Zaproszenie do zgłaszania uwag zgodnie z art. 1 ust. 2 części I protokołu 3 do Porozumienia o nadzorze i trybunale w sprawie Islandzkiego Funduszu Finansowania Mieszkalnictwa (Icelandic Housing Financing Fund — HFF)

(2006/C 314/13)

Na mocy decyzji 185/06/COL z dnia 21 czerwca 2006 r., zamieszczonej po niniejszym streszczeniu w języku oryginału, Urząd Nadzoru EFTA rozpoczął postępowanie zgodnie z art. 1 ust. 2 część I protokołu 3 do Porozumienia pomiędzy Państwami EFTA w sprawie ustanowienia Urzędu Nadzoru i Trybunału Sprawiedliwości (Porozumienia o nadzorze i trybunale). Rząd Islandii został poinformowany — otrzymał egzemplarz wymienionej decyzji.

Urząd Nadzoru EFTA wzywa niniejszym państwa EFTA, państwa członkowskie UE i zainteresowane strony do zgłaszania uwag w sprawie omawianego środka w ciągu jednego miesiąca od publikacji niniejszego zawiadomienia na poniższy adres Urzędu Nadzoru EFTA w Brukseli:

EFTA Surveillance Authority
Rue Belliard, 35
B-1040 Brussels

Wymienione uwagi zostaną przekazane rządowi Islandii. Zainteresowane strony zgłaszające uwagi mogą wystąpić z odpowiednio umotywowanym pisemnym wnioskiem o objęcie ich tożsamości klauzulą poufności.

Streszczenie

Okoliczności

Dnia 11 sierpnia 2004 r. Urząd Nadzoru EFTA przyjął decyzję nr 213/04/COL ([1]). W decyzji tej Urząd stwierdził, że zgodnie z art. 59 ust.2 Porozumienia EOG Islandzki Fundusz Finansowania Mieszkalnictwa (HFF) jest zgodny z zasadami dotyczącymi pomocy państwa.

HFF jest instytucją w całości należącą do państwa islandzkiego, udzielającą osobom rezydującym w Islandii zabezpieczonych kredytem hipotecznym pożyczek na cele mieszkaniowe. Urząd uznał, że HFF otrzymał od państwa islandzkiego pomoc w rozumieniu art. 61 ust. 1 Porozumienia EOG na działalność związaną z finansowaniem i prowadzeniem systemu udzielania pożyczek. Ponadto Urząd uznał, że system HFF ustanowiony w 1999 r. stanowił „nową pomoc", nielegalną ze względów proceduralnych, która przed udzieleniem powinna była zostać zgłoszona Urzędowi i zatwierdzona zgodnie z art. 1 ust. 3 części I Protokołu 3 Porozumienia o nadzorze i trybunale.

Jednakże Urząd doszedł do wniosku, że usługi świadczone przez HFF mogą zostać uznane za „usługi świadczone w ogólnym interesie gospodarczym" w rozumieniu art. 59 ust. 2 Porozumienia EOG. Wniosek ten oparty został na założeniu, że HFF jest zobowiązany do udostępniania środków na cele mieszkaniowe po korzystnych cenach i na takich samych warunkach na całym terytorium Islandii, bez względu na rentowność poszczególnych operacji. Zdaniem Urzędu HFF świadczył usługi niedostępne na rynku prywatnym w Islandii. Dlatego też po wstępnej ocenie Urząd podjął decyzję o zatwierdzeniu systemu HFF bez inicjowania formalnego postępowania wyjaśniającego zgodnie z art. 1 ust. 2 części I protokołu 3 Porozumienia o nadzorze i trybunale.

Decyzja ta została zaskarżona przed Trybunałem EFTA na wniosek Islandzkiego Stowarzyszenia Bankierów i Maklerów Giełdowych. Skarga o unieważnienie oparta została między innymi na twierdzeniu, że HFF nie świadczy usług w ogólnym interesie gospodarczym, ponieważ banki prywatne oferują środki na cele mieszkaniowe na podobnych warunkach. Derogacja zawarta w art. 59 ust. 2 Porozumienia EOG nie mogła być zatem zastosowana na korzyść HFF. Ponadto poniesiono argument, że Urząd powinien był wszcząć formalne postępowanie wyjaśniające, ponieważ uznanie działalności HFF za zgodne z art. 59 ust. 2 Porozumienia EOG nastręczało trudności.

