

Case No: 78027
Document No: 787595
Decision no: 075/16/COL

EFTA SURVEILLANCE AUTHORITY DECISION

of 20 April 2016

to propose appropriate measures regarding the use of publicly owned land and natural resources by electricity producers in Iceland

(Iceland)

The EFTA Surveillance Authority (“the Authority”),

HAVING REGARD to:

The Agreement on the European Economic Area (“the EEA Agreement”), in particular to Articles 61 to 63, and Protocol 26 thereof,

The Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice (“the Surveillance and Court Agreement”), in particular to Article 24,

Protocol 3 to the Surveillance and Court Agreement (“Protocol 3”), in particular Article 1(1) of Part I and Article 18 of Part II,

Whereas:

I. FACTS

1. Procedure

- (1) By letter dated 14 October 2008,¹ the EFTA Surveillance Authority (“the Authority”) requested information from the Icelandic authorities in accordance with Article 17(1) of Part II of Protocol 3 regarding the use of land and natural resources by publicly owned electricity producers in Iceland. The Icelandic authorities were asked to provide the Authority with all necessary information to assess the measure under the state aid rules of the EEA Agreement.

¹ Document No 494355.

- (2) By letter dated 4 December 2009,² 20 April 2010,³ 18 October 2010,⁴ 28 February 2014,⁵ and 1 October 2014,⁶ the Icelandic authorities submitted the requested information.
- (3) By letter dated 5 October 2015,⁷ the Authority initiated the procedure provided for in Article 17(2) of Part II of Protocol 3 with respect to the use of land and natural resources by electricity producers in Iceland, thereby informing the Icelandic authorities of its preliminary view that the administrative practice of concluding agreements with electricity producers to use public land and natural resources without requiring market remuneration, constituted state aid that was incompatible with the functioning of the EEA Agreement.
- (4) By letter dated 30 November 2015,⁸ the Icelandic authorities responded to the Article 17(2) letter. The Authority and the Icelandic authorities discussed the case in a telephone conference on 16 February 2016.

2. Background

2.1 Description of the measure

- (5) This case concerns the use of publicly owned or managed land and natural resources, exploited by electricity producers. In particular, the case concerns the administrative practice of concluding agreements with electricity producers to use public land and natural resources. Those agreements can be signed with both publicly owned electricity producers and private ones.
- (6) Article 40(2) of the Icelandic Constitution, *i.e.* Act No 33/1944, provides that the Icelandic authorities are only permitted to dispose of state assets or allow for the utilisation of state owned natural resources, if there is a legal basis for such a transfer of assets (either temporary or permanent). By way of agreements, the Icelandic authorities have on numerous occasions granted electricity producers, which have obtained licences to construct power plants, rights to exploit public natural resources in order to generate hydroelectric or geothermal energy. Although the Icelandic authorities have had a legal basis for entering into agreements with electricity producers concerning the exploitation of natural resources, there is no legal act establishing the required content of such agreements.
- (7) The aid measure consists in a scheme by means of which the Icelandic authorities grant concessions to the use of public land and natural resources without there being a clear legal requirement for the payment of a market-based remuneration and published and precise criteria for determining such remuneration. The main users and potential beneficiaries are the publicly owned Landsvirkjun and Orkuveita Reykjavíkur, as well as HS Orka (which is now privately owned).

2.2 The general legal framework concerning natural resources in Iceland

2.2.1 General

- (8) The general legal framework concerning ownership and utilisation of natural resources in Iceland is based on statutes that are further implemented through administrative rules and regulations. The official monitoring of utilisation of geothermal resources in Iceland is the responsibility of different public authorities.

² Document No 539362.

³ Document No 554319.

⁴ Document No 573873.

⁵ Document No 701088.

⁶ Document No 724372.

⁷ Document No 761219.

⁸ Document No 782469.

- (9) The current statutory rules are found in the Act on Survey and Utilisation of Ground Resources No 57/1998 (“the Ground Resources Act”), the Act on Public Land No 58/1998 (“the Public Land Act”), the Electricity Act No 65/2003 (“the Electricity Act”) and the Water Act No 15/1923 with later amendments (“the Water Act”).⁹
- (10) In the telephone conference held with the Icelandic authorities on 16 February 2016, the Icelandic authorities informed of the adoption of the Public Finance Act No 123/2015 (“the Public Finance Act”).¹⁰ According to the Icelandic authorities this new Act, and in particular its Article 45, is of relevance to the case at hand.

2.2.2 *The Ground Resources Act*

- (11) The private ownership of resources within the ground is associated with the ownership of the land. Therefore, on public land, underground resources are the property of the Icelandic State.¹¹ Research and utilisation is subject to licensing according to the Ground Resources Act, which lays down licensing requirements and licensing procedures for research on and utilisation of ground resources.¹² The Ground Resources Act prescribes the ownership status of ground resources and the rights and duties of the owner. The notion of resource applies to any element, compound and energy that can be extracted from the earth, whether in solid, liquid or gaseous form. The Ground Resources Act covers resources in the ground, at the bottom of rivers and lakes and the sea bed within netting boundaries. The Act also covers exploration of hydropower for the generation of electricity.
- (12) The Minister of Industry is authorized to take the initiative and/or to give instructions on exploration and prospecting for resources in the ground anywhere in Iceland, regardless of whether the owner of the land has started such exploration or prospecting or granted third parties such exploration rights, unless the party in question holds a valid prospecting license pursuant to the Ground Resources Act.
- (13) As a general rule, licenses under the Ground Resources Act and the Electricity Act are only granted to a single party within a certain area.¹³
- (14) According to Article 3a(1) of the Ground Resources Act, the Government, the municipalities and their wholly owned undertakings may not transfer, directly or indirectly, on a permanent basis, ownership rights of geothermal energy and groundwater. The Icelandic authorities are neither allowed to permanently assign publicly owned natural resources nor the rights to control and utilize water capable of generating energy in excess of 10 MW. In Article 3 there are however two exceptions to the ban:
- According to Article 3a(2) the Icelandic State, municipalities and companies owned by them are permitted to transfer rights to the Icelandic State, a municipality or a

⁹ For English versions of these acts see the Ministry of Industries and Innovation’s link, available at: <http://eng.atvinnuvegaraduneyti.is/laws-and-regulations/energy-and-natural-resources/>.

¹⁰ Available online at: <http://www.althingi.is/lagas/nuna/2015123.html>.

¹¹ See Article 3, Act No 57/1998 on the survey and utilisation of ground resources, available online at: <http://eng.atvinnuvegaraduneyti.is/media/acts/Act-No-57-1998-on-survey-and-utilisation-of-ground-resources.pdf> (English version).

¹² Similar rules apply for the Electricity Act No 65/2003. The ownership with respect to both the disposition and utilisation of geothermal are to a great extent limited by public law rules that regulate land use and access to the resources and how they are utilised.

¹³ An exception is found in Article 5(2) of the Ground Resource Act; a research license may be granted to more than one party jointly if they submit a joint application and an agreement is made on the division of costs.

company which is wholly owned by the State and/or municipalities and is organised specifically to control the ownership of such rights.

- According to Article 3a(3), the Icelandic State, municipalities and companies owned by them and specifically organised to control the ownership of such rights, are permitted to *grant temporary rights* to utilise geothermal energy and groundwater for a period of up to 65 years at a time. The holder of the temporary rights is entitled to seek extension of the rights when half of the agreed period has passed.

- (15) Article 3a(4) prescribes that licences shall be granted on a non-discriminatory basis. Efficient use of resources and infrastructure shall be enhanced.
- (16) Article 3a(5) of the Act provides that the responsible minister shall negotiate a *remuneration (rent) for the usage of resources in public land*. Remuneration for the utilisation is to be determined in line with the principles set out in the Act on Public Land.¹⁴ The same applies to the right to control and use water capable of generating energy in excess of 10 MW, in accordance with Article 2(2)-(6) of the Water Act.

2.2.3 Act on Public Land

- (17) The Act on Public Land divides all land in Iceland into two ownership categories: private land and public land. According to Article 1 of the Act, *private land* is an area of land which is subject to private property rights in the sense that the owner holds all normal ownership control within the limits set by law. On the other hand, *public land* is declared to be owned by the Icelandic State and defined as land outside private land. Individuals or legal persons can nevertheless possess indirect property rights in public land.
- (18) Despite the fact that the Icelandic State is declared the “owner” of public land, the property rights of the State are generally considered distinctive. The Icelandic State holds the ownership title as the custodian of the land.¹⁵
- (19) According to Article 3(4) of the Act the Prime Minister has the *power to decide or negotiate remuneration (rent) for the use of the rights (natural resources)*.¹⁶
- (20) The Act on Public Land establishes a special administrative body, a Committee for Uninhabited Areas (*Óbyggðanefnd*), which has the objective of determining the ownership of the land and whether the land was in private or public ownership. Decisions taken by the Committee can be challenged before the courts in Iceland.¹⁷ The Committee has finalised assessing the disputed areas where the hydro- and geothermal power plants subject to assessment in this case are located.

