragraph 40.

[17] Joined Cases T-298/97-T-312/97 e.a. *Alzetta a.o.* v *Commission* [2000] ECR II-2319, paragraph 91.

[18] Case E-6/98 *The Government of Norway* v *EFTA Surveillance Authority* [1999] Report of the EFTA Court, page 76, paragraph 59; Case C-303/88 *Italy* v *Commission* ECR [1991] I-1433, paragraph 27; Joined cases C-278/92 to C-280/92 *Spain* v *Commission* ECR [1994] I-4103, paragraph 40, Case C-280/00 *Altmark Trans and Regierungspräsidium Magdeburg* ECR [2003] I-7747, paragraph 78.

market on the same conditions but also because the protected undertakings are better placed to compete with other undertakings throughout the EEA.[19]

This is in particular so concerning the two biggest Icelandic utilities, Landsvirkjun and Orkuveita Reykjavíkur. Both Landsvirkjun and Orkuveita Reykjavíkur are active mainly in electricity production and distribution but they also offer other services such as telecommunications and energy-related consulting services. Therefore, the state guarantee covering all the activities of these utilities, has a twofold effect on competition and trade. On the one hand, it strengthens the utilities and supports the conditions under which they can participate in other companies active in energy markets throughout Europe as well as in the provision of related services to these markets. On the other hand, the state guarantee in favour of Landsvirkjun and Orkuveita Reykjavíkur also strengthens the financial capacities of the company with respect to the home market and has the indirect effect of foreclosing the Icelandic electricity market not only to foreign but also to national competitors.

2 Existing aid

According to Article 1(b) of Part II of Protocol 3, existing aid shall mean:

"(i) all aid which existed prior to the entry into force of the EEA Agreement in the respective EFTA States, that is to say, aid schemes and individual aid which were put into effect before, and are still applicable after, the entry into force of the EEA Agreement;

The Court of Justice has consistently held that the question of whether an aid is new or existing must be answered by reference to the legal provisions laying down the measure.[20] According to the provisions of the Chapter on state guarantees, it must be assessed whether a guarantee constitutes state aid at the moment the guarantee is given and not the moment at which the guarantee is invoked or the moment at which payments are made under the terms of the guarantee. Thus, the assessment of the existing or new aid character of the state guarantee must be based on the legislation granting this guarantee.

As explained above under Section I.2, the unlimited state guarantees in favour of Landsvirkjun and Orkuveita Reykjavíkur were established in legislation pre-dating the entry into force of the EEA Agreement. Therefore, the Authority considers that the measures under assessment qualify as existing aid measures within the meaning of Article 1(b) of Part II of Protocol 3.

3 Procedural requirements regarding the review of existing aid schemes

Article 1(1) of Part I of Protocol 3 provides that: "*The EFTA Surveillance Authority shall, in co-operation with the EFTA States, keep under constant review all systems of aid existing in those states. It shall propose to the latter any appropriate measures required by the progressive development or by the functioning of the EEA Agreement*".

[19] See also Commission Decision C 25/2003 State aid in favour of Electricité de France, page 8.

[20] Joined Cases T-298/97-T-312/97 e.a. *Alzetta a.o.* v *Commission* ECR [2000] II-2319, Case C-44/93 *Namur-Les Assurances du Crédit SA* v *Office National du Ducroire and the Belgian State* ECR [1994] I-3829, Case C-51/74 *P.J. van der Hulst's Zonen* v *Produktschap voor Siergewassen* ECR [1975] 79.

According to Article 17 of Part II of Protocol 3, the Authority shall obtain from the EFTA State concerned all necessary information for the review, in cooperation with that State, of existing aid schemes pursuant to Article 1(1) of Part I of Protocol 3.

By letter dated 20 June 2002 (Doc No. 02-4668-D), and in accordance with Article 17(1) of Part II of Protocol 3, the Authority requested information on the aid measure from the Icelandic authorities.

By letter dated 26 September 2006 (Event No. 280834), and in accordance with Article 17(2) of Part II of Protocol 3, the Authority informed the Icelandic authorities that it considered the existing aid scheme not to be compatible with the functioning of the EEA Agreement. It gave the Icelandic authorities an opportunity to submit comments.

By letter 27 March 2007, the Icelandic authorities submitted their comments (Event No. 415630). The letter was followed by an exchange of views between the Authority and the Icelandic authorities and several meetings.

The Authority therefore concludes that the procedure regarding the review of existing aid was carried out in accordance with Article 17 of Part II of Protocol 3.

4 Compatibility of the aid

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

The derogation of Article 61(2) of the EEA Agreement is not applicable to the aid measures under assessment in this Decision since they are not designed to achieve any of the aims listed in this provision.

The aid can also not be justified under Article 61(3)(a) of the EEA Agreement, which provides for regional support. The state guarantees do not pursue a regional aid objective as they do not concern aid to a region where the standard of living is abnormally low or where there is a serious underemployment. As the state guarantee was not given to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of Iceland, the Authority considers that Article 61(3)(b) of the EEA Agreement is not applicable.

The aid in question is not linked to any investment. It just reduces the costs which companies would normally have to bear in the course of pursuing their day-to-day business activities and is consequently to be classified as operating aid. Operating aid is normally not considered suitable to facilitate the development of certain economic activities or of certain regions as provided for in Article 61(3)(c) of the EEA Agreement. Operating aid is only allowed under special circumstances in accordance with the Authority's State Aid Guidelines. None of these Guidelines apply to the aid in question.

Finally, Article 59(2) of the EEA Agreement does not seem to be applicable to the case at hand since there is no public service obligation justifying the grant of an unlimited state guarantee. Even if the companies had to fulfil public service obligations, in so far as the guarantee covers all activities of the beneficiary undertakings and is unlimited in time and scope, the Authority considers that it is disproportionate. Therefore, it cannot be considered compatible with the rules of the EEA Agreement.

5 Recommendation of appropriate measures

For the above mentioned reasons, the Authority considers that an unlimited guarantee which creates a distortion of competition constitutes incompatible state aid and should accordingly be abolished by means of appropriate measures. Therefore, the Authority proposes that the unlimited state guarantee enjoyed by Landsvirkjun and Orkuveita Reykjavíkur be abolished with effect from 1 January 2010.

The Icelandic authorities shall communicate to the Authority the relevant measures it will take to discontinue the aid as soon as possible and in any event not later than 1 January 2010.

HAS ADOPTED THIS DECISION:

Article 1

Pursuant to Article 1(1) of Part I and Article 18 of Part II of Protocol 3, the Authority proposes that the Icelandic authorities shall take any legislative, administrative and other measures necessary to eliminate any incompatible aid resulting from the unlimited state guarantees granted to Landsvirkjun and Orkuveita Reykjavíkur. Any such aid measures should be abolished with effect from 1 January 2010.

Article 2

The EFTA Surveillance Authority invites the Icelandic authorities to accept this proposal for appropriate measures, pursuant to Article 19(1) of Part II of Protocol 3, and to provide the answer within one month of receipt of this proposal.

Article 3

This Decision is addressed to the Republic of Iceland.

Article 4

Only the English version is authentic.

Done at Brussels, 8 July 2009

For the EFTA Surveillance Authority,

Per Sanderud
President

Kristján Andri Stefánsson
College Member