([1]) Arkusz informacyjny dotyczący tej decyzji został opublikowany w Dz.U. 2005 C 112, str. 8. Zawiera on odsyłacz do strony internetowej Urzędu Nadzoru EFTA, na której zamieszczony został pełny tekst decyzji, nie zawierający informacji poufnych: www.eftasurv.int/fieldof work/fieldstateaid/stateaidregistry/

Orzeczenie Trybunału EFTA z dnia 7 kwietnia 2006 r. w sprawie E-9/04

Trybunał EFTA podtrzymał wniosek ([1]). Zgodnie z opinią Trybunału EFTA przedmiotowa pomoc państwa budziła „wątpliwości … co do zgodności z funkcjonowaniem Porozumienia EOG", które nie zostały rozstrzygnięte w ramach wstępnej oceny. Tym samym przed podjęciem decyzji Urząd miał obowiązek wszczęcia formalnego postępowania wyjaśniającego zgodnie z art. 1 ust. 2 części I Protokołu 3 Porozumienia o nadzorze i trybunale. Ponieważ nie doszło do wszczęcia formalnego postępowania wyjaśniającego, Trybunał EFTA unieważnił decyzję Urzędu.

W kwestii zastosowania art. 59 ust. 2 Porozumienia EOG Trybunał uznał, że usługi mające na celu udzielanie pożyczek przez HFF mogą być uznane za usługi świadczone w ogólnym interesie gospodarczym, co stanowi uzasadnienie dla przyznania pomocy państwa. Jednak pewne charakterystyczne cechy systemu wzbudziły wątpliwości co do jego zgodności z funkcjonowaniem Porozumienia EOG. System udzielania pożyczek nie był ograniczony do udzielania pożyczek na budowę lub zakup mieszkań spełniających konkretne kryteria co do wielkości czy wartości. System udzielania pożyczek nie był też ograniczony do pomocy kredytobiorcom przy finansowaniu ich własnych mieszkań. Trybunał EFTA uznał również, że istnieją wątpliwości co do określenia odnośnego rynku na potrzeby oceny, czy system udzielania pożyczek naruszałby rozwój handlu w zakresie pozostającym w sprzeczności z interesami Umawiających się Stron w rozumieniu art. 59 ust. 2 Porozumienia EOG.

Konsekwencje orzeczenia

Celem niniejszej decyzji o rozpoczęciu postępowania jest wykonanie postanowień orzeczenia Trybunału EFTA i zaproszenie zainteresowanych stron do zgłaszania uwag mogących przyczynić się do wyjaśnienia, czy usługi świadczone przez HFF są zgodne z warunkami zawartymi w art. 59 ust. 2 Porozumienia EOG.

EFTA SURVEILLANCE AUTHORITY DECISION

No 185/06/COL

of 21 June 2006

to initiate the formal investigation procedure provided for in Article 1(2) in Part I of Protocol 3 to the Surveillance and Court Agreement with regard to the Icelandic Housing Financing Fund

(Iceland)

THE EFTA SURVEILLANCE AUTHORITY,

HAVING REGARD TO the Agreement on the European Economic Area ([1]), in particular to Articles 59, 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 ([2]), in particular to Article 24 and Protocol 3 thereof,

HAVING REGARD TO the EFTA Surveillance Authority's Decision No 213/04/COL of 11 August 2004 concerning the Icelandic Housing Financing Fund and an increase of lending by that fund up to 90 % of the purchase price of housing ([3]),

HAVING REGARD TO the judgment of the EFTA Court dated 7 April 2006 in Case E-9/04 concerning an application for annulment of Decision No 213/04/COL regarding the Icelandic Housing Financing Fund ([4]),

([1]) Orzeczenie z dnia 7 kwietnia 2006 r., sprawa nr E-9/04 Islandzkie Stowarzyszenie Bankierów i Maklerów Giełdowych przeciwko Urzędowi Nadzoru EFTA [2006] Raport Trybunały EFTA (dotychczas nieopublikowany). Orzeczenie jest dostępne na stronie internetowej Trybunału EFTA: www.eftacourt.lu

([1]) Hereinafter referred to as 'the EEA Agreement'.