¹⁴ A similar provision can be found in the Water Act (Article 16(5)).

¹⁵ See Kristín Haraldsdóttir, “*Property Rights in Water and Social Conflict: An example from Iceland*”, in the 2011 Special Edition, International Journal of Rural Law and Policy Water law: Through the Lens of Conflict.

¹⁶ According to Article 3 of the Act income that accrue for the use of land and the natural resources within the public lands shall be used for projects to improve the land.

¹⁷ For an overview of the decisions of the Committee for Uninhabited Areas information is available at: www.obyggdanefnd.is.

2.2.4 Electricity Act

- (21) The electricity market in Iceland was liberalised by the adoption of the Electricity Act in 2003, implementing Directive 96/92/EC¹⁸ concerning common rules for the internal market in electricity.
- (22) The Electricity Act applies to electricity generation and the electricity market regardless of the source. This Act therefore applies to the utilisation of geothermal resources for electricity production whereas the Ground Resource Act applies to the utilisation of geothermal energy for other purposes.
- (23) According to the Electricity Act a license issued by the National Energy Authority (*Orkustofnun*) is required to construct and operate a power plant. However, such a license is not required for power plants with capacity of less than 1 MW, unless the energy produced is delivered into the distribution system or into the transmission grid.

2.2.5 The Water Act

- (24) The Act provides the legal framework for all water above ground, including water rights, priority rights to water, utilisation, irrigation and the management of water.
- (25) The right to utilise water on or flowing through the property is a part of the property rights of each piece of land, including public land. This includes utilisation of hydro power as stipulated in the Act. The utilisation of hydro power resources for electricity production is subject to the provisions of the Electricity Act.

2.2.6 Public Finance Act

- (26) The Public Finance Act was approved on 28 December 2015. Article 45 of the Act reads as follows (unofficial translation):

With regard to the sale, rent or other disposal of central government assets, and assets that need to be purchased or rented for central government needs, emphasis shall be placed on transparency, objectivity, equal treatment and cost-effectiveness. The competition perspectives shall as well be respected as applicable and relevant in such transactions.

- (27) The Authority notes that this new Act imposes obligations only on the disposal of central government assets, leaving outside the scope of the mandate the agreements regarding land or natural resources owned by municipalities or public companies.

2.3 Proposed amendments to the Grounds Resources Act and the Water Act

- (28) The Authority has been discussing with the Icelandic authorities the possible adoption of a bill amending the Water Act and the Ground Resources Act. The proposal for this Bill will be also assessed in present assessment.
- (29) The legislative proposal foresees amendments to Article 16 of the Water Act and Article 3 of the Ground Resources Act. The proposed amendments to both Acts are identical.

¹⁸ Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity. Repealed by Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity OJ L 176, 15.7.2003. Act referred to at point 22 at Annex IV to the EEA Agreement. Repealed by Directive 2009/72/EC not yet incorporated into the EEA Agreement.

According to the information received from the Icelandic authorities, a new paragraph might be added to the aforementioned provisions establishing that (unofficial translation):

A contract for the temporary right of use of the rights according to Paragraph 3 shall inter alia stipulate the obligations that the users have, the conditions of the utilization license, how to preserve nature, how to utilise the resources responsibly, how to leave the structures at the end of the contract period and how the resources shall be arranged at the end of the contract period. The minister may issue a regulation concerning the items that shall at a minimum be included in such contracts, how compensation should be arranged and the procedure for granting of temporary rights under the control of the State under this article.

- (30) Since the case at hand refers to the use of land and natural resources (including hydro resources) by electricity producers, the adoption of this draft bill could be of interest for the case at hand. The Icelandic authorities have however not yet submitted a draft regulation on the determination of compensation to the Authority, or even indicated whether such a regulation will indeed be introduced.

2.4 Market liberalisation in Iceland

- (31) The electricity market in Iceland was not open to competition prior to 1 July 2003, with about 73% of the electricity being supplied by Landsvirkjun. The company had *de facto* monopoly on investment in electricity generation although some distribution system operators had obtained limited concessions to generate electricity.
- (32) The Electricity Act implemented Directive 96/92/EC, and with this Act the Icelandic market was opened to competition. The Act laid down the obligation that, by 1 July 2004, all non-household consumers and, by 1 July 2007, all household consumers, should be free to purchase electricity from the supplier of their choice. The Act has later been amended in order to incorporate Directive 2003/54/EC into the Icelandic legal order.
- (33) Concession activities are regulated by the *Orkustofnun*, which oversees aspects such as pricing, quality and security of supply. According to Icelandic law, an electricity company can be a generator, distributor and supplier all at the same time. Legal and functional unbundling is required between concession and competitive activities.¹⁹

2.5 Remuneration for the use of natural resources

2.5.1 General

- (34) In a letter to the Authority in September 2004, the Icelandic authorities explained, in relation to the Authority's case leading to the adoption of Decisions No 302/09/COL and 159/13/COL, that they had not engaged in specific work for the purpose of clarifying the issue of charging market based remuneration for use of natural resources. They maintained that there were many reasons for this, first and foremost the ongoing work of the Committee for Uninhabited Areas (see section 2.2.3 above), and also that the use of compensation for the use of natural resources in the broad sense remained a matter of active public debate.²⁰
- (35) The Authority understands therefore that there are no clear rules on how to determine the remuneration for the use of public land and natural resources owned by all the public entities in Iceland, and the competent Icelandic authorities grant the right to use land and resources

¹⁹ Information on the Icelandic electricity market based on Landsnet's webpage, available at: <http://www.landsnet.is/english/transmissionandmarket/icelandselectricitymarket/>

²⁰ Letter from the Icelandic authorities dated 21 September 2004 (Document No 293427).

based on an administrative practice which can be traced back to the construction of the Elliðaárvirkjun power plant in 1921. The Authority acknowledges nevertheless that from the adoption of the Public Finance Act, the central Government will be bound by the requirements described in Article 45 thereof.

- (36) Moreover, it is the Authority's understanding that there have been no procurement procedures in place when it comes to licenses for research and utilisation of geothermal or hydropower resources. This is despite Article 19 of the Ground Resource Act, which states that the Minister of Industry can call for applications in a particular area by publishing an announcement.
- (37) Since 2004 the issue of remuneration for public land and natural resources for the production of electricity has been addressed on several occasions by the Authority, including in an annual state aid meeting in Iceland in May 2014, where the Icelandic authorities confirmed that no specific work was being put into clarifying the issue. Moreover, no bills of law have been presented to the Parliament, covering all the use of land and natural resources of all the Icelandic public entities.²¹ Thus, according to the information available to the Authority, no criteria or methodology has been established by the Icelandic authorities on how to establish remuneration for the use of land and natural resources in public land applicable to all public entities (*i.e.* central government, municipalities and public companies).

2.5.2 Icelandic reports on remuneration for the use of natural resources

- (38) Despite the fact that no binding and generally applicable criteria or methodology has been established regarding remuneration for the use of land and natural resources in publicly owned land, there has been ongoing work on the remuneration policy. However, the Authority has not received information regarding the conclusion of this work.
- (39) Following the adoption of Act No 58/2008, the Prime Minister appointed a committee to discuss an arrangement concerning the lease of water and geothermal rights owned by the State ("the WG Committee"). The WG Committee finalized its report in March 2010.²² The report proposes various ways to implement remuneration for the use of natural resources. In short, the WG Committee came to the following conclusion in respect of the arrangements that should be adopted in the future as to the remuneration for State owned water- and geothermal rights:
- i. A charge should be collected relating to rent/utilisation of water and geothermal rights subject to public ownership, with no exemptions. The right should only be granted for a limited period of time, through a transparent and non-discriminatory tender procedure;
 - ii. Once temporary utilisation rights would be granted, they could normally be extended, at least in cases where a proprietor has fulfilled all his obligations and used the natural resources in a respectful manner.
- (40) Furthermore, the WG Committee proposed that the temporary utilisation rights should be tendered out in a two-step procedure and the remuneration to the State would be threefold, *i.e.*:

²¹ The Authority reiterates that the Public Finance Act only refers to the central Government.

²² Arrangement concerning the lease of water and geothermal rights owned by the State (i. Fyrirkomulag varðandi leigu á vatns- og jarðhitaréttindum í eigu íslenska ríkisins, skýrsla nefndar forsætisráðherra sem skipuð var samkvæmt III. Bráðabirgðaákvæði laga nr. 58/2008, March 2010) <https://www.forsaetisraduneyti.is/media/Skyrslur/leiga-a-vatns-og-jardhitarettindum.pdf>

- i. Fixed minimum charge to cover expenses by the State (various administration fees);
- ii. Additional remuneration that would be determined by competition by the tender (in case there are more than two bids);
- iii. Part of the resource rent that arise from the natural resource, *i.e.* when the project starts to provide additional return.

- (41) According to the Icelandic authorities, the Ministry of Finance and Economic Affairs has now developed a methodology and formal procedure with regard to the remuneration to the Icelandic State for the utilisation of rights by electricity producers. The methodology (mechanism) is subject to reviews and it seeks to exclude the possibility of foregone state revenue. In recent cases where the Ministry of Finance and Economic Affairs has been tasked with negotiating a price for utilisation of resources for electricity production within state owned land (other than public land within the meaning of the Act on Public Land), the value of such utilisation is assessed by an independent expert on behalf of the Ministry. The basis of the assessment mainly takes into account: estimated investment costs, term of the investment, estimated operating costs, expected electricity prices, cost of finance and general State references concerning adequate remuneration.
- (42) In short, the procedure that is in place at the Ministry of Finance and Economic Affairs calls for an offer from the company which has been granted rights for research and utilisation of power resources. That offer is assessed using the methodology described above and the assessment forms the basis of negotiations with the electricity company. According to the Icelandic authorities a similar procedure and methodology is likely to be applied in the case of the Prime Minister's authorisation under Article 3(4) of the Public Land Act. The Authority has not received information confirming that this methodology has already been adopted. Moreover, the Public Finances Act only applies to the central Government and not to state owned companies or municipalities.

3. Comments by the Icelandic authorities

- (43) The Icelandic authorities maintain that the work on the overall remuneration policy is still ongoing. They have referred to the studies and the reports of two working groups commissioned to assess different policy aspects, discussed above in section 2.5.2 However, the preparatory work contained in the two reports has not to date led to the adoption of an overall policy in terms of remuneration to be paid for the utilisation of public land and natural resources. The Icelandic authorities maintain that the matter is therefore still pending and await the Governments decision.
- (44) The Icelandic authorities maintain that remuneration has been fully paid in the case of certain power plants. They further submit that full remuneration will be paid as regards other plants. According to the Icelandic authorities it is foreseen that the judgment of the Supreme Court in the *Kárahnjúkavirkjun* case No 233/2011 will “among other parameters” serve as a precedent to determine the appropriate remuneration for the use of natural resources in Iceland.²³
- (45) According to the Icelandic authorities, the methods applied by the Icelandic State, particularly after 1998, have resulted in transactions that do reflect market prices. The procedure by which to charge remuneration in cases such as the ones under assessment by the Authority, has been under review for some time. This work does not concern the

²³ Icelandic Supreme Court judgment No 233/2011, 18.10.2012, available online at: <http://www.haestirettur.is/domar?nr=8364&leit=t>.

question *whether* to charge a full (*i.e.* market based) remuneration. Rather, it is the procedure to be followed and the public policy aspect of the lease of national resources that is the focus point of the work, *i.e.* matters such as length of contracts, increased transparency and development of procedures.

- (46) The Icelandic authorities note, that for the Icelandic State to grant concessions by way of concluding agreements on utilisation, there has to be a legal act establishing the content of and requirements for such agreements. Thus, while the Prime Minister is authorised to decide or negotiate remuneration for the use of rights under Article 3(4) of the Act on Public Land, he is very much bound by an obligation to seek the highest price available. The same is true for the Minister of Finance and Economic Affairs which concludes agreements on state owned land and resources other than Public Land.
- (47) The Icelandic authorities further note that based on the legal and administrative principles of practicality (efficiency) and equality, the Icelandic State, when conducting agreements with private undertakings concerning sale or rent of property, must seek the highest price available, in the absence of express legal provisions stating otherwise. In that regard, reference can be made to Supreme Court judgments and opinions from the Parliamentary Ombudsman.²⁴
- (48) According to the Icelandic authorities, when an agreement is made without the prior advertisement of land or utilisation rights, the remuneration is based on “coherent, justifiable and not arbitrary” considerations. This is done by independent evaluation or other suitable means. As an example, Article 3 of the 1982 Agreement made between the Icelandic State and Landsvirkjun, stipulated that the remuneration to be paid for utilisation of water rights should be comparable with what is generally accepted with regard to such rights. Additionally, it stipulated that the remuneration could be in the form of one-off payment or an annual payment, and that if the parties could not reach an agreement, they would commit to the assessment of unbiased asset valuers.
- (49) The Icelandic authorities disagree with the assumption that the absence of a legal act establishing the detailed content of agreements or the precise manner of negotiations and price determination, allows the State to “decide legitimately not to maximise” the revenues related to sale or utilisation of public land and resources. On the contrary, such full or partial waiving of State resources without “full” compensation would, according to the Icelandic authorities, be unlawful.
- (50) According to the Icelandic authorities the Judgment in the *Kárahnjúkar* case as well as recent findings by the Parliamentary Ombudsman demonstrate that there exists a long standing method of assessing the market value of land and land resources.²⁵ The Icelandic authorities submit that if the fair value of the underlying asset takes into account expected profits, then that valuation is an important and appropriate starting point when it comes to determining the lease of public land, state owned land or resources therein. In other words, when a valuation of land and natural resources reflects the earning potential of the land or resources, that valuation is in principle also an appropriate benchmark for lease value.
- (51) According to the Icelandic authorities they have operated a framework or scheme concerning the utilisation of publicly owned land and land resources which aims, *inter alia*,

²⁴ Icelandic Supreme Court Judgment No 407/1999, 23.032000 and Parliamentary Ombudsman Cases No. 3163/2001 and 6093/2010.

²⁵ Icelandic Supreme Court Judgment No 233/2011 18.10.2012, available online at: <http://www.haestirettur.is/domar?nr=8364&leit=t>.

to maximise the possible income for the State. Market based compensation is and has been charged for such utilisation. It might possibly be argued that a practice of (unintentional) foregoing of revenue in relation to the conclusion of agreements with electricity producers existed prior to the entry into force of Acts No 57 and 58 of 1998, but has since ceased to exist.

- (52) The considerations and methodology which has been applied when transferring rights to utilise state owned land and resources and determine remuneration is set to be reviewed, codified and published in a comprehensive manner through an ownership policy that is currently being drafted, concerning public land and natural resources on one hand and state land and natural resources on the other. The Icelandic authorities also refer to the recently adopted Public Finance Act.²⁶
- (53) The Icelandic authorities submit that electricity producers have not been relieved of charges that would normally be borne by their budget. In case the practice of negotiating with electricity producers for remuneration for the use state resources has, in the past, not entirely excluded state aid, that situation has at least been mitigated with the entering into force of the Ground Resources Act, which stipulates that “*compensation may be fully or partly based on the results of the utilisation in question*”. This consideration is fully applicable for valuation of resources outside the realm of expropriation, negotiated by the Minister of Finance and Economic Affairs or the Prime Minister.
- (54) Finally, the Icelandic authorities submit that a conclusion by the Authority, that the State’s methods for determination of remuneration might not have excluded state aid, would be more objective than a finding that market remuneration has not been obtained for use of natural resources by electricity producers. For the sake of the business interests of the Icelandic State and the undertakings involved, the Icelandic authorities invite the Authority to consider applying a factual line of reasoning, along the lines that there are no indications that state aid has been granted by way of agreements on remuneration, but that in general, there is a lack of precise and published criteria to determine market remuneration, which produces a risk of such transactions not reflecting the remuneration which a market economy operator would seek. Therefore, the existence of aid and by extension the existence of aid under the scheme operated by the Icelandic authorities to charge remuneration cannot be excluded. However, according to the Icelandic authorities, a definitive finding in this regard is not necessary since the scheme qualifies as existing aid.

²⁶ Available online at: <http://www.althingi.is/lagas/nuna/2015123.html>.

II. ASSESSMENT

1. The presence of state aid

(55) In the following chapters, the Authority will assess whether the Icelandic authorities' scheme of concluding agreements with electricity producers, whereby they are granted the use of public water and geothermal resources for electricity generation, involves state aid within the meaning of Article 61(1) of the EEA Agreement.