([2]) Hereinafter referred to as 'the Surveillance and Court Agreement'.

([3]) The cartouche of this Decision is published in OJ 2005 C 112, page 8. The cartouche makes reference to the EFTA Surveillance Authority's website, where the non-confidential full text of the Decision is available: www.eftasurv.int/fieldof work/fieldstateaid/stateaidregistry/

([4]) Judgment of 7 April 2006, Case E-9/04 *The Bankers' and Securities' Dealers Association of Iceland* v *EFTA Surveillance Authority* [2006] EFTA Court Report (not yet reported). The judgment is available at the EFTA Court's website: www.eftacourt.lu

HAVING REGARD TO the Authority's Guidelines ([1]) on the application and interpretation of Articles 61 and 62 of the EEA Agreement, and in particular Chapter 18C on 'State aid in the form of public service compensation',

WHEREAS:

I. **FACTS**

1. **Introduction**

On 11 August 2004, the EFTA Surveillance Authority (hereinafter referred to as 'the Authority') adopted Decision No 213/04/COL. In this Decision the Authority declared, according to Article 59(2) of the EEA Agreement, the Icelandic Housing Financing Fund (*Íbúðalánasjóður*) to be compatible with the State aid rules.

The Icelandic Housing Financing Fund (hereinafter referred to as 'the HFF' or 'the HFF system'), an institution wholly owned by the Icelandic State, provides mortgage-secured housing loans to residents in Iceland. The Authority found that in funding and operating its loan system, the HFF received State aid from the Icelandic State within the meaning of Article 61(1) of the EEA Agreement. Furthermore, the Authority found that the HFF system, established in 1999, constituted 'new aid', unlawful on procedural grounds, which should have been notified to and approved by the Authority pursuant to Article 1(3) in Part I of Protocol 3 to the Surveillance and Court Agreement, prior to putting it into effect.

Nevertheless, the Authority concluded that the service provided for by the HFF could be qualified as a 'service of general economic interest', in the meaning of Article 59(2) of the EEA Agreement. This conclusion was based on the premise that the HFF was obliged to provide house financing at affordable rates and on equal conditions throughout the entire Icelandic territory, irrespective of the profitability of individual operations. In the Authority's view, the HFF offered a service which was not available on the private market in Iceland. Therefore, the Authority decided to approve the HFF system, by means of a preliminary examination, without opening the so-called formal investigation procedure provided for in Article 1(2) in Part I of Protocol 3 to the Surveillance and Court Agreement.

This Decision was challenged before the EFTA Court by an application of the Bankers' and Securities' Dealers Association of Iceland. The annulment action was, *inter alia*, based on the plea that the HFF did not provide a service of general economic interest, since the private banks offered house financing at comparable conditions. The HFF could therefore not profit from the derogation in Article 59(2) of the EEA Agreement. It was further argued that because of the difficulty to declare the HFF compatible with Article 59(2) of the EEA Agreement, the Authority should have opened the formal investigation procedure.

The EFTA Court sustained the application. In the opinion of the EFTA Court, the State aid scheme in question had raised 'doubts … as to the compatibility with the functioning of the EEA Agreement', doubts which had not been overcome by means of the preliminary examination. Hence, the Authority was under an obligation to initiate a formal investigation procedure as provided for under Article 1(2) in Part I of Protocol 3 to the Surveillance and Court Agreement, before making a decision. This was not done and, for that reason, the EFTA Court annulled the Authority's Decision.