(56) A measure constitutes state aid within the meaning of Article 61(1) of the EEA Agreement if the following conditions are cumulatively fulfilled: the measure (i) is granted by the state or through state resources; (ii) confers an economic advantage on an undertaking; (iii) is selective; and (iv) is liable to distort competition and trade between Contracting Parties.

1.1 Presence of state resources

(57) 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.

(58) The State, for the purpose of Article 61(1) of the EEA Agreement, covers all bodies of the public administration, from the central government to the city level or the lowest administrative level as well as public undertakings and bodies.²⁷

(59) Not charging remuneration for publicly owned land and natural resources owned or held by the State is equivalent to consumption of state resources. Granting access to public land or state owned land and natural resources without remuneration based on market terms can therefore constitute foregone state revenues.

(60) The role of the State as the seller/lessor of resources on the one hand and its obligations in its capacity as a public authority on the other hand should not be confused.²⁸ In cases where the State acts as a regulator, it can decide legitimately not to maximise the revenues which would otherwise have been achieved, without falling within the scope of the state aid rules, provided that all operators concerned are treated equally, and that there is an inherent link between achieving the regulatory purpose and the foregoing of revenue.²⁹ It is the Authority's conclusion that in the present case this is not the case as it has not been secured that all operators concerned are treated equally. Indeed, in some cases remuneration has been established to some extent for the use of natural resources, while this is not the case in all instances.

(61) Article 9 of Directive 2000/60/EC,³⁰ lays down the principles of cost recovery for water services, adequate incentives in water pricing policies for the efficient use of water resource and adequate contribution from, inter alia, industry. These provisions recognise an economic value in different water uses. As referred to above, the Authority has not received any information demonstrating that the lease of public land or state owned land and natural

²⁷ Judgment in *Germany v Commission*, Case-248/84, EU:C:1987:437, paragraph 17.

²⁸ See for example judgments in *Spain v Commission*, C-278/92 to C-280/92, EU:C:1994:325; and *Germany v Commission*, C-334/99, EU:C:2003:55, which make a distinction between the State's obligations when acting as a public authority and in another capacity.

²⁹ See for example judgment in *Bouygues and Bouygues Télécom v Commission*, C-431/07 P, EU:C:2009:223, paragraphs 90-97 and 122.

³⁰ Directive 2000/60/EC of the European Parliament and of the Council of 23 October 2000, establishing a framework for Community action in the field of water policy (OJ L 327, 22.12.2000, p. 1). Incorporated into the EEA Agreement by Decision No 124/2007 (OJ L 047, 21.2.2008, p 53 and EEA Supplement No 9, 21.2.2008, p. 41), e.i.f. 1.5.2009. In Iceland, the directive has been implemented in Act No 36/2011 on Water Management.

resources are tendered out. The Authority considers that the granting, without tendering, of the permission to occupy or use publicly owned natural resources, or of other special or exclusive rights having an economic value, may imply a waiver of State resources.³¹ This applies *mutatis mutandis* for the use of public land and state owned land and natural resources which are part of the public resources of the Icelandic State, as long as the use of resources for power generation can be ascribed an economic value. In contrast, would there be no economic value attributed to its use then such resources would not necessarily constitute a vehicle for the attribution of economic benefits within the meaning of Article 61(1) of the EEA Agreement.³²

- (62) In light of the facts of the case, it is the Authority's view that the State, when concluding agreements with electricity producers for the use of land and natural resources for electricity generation, is not acting as a regulator pursuing a regulatory objective or public policy. Indeed, the issuing of licences to harness the resources is the task of the *Orkustofnun* while the negotiation of the remuneration for the usage of the natural resources on public land or state owned land is with the Prime Minister and/or the Minister of Finance and Economic Affairs, which have no regulatory powers in this respect.
- (63) Pursuant to the Ground Resources Act referred to in section 2.2.2 above, the private ownership of resources in the ground is associated with the ownership of the land, while on public land underground resources are the property of the Icelandic State.
- (64) In light of the above considerations, the Authority concludes that the measure involves state resources within the meaning of Article 61(1) of the EEA Agreement, since agreements may be concluded without a market-based remuneration for the use of the public land and natural resources.

1.2 Undertaking

- (65) In order to constitute state aid within the meaning of Article 61(1) of the EEA Agreement, the measure must confer an advantage upon an undertaking. Undertakings are entities engaged in an economic activity, regardless of their legal status and the way in which they are financed.³³ Economic activities are activities consisting in offering goods or services on a market.³⁴
- (66) The potential beneficiaries of the measures are electricity producers established in Iceland, *i.e.* currently Landsvirkjun, Orkuveita Reykjavíkur and HS Orka. The companies all engage in economic activities related to the production and sale of electricity in a liberalised market. Accordingly, any advantage involved in the granting of rights relating to the utilisation of public water and geothermal resources for electricity generation would be conferred upon undertakings.

1.3 Advantage

- (67) In order to constitute state aid within the meaning of Article 61(1) of the EEA Agreement, the measure must confer an advantage upon a beneficiary undertaking..

³¹ See judgments in *Connect Austria Gesellschaft für Telekommunikation GmbH v Telecom-Control-Kommission, and Mobilkom Austria AG*, C-462/99, EU:C:2003:297, paragraphs 92 and 93; and *Bouygues and Bouygues Télécom SA v Commission*, T-475/04, EU:T:2007:196, paragraphs 101, 104, 105 and 111.

³² See Commission Decision No SA.35429 *Portugal*, paragraph 34.

³³ Judgment in *Höfner and Elser v Macroton*, Case C-41/90, EU:C:1991:161, paragraphs 21-23 and Case E-5/07 *Private Barnehagers Landsforbund v ESA* [2008] EFTA Ct. Rep. 61, paragraph 78.

³⁴ Judgment in *Ministero dell'Economica e delle Finanze v Cassa di Risparmio di Firenze SpA*, C-222/04, EU:C:2006:8, paragraph 108.

- (68) An economic advantage, within the meaning of Article 61(1) EEA, is any economic benefit which an undertaking would not have obtained under normal market conditions,³⁵ thus placing it in a more favourable position than its competitors.³⁶
- (69) Not only the grant of positive economic advantages is relevant for the notion of state aid, relief from economic burdens can also constitute an advantage, *i.e.* mitigation of charges normally included in the budget of an undertaking.³⁷ This would cover all situations in which economic operators are relieved of the inherent costs of their economic activities,³⁸ despite the fact that there is no legal obligation to assume those costs.³⁹
- (70) In order to escape the notion of aid, the use of natural resources with an economic value which provides an advantage to specific competitors on the market “*must be attributed against payment of a consideration that should be coherent, justifiable and not arbitrary*”.⁴⁰
- (71) When public authorities carry out economic activities in any form, they are subject to state aid rules. However, if the transaction is carried out in line with normal market conditions it will not give rise to an advantage, and thus will not constitute state aid. In order to determine whether a transaction carried out by the State or a public authority has been carried out according to normal market conditions, the European Union Courts have developed the “*private vendor test*”,⁴¹ whereby the conduct of states or public authorities when selling or leasing assets is compared to that of private economic operators.
- (72) The purpose of the private vendor test is to assess whether a sale or leasing of assets carried out by a public body involves state aid, by examining whether a private vendor, under normal market conditions, would have acted in the same manner. If this is not the case, the beneficiary of the measure should be considered as having received an economic advantage, which it would not have obtained under normal market conditions, placing it in a more favourable position than that of its competitors. The public authority must disregard public policy objectives and instead focus on the single objective of obtaining a market rate of return or profit on its investments and a market price for the sale or lease of assets.⁴² The Authority notes, however, that this assessment normally has to take into account any special

³⁵ Judgments in *France v Commission*, C-301/87, EU:C:1990:67, paragraph 41; *De Gezamenlijke Steenkolenmijnen v High Authority of the European Coal and Steel Community*, Case 30/59, EU:C:1961:2, paragraph 19; *France v Commission (Kimberly Clark)*, C-241/94, EU:C:1996:353, paragraph 34; *Fleuren Compost*, T-109/01, EU:T:2004:4, paragraph 53; and *Land Burgenland and Others v Commission*, C-214/12 P, C-215/12 P and C-223/12 P, EU:C:2013:682.

³⁶ See for instance judgments in *Commission v EDF*, C-124/10 P, EU:C:2012:318, paragraph 90; in *Banco Exterior de España*, C-387/92, EU:C:1994:100, paragraph 14; and *Italy v Commission*, C-6/97, EU:C:1999:251, paragraph 16.

³⁷ Judgments in *Banco Exterior de España*, C-387/92, EU:C:1994:100, paragraph 13; *Germany v Commission*, C-156/98, EU:C:2000:467, paragraph 25; *Italy v Commission*, C-6/97, EU:C:1999:251, paragraph 15; *Heiser*, C-172/03, EU:C:2005:130, paragraph 36.