With regard to the application of Article 59(2) of the EEA Agreement, the Court found that a service with the objectives of the HFF's loan scheme may qualify as a service of general economic interest justifying State aid. However, certain specific features of the scheme gave rise to doubts as to the compatibility with the functioning of the EEA Agreement. The loan scheme was not limited to providing loans for the construction or purchase of dwellings that fulfilled any particular criteria as to size or value. Neither was the lending scheme limited to assisting the borrowers in financing their own dwellings. The EFTA Court also found that there were doubts as to the identification of the relevant product market for the assessment of whether the lending scheme would affect the development of trade contrary to the interest of the Contracting Parties to the EEA Agreement, in the meaning of Article 59(2) of the EEA Agreement.

The purpose of this opening Decision is to follow the EFTA Court's judgment and to call upon the parties concerned to submit their comments, in order to clarify whether the services provided by the HFF comply with the conditions laid down in Article 59(2) of the EEA Agreement.

([1]) Procedural and Substantive Rules in the Field of State Aid (hereinafter referred to as the 'State Aid Guidelines'), adopted and issued by the Authority on 19 January 1994, published in OJ 1994 L 231. The State Aid Guidelines are available on the Authority's website: www.eftasurv.int

2. The administrative procedure and developments leading up to the EFTA Court's judgment of 7 April 2006

By letter of 20 November 2003 from the Icelandic Mission to the EU, forwarding a letter from the Icelandic Ministry of Finance dated the same date, both received and registered by the Authority on 25 November 2003 (Doc No: 03-8227 A, now Event No: 255584), the Icelandic Government notified, pursuant to Article 1(3) in Part I of Protocol 3 to the Surveillance and Court Agreement, an increase of lending by the HFF up to 90 % of the purchase price of housing.

According to Article 5(1) in Part II of Protocol 3 to the Surveillance and Court Agreement, the Competition and State Aid Directorate sent a letter dated 23 January 2004 (Event No: 184357), requesting additional information from the Icelandic Government. By letter of 11 March 2004 from the Icelandic mission to the EU, forwarding a letter from the Icelandic Ministry of Finance dated the same date, both received and registered by the Authority on 12 March 2004 (Event No: 259197), the Ministry of Finance replied to the request for additional information. Attachments to the letter of 11 March 2004 were forwarded separately by the Icelandic Mission to the EU on 18 March 2004, received and registered by the Authority on the same day (Event No: 259976).

By letter dated 23 April 2004, received and registered by the Authority on 27 April 2004 (Event No: 279495), the Bankers' and Securities Dealers' Association of Iceland (hereinafter referred to as 'SBV') lodged a complaint with the Authority, alleging that the '… *current legislation in Iceland on the operation of the State Housing Financing Fund is incompatible with the EEA Agreement, in particular the competition rules, the rules on State aid, free movement of services, capital and the freedom of establishment of the EEA Agreement*'. As a consequence of this complaint, the Authority opened two additional cases, to the already existing State aid case, which dealt separately with the alleged infringements of the competition rules and the rules on the four freedoms.

Based on Article 5(1) in Part II of Protocol 3 to the Surveillance and Court Agreement, the Competition and State Aid Directorate sent a letter dated 14 May 2004 (Event No: 280306) to the Icelandic Government requesting, for a second time, information and clarification, and forwarded by that letter with the consent of SBV, a copy of the complaint.

The notification was discussed between representatives of the Icelandic Ministries of Finance and Social Affairs, the HFF and the Authority during the State aid package meeting in Reykjavik on 26 May 2004. By letter of 10 June 2004 from the Icelandic Mission to the EU, forwarding a letter from the Icelandic Ministry of Finance dated the same date, both received and registered by the Authority on 11 June 2004 (Event No: 284350), the Ministry of Finance replied to the second request for information.

On the request of SBV, a meeting took place in Brussels on 14 June 2004 between representatives of SBV and the Authority, to discuss the complaint.

By letter of 23 June 2004 (Event No: 284459), the Authority informed SBV that it saw no reason to take further action on the complaint with regard to the alleged abuse of the dominant position of the HFF. Therefore, the Authority indicated that it was inclined to close the case, unless SBV would submit further information or arguments within two weeks from the receipt of the letter. SBV did not react to the letter.

On 1 July 2004, the Icelandic Mission to the EU forwarded a letter from the Icelandic Ministry of Finance dated 30 June 2004, received and registered by the Authority on 1 July 2004 (Event No: 286392), in which the Icelandic Government provided outstanding information in response to the Authority's second information request.

By letter of 1 July 2004 (Event No: 285198), the Authority informed SBV that it had not been able to detect any incompatibility of the HFF system with the four freedoms. SBV was informed that the case was proposed to be closed and was invited to submit its comments at the latest by 12 July 2004. SBV did not react to the letter.

The Authority received an email from the Department of Local Government in the Ministry of Social Affairs on 7 July 2004, registered by the Authority on 8 July 2004 (Event No: 287125), by which the Icelandic Government forwarded the following laws: Act No 57/2004, amending the Housing Act No 44/1998; Regulation No 544/2004 on '*the Finances and Risk Management of the Housing Financing Fund*'; Regulation No 522/2004 on '*HFF Mortgages and HFF Bonds*'; Regulation No 521/2004 on '*Loan Proportions and Maximum Amounts of HFF Mortgages*' [1]. By the same email the Icelandic Government also provided a document on the HFF's Funding and Risk Policy elaborated by a financial consultant.

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[1] The Icelandic Government provided English translations of these laws. Quotes from these laws in this decision are based on the translation provided by the Icelandic Government.

Supplementary information and explanations concerning the above mentioned laws, the document on the HFF's Funding and Risk Policy, and certain other issues were sent by fax from the Icelandic Ministry of Social Affairs dated 8 July 2004, forwarded to the Authority by letter of 9 July 2004 from the Icelandic Mission to the EU, received and registered by the Authority on the same day (Event No: 287337).

In light of the Authority's assessment of the raised competition issues and SBV's inactivity, the Authority decided to close the case and informed SBV of this closure by letter of 27 July 2004 (Event No: 288068).

On 11 August 2004, the Authority adopted Decision No 213/04/COL approving the HFF system and declaring it compatible with Article 59(2) of the EEA Agreement ([1]).

By letter dated 23 August 2004 (Event No: 289467), the Authority informed SBV that it had closed the case with regard to the alleged violation of the four freedoms.

By letter dated 15 September 2004 (Event No: 292140), the Authority informed SBV of Decision No 213/04/COL and attached, to this end, a copy of the decision.

By an application lodged at the Registry of the EFTA Court on 23 November 2004, SBV brought an action under Article 36 of the Surveillance and Court Agreement for annulment of the Authority's Decision No 213/04/COL.

On 7 April 2006, the EFTA Court rendered its judgment in the case and annulled the Authority's Decision No 213/04/COL (hereinafter referred to as the 'annulled Decision') ([2]).

3. **The HFF system**

3.3. *Background*

In 1955, a basis for State involvement, both as regards policy making in the field of housing affairs and the provision of loans for private housing, was laid. Later the State Housing Agency (*Húsnæðisstofnun ríkisins*) was established by Act No 51/1980 and provided, *inter alia*, loans on preferential terms to private home buyers.

In 1986 Icelandic Government assistance to private home-ownership was tied to access to pension funds, with the pension funds being required to provide partial funding for the system. The Icelandic banks generally did not provide funding for private housing. At this time, the State Housing Agency issued housing loans at affordable rates. This led to a substantial increase in demand, which in turn stretched the resources of the pension funds beyond their limits. To remedy the situation and in order to generate more financial resources to finance housing, a Housing Bond system was introduced in 1989. The Housing Bond system generated funding for the provision of housing loans. The issuing of Housing Bonds and the operation of the system were entrusted to the State Housing Agency.

The Housing Bond system was not a traditional mortgage loan system, but a bond swap system, meaning that homebuyers applied to the HFF to issue a mortgage bond, which was secured against the property to be bought. The State Housing Agency then bought this bond from the homebuyer and paid for it by issuing a Housing Bond to the seller. This Housing Bond could then be freely traded in the securities market. The seller could sell the Housing Bond on the securities market, use it as means of payment or keep it.