³⁸ Judgment in *GEMO SA*, C-126/01, EU:C:2003:622, paragraphs 28 to 31 on the free collection and disposal of waste.

³⁹ Judgments in *France v Commission*, C-241/94, EU:C:1996:353, paragraph 40; *Belgium v Commission*, C-5/01, EU:C:2002:754, paragraphs 38 and 39; and *Corsica Ferries France SAS v Commission*, T-565/08, EU:T:2012:415, paragraphs 137 and 138.

⁴⁰ Commission Decision No SA.35429 *Portugal*. Extension of use of public water resources for hydro electricity generation, paragraph 47 (OJ C 117, 16 April 2014, p. 113).

⁴¹ For the application of the “*private vendor test*”, see Case E-12/11 *Asker Brygge* [2012] EFTA Ct. Rep. 536 and judgment in *Land Burgenland and Others v Commission*, C-214/12 P, C-215/12 P and C-223/12 P, EU:C:2013:682. These cases concern the sale of an outright property right in land. However, they also provide guidance for the sale or lease of other rights in land, such as natural resources.

⁴² Judgment in *Land Burgenland and Others v Commission*, C-214/12 P, C-215/12 P and C-223/12 P, EU:C:2013:682.

rights or obligations attached to the asset concerned, in particular those that could affect the market price.

- (73) Compliance with market conditions, and whether the agreed price in a transaction corresponds to market price, can be established through certain proxies. Organising an open, transparent and unconditional bidding procedure is generally an appropriate means to ensure that the sale or lease by national authorities of assets is consistent with the private vendor test and that a fair market value has been paid for the goods and services in question. However, this does not automatically mean that the absence of an orderly bidding procedure or a possible flaw in such a procedure justifies a presumption of state aid. Public procurement law and state aid law exist in parallel and there is no reason that the violation of, for example, a public procurement rule should automatically mean that state aid rules have been infringed.⁴³
- (74) On the other hand, as stated in the *Land Burgenland* case, cited in paragraph 97 of the EFTA Court judgment in Case E-1/13, “where a public authority proceeds to sell an undertaking belonging to it by way of an open, transparent and unconditional tender procedure, it can be presumed that the market price corresponds to the highest offer, provided that it is established, first, that the offer is binding and credible and, secondly, that the consideration of economic factors other than the price is not justified”.⁴⁴ The same principle must apply in the case of lease of assets. A private operator leasing his assets would normally try to obtain the best offer with an emphasis on price, and, for example, not consider elements that would relate to the intended use of such assets, unless they might affect the value of the assets after the lease period. Therefore, provided that the said pre-conditions are met, it can be presumed that the market price is the highest price which a private operator acting under normal competitive conditions is ready to pay for the use of the assets in question.⁴⁵
- (75) The Authority understands that the rights for the use of public land or natural resources have traditionally not been tendered out. When establishing a market price, the tender must give rise to a sufficient level of competition to be qualified as a competitive tender process. Where only one operator is realistically able to submit a credible bid, the tender cannot be deemed to be competitive and thus cannot be considered to adequately establish the market price for a transaction. If the Icelandic authorities have not acted as a market economy operator would have done in a similar situation, the beneficiary undertaking has received an economic advantage which it would not have obtained under normal market conditions,⁴⁶ thus placing it in a more favourable position than that of its competitors.⁴⁷
- (76) In line with the above, it appears that no formal procedure is in place for the lease of public land or state owned land and its natural resources. The Authority therefore understands that there is not yet a mechanism in place to establish actual market price of the use of publicly owned land and natural resources applicable for all the public Icelandic authorities and irrespectively of the type of land to be used (*i.e.* state owned land, public land and municipality owned land), capable of excluding state aid being granted to the electricity

⁴³ Judgment in *SIC v Commission*, T-442/03, EU:T:2008:228, paragraph 147. By analogy, see judgment in *Matra v Commission*, C-225/91, EU:C:1993:239, paragraph 44.

⁴⁴ See judgment in *Land Burgenland v European Commission*, C-214/12 P, C-215/12 P and C-223/12 P, EU:C:2013:682, paragraph 94.

⁴⁵ See, for example, judgments in *Banks*, C-390/98, EU:C:2001:456, paragraph 77; and *Germany v Commission*, C-277/00, EU:C:2004:238, paragraph 80.

⁴⁶ Judgment in *Land Burgenland and Austria v Commission*, T-268/08 and T-281/08, EU:T:2012:90.

⁴⁷ See for instance judgments in *Commission v EDF*, C-124/10 P, EU:C:2012:318, paragraph 90; and *Banco Exterior de España*, C-387/92, EU:C:1994:100, paragraph 14; and *Italy v Commission*, C-6/97, EU:C:1999:251, paragraph 16.

producers. Generally, a credible and binding offer would seem to be the best basis for the determination of market price as it reflects what a market player would actually be prepared to pay for the public land and the use of the natural resources.

- (77) The fact that the natural resources have not been tendered out does not exclude the possibility of the Authority applying the private vendor test. However, the Authority will need to examine the substance of the transactions in question, and in particular compare the agreed price to the market price. For this purpose, the Authority normally refers to an independent expert valuation study as a proxy for the market price. Such a study should ideally be prepared at the time of the transaction. However, the Authority can also rely on an *ex post* valuation study in its assessment.⁴⁸
- (78) The Authority has not received any documentation as to whether an independent evaluator has been appointed to assess all individual cases on the basis of generally accepted market indicators and valuation standards. The committee appointed by the Prime Minister to discuss arrangements concerning the lease of the natural resources owned by the Icelandic State, see section 2.5.2 above, was appointed by the Minister in order to make proposals and to evaluate different options. Therefore, it cannot be regarded as an independent evaluator.
- (79) As previously noted, the Ministry of Finance and Economic Affairs has in recent cases enlisted an independent expert to assess the value for the utilisation of resources for electricity production within state land (other than public land). According to the Icelandic authorities, the basis for the assessment mainly takes into account: estimated investment costs, term of the investment, estimated operating costs, expected electricity prices, cost of finance and general State references concerning adequate remuneration. However, it is the Authority's understanding that this assessment is not in any way binding as it only forms the basis for negotiations with the relevant electricity company. Moreover, it is unclear whether a similar procedure and methodology is applied under the Prime Minister's authorisation pursuant to Article 3(4) of the Public Land Act or when it comes to the transfer of municipality owned resources. Therefore, there is no mechanism in place which ensures that an independent evaluation is always carried out on the basis of generally accepted market indicators and valuation standards.
- (80) Furthermore, although the recently adopted Public Finance Act and general administrative principles might mitigate the situation, by stressing that emphasis should be placed on transparency, objectivity, equal treatment and cost-effectiveness when selling, renting or disposing of central government assets by other means, they only apply to central government assets, not municipality owned assets and assets of publicly owned companies. The newly adopted Act and the administrative principles also do not establish a clear rule that market price should always be required, or set out a methodology for determining market price.
- (81) The Authority notes that the general legal framework does not lay down criteria for how to determine the remuneration, or require that market remuneration is sought for the use of natural resources. Even though in certain cases the remuneration might reflect market terms, there is no certainty that this happens in all the agreements currently in force.
- (82) The lack of precise and published criteria and a methodology for determining market remuneration entails a risk of such transactions not reflecting the remuneration which a market economy operator would seek. Granting access to public land or state owned land

⁴⁸ Case E-12/11 *Asker Brygge* [2012] EFTA Ct. Rep. 536, paragraph 81.

and natural resources without any remuneration or not requiring market price to be paid based on a transparent methodology, will involve the granting of an advantage in the meaning of Article 61(1) of the EEA.⁴⁹

- (83) On the basis of the above, the Authority concludes that the measure is liable to confer an advantage on electricity producers by potentially relieving them of charges that would normally be borne by their budgets, thus preventing market forces from having their normal effect.⁵⁰

1.4 Selectivity

- (84) The measure must also be selective, in that it must favour “*certain undertakings or the production of certain goods*”.
- (85) When examining a general scheme of aid, it is necessary to identify whether the measure in question, notwithstanding the finding that it confers an advantage of general application, does so to the exclusive benefit of certain undertakings or certain sectors of activity.⁵¹
- (86) The measure in question is sector-specific⁵² in that it is limited to the electricity production market: it gives electricity producers advantages by relieving them of charges that would normally be borne by their budgets. The measure therefore appears to only favour electricity producers, which have obtained licences to construct power plants. As previously noted, the main potential beneficiaries are the publicly owned Landsvirkjun and Orkuveita Reykjavíkur as well as HS Orka.
- (87) Due to the lack of a legally binding, transparent and clear criteria for determining remuneration, the Icelandic authorities enjoy a margin of assessment when charging and determining remuneration for the use of natural resources. Indeed the practice of the Icelandic authorities for transferring rights to utilise natural resources throughout the years, has shown that they have applied different methodologies and parameters for determining remuneration and in some cases no remuneration appears to have been paid.⁵³
- (88) Nevertheless, the aforementioned margin of assessment cannot automatically be regarded as favouring certain undertakings or the production of certain goods over others given that it may be justified by various factors.⁵⁴ However, the Icelandic authorities have not provided any justification for their practice based on the objective of the measure.
- (89) In light of the above, the Authority concludes that the measure is selective.

1.5 Distortion of competition and effect on trade between Contracting Parties

- (90) The measure must be liable to distort competition and to 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.

⁴⁹ See also Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest, OJ C 8, 11.1.2012, p. 4, paragraph 33.

⁵⁰ Judgment in *Corsica Ferries France SAS v Commission*, T-565/08, EU:T:2012:415, paragraph 138.

⁵¹ Judgment in *Commission v MOL*, C-15/14 P, EU:C:2015:362, paragraph 60.

⁵² Judgment in *Belgium v Commission (Maribel bis/ter'scheme)*, C-75/97, EU:C:1999:311, paragraphs 29-31.

⁵³ Document No 750685.

⁵⁴ Judgment in *MOL v Commission*, T-499/10, EU:C:2013:592, paragraph 72.

- (91) According to settled case-law, it is not necessary to establish that the aid has a real effect on trade between the Contracting Parties and that competition is actually being distorted, but only to examine whether the aid is liable to affect such trade and distort competition.⁵⁵
- (92) When aid granted by an EFTA State strengthens the position of an undertaking compared with other undertakings competing in intra-EEA trade, the latter must be regarded as influenced by that aid.⁵⁶
- (93) Furthermore, it is not necessary that the aid beneficiary itself is involved in intra-EEA trade. Even a public subsidy granted to an undertaking, which provides only local or regional services and does not provide any services outside its state of origin, may nonetheless have an effect on trade if such internal activity can be increased or maintained as a result of the aid, with the consequence that the opportunities for undertakings established in other Contracting Parties are reduced.⁵⁷
- (94) In an EEA-wide liberalised sector, measures foreclosing a national market from competitors clearly have an effect on trade. Not only because new entrants cannot access the market on the same conditions, but also because the protected undertakings are better placed to compete with other undertakings throughout the EEA.⁵⁸
- (95) The Icelandic electricity system is isolated and no interconnection exists. There have been discussions about an interconnector between Iceland and the UK, but these discussions have been preliminary and no decision has been taken.⁵⁹ Therefore, to compete on the Icelandic electricity market an electricity company must generate any electricity it intends to sell in Iceland.
- (96) Iceland has attracted energy-intensive users since the creation of Landsvirkjun and the exploration of hydroelectric energy resources. These energy-intensive users include large international aluminium and silicon metal producers. The measures under assessment involve undertakings active on markets where there is competition. Landsvirkjun has a large share of the electricity market in Iceland, and is mainly operating on the wholesale market for electricity. Orkuveita Reykjavíkur is active mainly in the market for the production and sale of electricity. HS Orka is also mainly active in the production and sale of electricity, mostly in the Reykjanes area in Iceland.
- (97) The measure therefore 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 competition with other companies active in energy markets throughout Europe, *i.e.* the market for selling energy to energy-intensive users. On the other hand, they are liable to strengthen the financial capacities of the companies with respect to the home market. This has the indirect effect of foreclosing the Icelandic electricity market not only to foreign but also to national competitors.

⁵⁵ Case E-6/98 *Norway v ESA* [1999] EFTA Ct. Rep. 76.

⁵⁶ *Ibid*, paragraph 141.

⁵⁷ Judgment in *Libert and Others*, Joined cases C-197/11 and C-203/11, EU:C:2013:288, paragraphs 76-78.

⁵⁸ Commission Decision No C 25/2003 *State aid in favour of Electricité de France*, page 8.

⁵⁹ See draft Ten-Year Network Development Plan 2014, prepared by ENTSO-E, European Network of Transmission System Operators for Electricity, pages 161-2, available at <https://www.entsoe.eu/major-projects/ten-year-network-development-plan/tyndp-2014/Pages/default.aspx>.

- (98) In light of the foregoing considerations, the measure is liable to distort competition and affect trade between the Contracting Parties.

1.6 Conclusion on the existence of state aid

- (99) With reference to the above considerations the Authority considers that the measure under assessment constitutes state aid within the meaning of Article 61(1) of the EEA Agreement.

2. New or existing aid

2.1 General

- (100) According to Article 1(b)(i) of Part II of Protocol 3 “existing aid” shall mean: “*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*”. Existing aid also embraces aid measures that the Authority has authorised as well as certain other aid as explained in the same Article 1(b)(ii)–(v).

- (101) In Case E-14/10, the EFTA Court stated, as concerns existing aid pre-dating the EEA Agreement, that: “[...]to qualify as an ‘existing aid measure’ under the EEA state aid rules, it must be part of an aid scheme that was put into effect before the entry into force of the EEA Agreement”.⁶⁰ Existing aid therefore also covers individual aid awards which have been granted on the basis of an existing aid scheme.

- (102) Regarding the legal assessment of whether aid is new or existing, the Court of Justice held in *Namur-Les Assurances* that: “*the emergence of new aid or the alteration of existing aid cannot be assessed according to the scale of the aid, or, in particular, its amount in financial terms at any moment in the life of the undertaking if the aid is provided under earlier statutory provisions which remain unaltered. Whether aid may be classified as new aid or as alteration of existing aid must be determined by reference to the provisions providing for it*”.⁶¹

2.2 Definition of an aid scheme

- (103) Article 1(d) of Part II of Protocol 3 provides that an “aid scheme”: “*shall mean any act on the basis of which, without further implementing measures being required, individual aid awards may be made to undertakings defined within the act in a general and abstract manner and any act on the basis of which aid which is not linked to a specific project may be awarded to one or several undertakings for an indefinite period of time and/or for an indefinite amount.*”

- (104) Existing “aid schemes” have been held to encompass non-statutory customary law⁶² and administrative practice related to the application of statutory⁶³ and non-statutory law. In one case, the Commission found that an aid scheme relating to *Anstaltslast and*

⁶⁰ Case E-14/10 *Konkurrenten.no AS v ESA* [2011] EFTA Ct Rep. p. 266, paragraph 53.

⁶¹ Judgment in *Namur-Les Assurances du Crédit SA*, C-44/93, EU:C:1994:311, paragraph 28.

⁶² See Decision No 405/08/COL closing the formal investigation procedure with regard to the Iceland Housing Financing Fund (OJ L 79, 25.3.2010, p. 40 and EEA Supplement No 14, 25.3.2010, p.20), section II.2.3.1, p. 53: “*The State guarantee on all State institutions for all their obligations follows from general unwritten rules of Icelandic public law predating the entry into force of the EEA Agreement. The guarantee is applicable to all State institutions, regardless of when they are established, or of their activities, or changes in those activities. This possible aid measure must be regarded as a scheme falling within the definition in Article 1(d) in part II of Protocol 3 to the Surveillance and Court Agreement*”.

⁶³ See Commission Decision No E-45/2000 *Fiscal exemption in favour of Schiphol Group* (OJ C 37, 11.2.2004, p. 13).