The Housing Bonds had maximum loan periods of 40 years but were subject to prepayment without penalty. They were linked to the consumer price index and carried a fixed real interest of 4,75 %. The Housing Bonds were secured by all the assets of the State Housing Agency, which consisted primarily of the collateral (mortgage-secured bonds) that the Agency held in property. In addition, the Housing Bonds carried an implicit State guarantee, due to the State ownership of the State Housing Agency.

([1]) The cartouche of this Decision is published in OJ 2005 C 112, page 8. The cartouche makes reference to the EFTA Surveillance Authority's website, where the non-confidential full text of the Decision is available: www.eftasurv.int/fieldof work/fieldstateaid/stateaidregistry/.

([2]) Judgment of 7 April 2006, Case E-9/04, cited above.

The mortgage bonds had the same loan terms as the Housing Bonds, but with a fixed interest surcharge of 0,35 percentage points, to cover operational costs and expected losses on loans. This meant that the lending rate under the Housing Bond system was set at 5,10 % in real terms.

3.2. *The Act on Housing Affairs No 44/1998*

On 1 January 1999, the Act on Housing Affairs No 44/1998 (hereinafter referred to as 'the Housing Act') entered into force ([1]).

The Housing Act established and governed the HFF ([2]). The HFF was entrusted with the management and implementation of housing affairs under the Housing Act. The previous State Housing system was repealed ([3]) and the HFF took over all assets and obligations of the State Housing Agency ([4]), including the tasks of issuing Housing Bonds and providing housing loans through the bond-swap system. The HFF is a separate State-owned institution subject to special management. The State carries full liability for all obligations undertaken by the HFF. Organisationally, the HFF is accountable to the Minister of Social Affairs, who appoints its Board of Directors in accordance with Article 7 of the Housing Act.

According to Article 1 of the Housing Act, it is the purpose of this Act '… *to promote, through the granting of loans and the organisation of housing affairs, the ability of Icelanders to live with security and equal rights in housing affairs along with the special allocation of funds to increase people's chances of acquiring or renting housing on manageable terms*'.

The Housing Act was amended, *inter alia*, by Act No 57/2004, which entered into force on 1 July 2004. A number of changes were made to the housing loan system. These changes comprised, *inter alia*, the abolition of the system of swapping mortgage bonds for Housing Bonds. After 1 July 2004, loans have been paid out in cash to home buyers and secured by mortgages in the property under purchase.

At the time the Authority adopted the annulled Decision, the HFF provided the following three loan categories:

— General loans to individuals for the purchase, renovation or construction of residential housing.

— Additional loans to individuals with low income and limited assets for the construction or purchase of their own residential housing. The additional loans were, however, later abolished by Act No 120/2004, which entered into force on 3 December 2004.

— Loans for rental housing to municipalities, associations and companies for the construction or purchase of residential housing to be rented out.

3.2.1. ***General Loans***

The conditions for general loans are established in Chapter VI of the Housing Act. The general loans are available on equal terms to all residents in Iceland, regardless of nationality, on the conditions laid down in and pursuant to the Housing Act. The loans are not limited to persons with income below a certain income bracket or with limited assets.

Before a general loan is paid out, the borrower must issue a borrower's mortgage instrument as a security as stated in Article 19(1) of the Housing Act. Article 19(2) of the Housing Act and Articles 2 and 3 of Regulation No 521/2004 on 'Loan Proportions and Maximum Amounts of Borrowers' Mortgages' set out maximum amounts for general loans in percentage of the value of the housing and in absolute figures.

According to Article 19(2) of the Housing Act, prior to 1 July 2004, a mortgage bond was exchanged for a Housing Bond for an amount up to 70 % of a dwelling's appraised value if the applicant was buying or building his first dwelling, but otherwise for up to 65 % of the dwelling's appraised market value (the 'relative lending cap'). The loans were also limited in relation to the fire insurance value, which was often lower than the market value. The relative lending cap has later been raised to 90 % with Act No 120/2004, amending the Housing Act, which entered into force on 3 December 2004.