Gewährträgerhaftung was based on the combination of an unwritten old legal principle combined with widespread practice across Germany.⁶⁴

2.3 The use of public natural resources for electricity generation

2.3.1 The existence of an aid scheme

- (105) In the case at hand, it is the administrative practice of concluding agreements with electricity producers, whereby they are granted public water and geothermal resources for electricity generation, which gives rise to the state aid measures in the form of foregone revenue from state resources.
- (106) According to Article 40(2) of the Icelandic Constitution, *i.e.* Act No 33/1944, the Icelandic authorities are only permitted to dispose of state assets or allow for the utilisation of state owned natural resources, if there is a legal basis for such a transfer of assets (either temporary or permanent). This *inter alia* includes water utilisation rights, both for the generation of geothermal- or hydroelectric power. Therefore, there must be a clear legal basis for any agreement concluded between the Icelandic State and electricity producers relating to the use of public water and geothermal resources for electricity generation.
- (107) The existence of an aid scheme depends on an examination of whether the legal framework concerning the utilisation of public water and geothermal resources for electricity generation can be considered to be “*an act on the basis of which, without further implementing measures being required, individual aid awards may be made to undertakings defined within the act in a general and abstract manner*”.⁶⁵ This definition includes three criteria: (i) there must be an act on the basis of which aid can be awarded, (ii) the act shall not require any further implementing measures, and (iii) the act shall define the potential aid beneficiaries in a general and abstract manner.
- (108) As for the *first* criterion, the Authority notes that the Icelandic authorities have throughout the last 80 years, in line with the Icelandic Constitution, been provided with a legal basis to conclude agreements with electricity producers for the use of public water and geothermal resources. A specific minister has typically been conferred the competence to conclude such agreements, either on the grounds of a general legal basis or through a specific legal act relating to the construction of a particular power plant.⁶⁶
- (109) As for the *second* criterion, it is noted that the administration of any aid scheme requires a certain decision-making process that allows for individual awards of aid without the adoption of further implementing measures.
- (110) The Authority notes that there is no legislation or system in place to ensure that the conditions established in those agreements reflect the real value of the resources to be used. The conditions of the agreements have been decided on an *ad hoc* basis, left to the discretion of the contracting parties and therefore a risk of state aid exists.
- (111) Indeed, since 1950, Icelandic ministers have on behalf of the State concluded numerous agreements with electricity producers concerning the use of public water and geothermal resources for electricity generation. Although the Icelandic authorities have been provided

⁶⁴ See Commission Decision No E-10/2000 *State guarantees for public banks in Germany* (OJ C 150 22.6.2002, p. 7).

⁶⁵ Article 1(d) of Part II of Protocol 3.

⁶⁶ See for example, the Water Act No 15/1923, the Energy Act No 58/1967, Act No 59/1965 on Landsvirkjun (with subsequent amendments), Act No 42/1983 on Landsvirkjun, Act No 57/1998 on Survey and Utilisation of Ground Resources, and the Electricity Act No 65/2003.

with a legal basis to conclude such agreements, as required by the Constitution, the nature and the conditions of those agreements have been a matter of administrative practice, where an important margin of appreciation has been granted to the parties negotiating the use of land. In particular, there has been no clear rule as to whether remuneration should be charged for the utilisation of the resources in question and if so, how the remuneration shall be determined. The fact that in some cases the remuneration is allegedly, according to the Icelandic authorities, in line with market principles does not eliminate the risk of state aid.

- (112) It is therefore clear in the case at hand that no further legislative measures or other implementing measures needed to be adopted in order for the Icelandic authorities to decide on individual aid awards by concluding agreements with electricity producers for the use of public water and geothermal resources for electricity generation.
- (113) Finally, as for the *third* criterion, the aforementioned scheme does apply to all those electricity producers which have been granted a permit to utilise the resources in question for electricity production.
- (114) Consequently, the Authority finds that the consistent administrative practice by the State of concluding such agreements with electricity producers, which in turn has sometimes been based on general or specific legal acts and ultimately on the relevant requirement of the Constitution, must be viewed as a state aid scheme based on legal provisions.⁶⁷
- (115) On the basis of this scheme the Icelandic authorities have been able to decide on individual aid awards in accordance with Article 1(d) of Part II of Protocol 3. The individual aid would be defined by the forgone state revenue that in some cases may arise, when the conditions of the contracts do not foresee a remuneration in line with the market value of the resources.
- (116) The adoption of the Public Land Act is relevant for the central government agreements, but it does not resolve in full the above mention concerns. Thus, there is no a clear legal obligation applicable to all public entities in Iceland to ensure that the electricity producers will pay market remuneration in all cases for the use of hydro and geothermal resources.

2.3.2 Existing aid

- (117) As mentioned above, existing aid encompasses *inter alia* all aid which existed prior to the entry into force of the EEA Agreement. 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 in 1994.
- (118) It has been established by the Court of Justice that alterations, which have no bearing on the advantage that is conferred on the beneficiary of the aid, do not make existing aid new aid.⁶⁸ Furthermore, “*any change [...] which cannot affect the evaluation of the compatibility of the aid measure with the common market*” is not sufficiently substantial to require a reclassification of a measure as new aid.⁶⁹

⁶⁷ Reference is made to the Authority’s decisional practice, see Decision No 519/12/COL of 19.12.2012 closing the formal investigation into potential aid to AS Oslo Sporveier and AS Sporveisbussene (OJ L 276, 17.10.2013, p. 8 and EEA Supplement No 57, 17.10.2013 p. 1). A combination of a legislative act, regulation and administrative practice was in this Decision regarded as one aid scheme. See also Decision No 460/13/COL of 20.11.2013 to propose appropriate measures with regard to state aid granted to publicly owned hospital pharmacies in Norway (not yet reported), paragraphs 104-108.

⁶⁸ Judgment in *Namur-Les assurances du crédit*, C-44/93, EU:C:1994:311, paragraph 29.

⁶⁹ Decision No 195/04/COL of 14 July 2004 on the implementing provisions referred to under Article 27 in Part II of Protocol 3 to the Agreement between the EFTA States on the Establishment of a Surveillance

- (119) Whether aid must be classified as new aid or alterations of existing aid must be determined with reference to the provisions providing for it. Negligible changes,⁷⁰ or purely administrative changes,⁷¹ or aid which does not influence “*any of the basic features of the previous system of aid*”⁷² do not lead to existing aid being reclassified as new aid.
- (120) As previously noted, the Icelandic authorities have throughout the last 80 years, in line with the Icelandic Constitution, been provided with a legal basis to conclude agreements with electricity producers for the use of public water and geothermal resources. The competence to conclude such agreements has typically been conferred on a specific minister. This practice, defined as an aid scheme, pre-dates the entry into force of the EEA Agreement and has been constant during the years.
- (121) The currently applicable legal basis can be found in Article 38 of the Electricity Act and Article 31 of the Ground Resources Act, which permit the responsible minister to conclude agreements with the electricity producers for the use of natural resources in state-owned lands. The criteria for concluding such agreements is that the power company has been granted a permit for the utilisation of the resources in question. However, as previously mentioned there has been no clear provisions or reservations, in the relevant legal bases, *i.e.* the acts providing the relevant minister with authorisation to transfer rights to electricity producers allowing the utilisation of public natural resources, concerning whether to charge remuneration in line with market prices or how such remuneration should be calculated.
- (122) It can be established that, whereas the 1998 Ground Resources Act clarifies that a remuneration should be requested for the use of natural resources, it did not change the common practice of the Icelandic authorities to negotiate on an *ad hoc* basis such remuneration.⁷³ It also did not lay down criteria for how to determine the remuneration or require that the remuneration should be on market terms. The Ground Resources Act in fact appears to be in line with the framework agreement between the Icelandic State and Landsvirkjun of 11 August 1982 on power plant issues etc., which *inter alia* stated that: “*Before each power plant becomes operational, an agreement should be made on payments from LV to the treasury in exchange for obtaining water rights which were at the State’s disposal [...]*”. The Ground Resources Act was thus simply a codification of the already existing administrative practice. Therefore, the Authority concludes that the 1998 Law did not modify substantially the previous practice of the Icelandic authorities.
- (123) On 7 April 2003, the Icelandic Electricity Act entered into force, implementing into Icelandic law the EU Electricity Directive, providing for market liberalisation in the electricity sector. The adoption of the Electricity Act did not change or abolish the previous practice described above. The long-term practice of concluding agreements with electricity producers for the utilisation of public water and geothermal resources for electricity generation without clear criteria concerning remuneration therefore continued following the entry into force of the Electricity Act. The State neither changed its practice nor established clear criteria for determining market price for the use of these state owned resources.

Authority and a Court of Justice, Article 4(1) (OJ L 139, 25.5.2006, p. 37 and EEA Supplement No 26, 25.5.2006, p. 1).

⁷⁰ Opinion of A.G Warner in *Pigs and Bacon*, C-177/78, EU:C:1979:164.

⁷¹ Opinion of A.G Darmon in *Irish Cement*, C-166/86 and C-220/86, EU:C:1988:549, paragraph 34.

⁷² Opinion of A.G. Trabucchi in *P.J. Van der Hulst’s Zonen v Produktschap voor Siergewassen*, C-51/74, EU:C:1975:9.

⁷³ See Articles 3(a) and 7 of Act No 57/1998, on Survey and Utilisation of Ground Resources, available online at: <http://www.althingi.is/lagas/nuna/1998057.html>.

- (124) The fact that there have been different legal bases, which have granted the Icelandic authorities competence to conclude agreements on the utilisation of state resources and the fact that the legal system concerning state resources has developed throughout the years is not decisive in this case because none of these legislative changes have had any impact on how the State has designed or negotiated agreements with electricity producers concerning the utilisation of public water and geothermal resources. There has thus been no substantial alterations made to the scheme that would affect its classification as existing aid.
- (125) Consequently, the Authority concludes that the aid scheme relating to the utilisation of public water and geothermal resources by electricity producers for electricity generation, without charging adequate remuneration, constitutes existing aid within the meaning of Article 1(b)(i) of Part II of Protocol 3 to the Surveillance and Court Agreement.

3. Compatibility of the existing aid scheme

- (126) Measures caught by Article 61(1) of the EEA Agreement are incompatible with the functioning of the EEA Agreement unless they qualify for a derogation under Article 61(2) or (3) or Article 59(2) of the EEA Agreement and are necessary, proportionate and do not cause undue distortion of competition. The derogation in Article 61(2) of the EEA Agreement is, however, clearly not applicable to the aid in question, which is not designed to achieve any of the aims listed in this provision.
- (127) According to established case law, it is up to the Contracting Party concerned to invoke possible grounds of compatibility and to demonstrate that the conditions for such compatibility are met.⁷⁴
- (128) The Icelandic authorities have not put forward any arguments demonstrating that the potential state aid involved could be considered compatible on the basis of Article 59(2) or 61(3) of the EEA Agreement.
- (129) Furthermore, doubts can be raised as to whether other provisions of Icelandic law inextricably linked to the possible state aid are in compliance with the EEA internal market rules. Indeed, the Authority cannot permit state aid or systems of aid where the way in which they operate is in breach of provisions of the EEA Agreement⁷⁵ or the general principles of EEA law; this is because a breach of EEA law cannot be ‘in the common interest’, as referred to for instance in Article 61(3)(c) of the EEA Agreement.
- (130) In this respect, the Authority recalls that on 7 May 2015 it issued a reasoned opinion to Iceland concerning the award and renewal of hydropower and geothermal authorisation,⁷⁶ in which the Authority concluded that Articles 3a(2)-(6) of the Ground Resources Act and 16(2)-(6) of the Water Act are in breach of EEA law, specifically Article 12 and 13 of the Services Directive.⁷⁷ The Icelandic Acts set up an authorisation scheme for the right to harness, respectively, geothermal energy and groundwater owned by the State,

⁷⁴ Judgment in *Italy v Commission*, C-372/97, EU:C:2004:234, paragraph 44.

⁷⁵ Judgments in *Matra v Commission*, C-225/91, EU:C:1993:239, paragraph 41; and *Germany v Commission*, C-156/98, EU:C:2000:467, paragraph 78 and the case-law cited.

⁷⁶ Reasoned opinion delivered in accordance with Article 31 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice concerning Iceland’s breach of Directive 2006/123/EC on services in the internal market (the Services Directive) and/or Article 31 of the Surveillance and Court Agreement. Decision No 176/15/COL (Document No 751424).

⁷⁷ Directive 2006/126/EC of the European Parliament and of the Council of 12 December 2006 on services in the Internal market (“the Services Directive”). Act referred to at point 1 of Annex X to the EEA Agreement.

municipalities or companies owned by them, and the right to occupy and harness water resources owned by the State, municipalities or companies owned by them, that contains exploitable energy in excess of 10 MW. The Authority considers that this authorisation scheme within the meaning of Article 4(6) of the Services Directive must comply with the requirements imposed upon such schemes by the Directive. In particular, the requirements of Articles 12 and 13 of the Directive should be met.⁷⁸ Those requirements are:

(1) The procedures and formalities for the authorisation must be clear, made public in advance and be such as to provide the applicants with a guarantee that their application will be dealt with objectively and impartially (Article 13(1) of the Services Directive).

(2) The selection procedure applied to potential candidates must provide full guarantees of impartiality and transparency, including, in particular, adequate publicity about the launch, conduct and completion of the procedure (Article 12(1) of the Services Directive).

(3) The authorisation must only be granted for an appropriate limited period of time, in such a way that it does not restrict or limit free competition beyond what is necessary in order to enable the provider to recoup the cost of investment and to make a fair return on the capital invested (Article 12(2) of the Services Directive, read in light of Recital 62 of the Services Directive).

(4) The authorisation must not be open to automatic renewal nor confer any other advantage on the provider whose authorisation has just expired or on any person having any particular links with that provider (Article 12(2) of the Services Directive).

(131) However, in its reasoned opinion, the Authority concludes that those requirements are not met since the Icelandic acts establish an authorisation scheme without published, transparent and non-discriminatory award and renewal procedures, and without a requirement for a proportionate length for the authorisations.

(132) In its reasoned opinion, the Authority notes that if the Services Directive was not applicable, the Authority reached the alternative conclusion that, by maintaining in force Article 3a(2)-(6) of the of the Ground Resources Act and 16(2)-(6) of the Water Act, Iceland has failed to comply with its obligations arising from Article 31 of the EEA Agreement.

(133) The Authority requested Iceland to take the measures necessary to comply with the reasoned opinion. The Authority has not been informed that this is the case. By letter dated 5 October 2015, the Authority enquired further about the state of play.⁷⁹ On 11 November 2015, the Icelandic authorities replied and informed the Authority that a working group had been established in order to address the reasoned opinion.⁸⁰ The working group was to deliver a report and draft a legislative proposal aimed at addressing the legal concerns raised in the reasoned opinion.

(134) By email dated 2 February 2016, the Icelandic authorities submitted to the Authority draft amendments to the Water Act and the Ground Resources Act. The amendments *inter alia* set out more transparent procedures for granting licenses and stipulate that licence periods shall be appropriate and decided on a case by case basis. Moreover, the amendments provide that the relevant minister is entitled to set out in a regulation the minimum requirements which should be included in agreements for temporary utilisation of natural resources, such

⁷⁹ Document No 775102.

⁸⁰ Document No 780858.

as how to determine remuneration. However, the Authority has not been informed of any draft regulation in this regard and to date it is unclear whether the legal amendments will be approved by the Icelandic Parliament.

4. Proposal for appropriate measures

- (135) For the above mentioned reasons, the Authority considers that the measures at issue constitute an incompatible existing scheme of state aid that should accordingly be abolished by way of appropriate measures.
- (136) The Authority considers that the following set of measures would qualify as appropriate means to ensure that no aid is granted in the future when natural resources are transferred to electricity producers:
1. to ensure that there is a legally binding obligation on all emanations of the Icelandic State (*i.e.* in particular on the central government, municipalities and publicly owned companies), that any transfer of rights to utilise public land, state owned land and their natural resources (public natural resources) for electricity generation takes place on market terms and that consequently any such transfer of rights is made conditional upon adequate remuneration to be paid;
 2. to ensure that all operators, regardless of whether they are state owned or not, receive equal treatment as regards the adequate remuneration for the use of public natural resources for electricity generation;
 3. to ensure that a clear and transparent methodology to set the price for the right to utilise public natural resources for electricity generation is established; and
 4. to review all existing contracts to ensure that the companies pay an adequate remuneration for the remainder of those contracts.
- (137) The Icelandic authorities shall implement the relevant measures and discontinue the aid as soon as possible and in any event not later than 1 January 2017.
- (138) The Icelandic authorities are invited to inform the Authority in writing that Iceland accepts, pursuant to Article 19(1) of Part II of Protocol 3, unconditionally and unequivocally this proposal for appropriate measures in its entirety within one month from the receipt of this proposal, otherwise the Authority will proceed in accordance with the rules laid down in Article 19(2) of Part II of Protocol 3.

HAS ADOPTED THIS DECISION:

Article 1

The practice by the Icelandic authorities of granting undertakings generating electricity concessions for the use of public land, state owned land and their natural resources without there being a clear legal requirement to pay a market-based remuneration and without any precise criteria for determining the market price based on a transparent methodology, constitutes an existing state aid scheme that is incompatible with the functioning of the EEA Agreement.

Article 2

Pursuant to Article 1(1) of Part I and Article 18 of Part II of Protocol 3, the Icelandic authorities are recommended to take legislative, administrative and other measures, in accordance with paragraph (136) to (137) of this Decision, in order to eliminate with effect from 1 January 2017 any incompatible aid resulting from the measures covered by this Decision.

Article 3

The Icelandic authorities are invited to accept this proposal for appropriate measures, pursuant to Article 19(1) of Part II of Protocol 3, and to provide their answer within one month of receipt of this proposal

Article 4

This Decision is addressed to Iceland.

Article 5

Only the English language version of this decision is authentic.

Done in Brussels, on 20 April 2016

For the EFTA Surveillance Authority

Sven Erik Svedman
President

Frank J. Büchel
College Member

Placeholder for digital signature. Please do not delete.