([1]) The Housing Act was amended by Act No 57/2004. Act No 57/2004 entered into force on 1 July 2004, except for Temporary Provision I, which entered into effect immediately (see Article 22 of Act No 57/2004).

([2]) As amended, and various regulations, *inter alia*, Regulation No 544/2004 on 'the Financing and Risk Management of the Housing Financing Fund', Regulation No 522/2004 on 'Borrowers' Mortgages and HFF Bonds' and Regulation No 521/2004 on 'Loan Proportions and Maximum Amounts of Borrowers' Mortgages'.

([3]) Section XII of the Housing Act. For example, according to Article 52 of the Housing Act, Act. No 97/1993 on the State Housing Board was repealed.

([4]) Article 53 of the Housing Act merged the State Housing Fund and the Workers' Building Fund and transferred the rights, assets, liabilities and obligations of these two funds to the HFF.

In addition to the relative lending cap, the Housing Act, both under the bond-swap system and after the amendments of 1 July 2004, states that a maximum lending cap is to be specified in regulations (the 'absolute lending cap'). As specified in Regulation No 521/2004, which entered into force on 1 July 2004, the absolute lending cap was ISK 9,7 million for new housing and ISK 9,2 million for existing housing. Regulation No 959/2004 replaced Regulation No 521/2004 on 6 December 2004 and the absolute lending cap was raised to ISK 14,9 million (subsequently increased to ISK 15,9 million and later to ISK 18 million) for both new and existing housing.

With the entry into force of Regulation No 522/2004 on 1 July 2004, a limit was set of two dwellings for each borrower financed through HFF general loans. In exceptional circumstances, a loan for a third dwelling could be authorised, but it would be up to the Board of Directors to define the precise conditions for such an exception.

3.2.2. ***Additional Loans and Loans for rental housing***

Prior to the amendments of 1 July 2004, additional loans and loans for rental housing were not financed through Housing Bonds, but through a separate class of bonds issued by the HFF. As of 1 July 2004, the HFF stopped issuing both separate class of bonds and the Housing Bonds. The main means of funding the HFF became the HFF bonds. Unlike the Housing Bonds, which were subject to prepayment without penalty, the HFF bonds are non-callable. As for the loans from the HFF which are still subject to prepayment without penalty, the interest surcharge paid by borrowers was increased from 0,35 to 0,6 percentage points as of 1 July 2004, in order to take account of the new risk created by the mismatch in optionality between assets and liabilities. However, as the HFF bonds are issued in classes with varying interest rates depending on the market situation, the interest rates charged to HFF borrowers fluctuate.

3.3. *The financing mechanism*

The HFF financed its tasks with the income from the fund's equity capital (i.e. the payments, interest and indexation of granted loans), by issuing Housing Bonds and by the sale of Housing Authority Bonds and the taking of loans ([1]).

The HFF's management of its assets and liabilities is described in Article 11 of the Housing Act. The HFF must always have adequate liquid funds to honour its obligations. Furthermore, it has to keep its revenues and expenses in balance and must establish a risk management system. Further requirements concerning risk management are set out in Articles 6 and 7 of Regulation No 544/2004 on 'the Financing and Risk Management of the Housing Financing Fund', according to which the HFF must, *inter alia*, keep its equity ratio over 5 % and provide quarterly reports on the progress of its risk management policy and key figures in operation to the Minister of Social Affairs and the Financial Supervisory Authority.

In case of unexpected difficulties such as illness, accident, loss of employment or comparable situations, the HFF may extend refinancing loans for up to 15 years in order to address temporary payment difficulties experienced by borrowers according to Article 48(1) of the Housing Act. The HFF is further authorised to freeze payments from borrowers for up to three years and add the payments due during that period to the debt proper, if this is considered likely to prevent payment difficulties as stated in Article 48(2) of the Housing Act.

According to Articles 2 and 3 of Regulation No 119/2003 on 'Treatment of claims by the Housing Financing Fund that are without Collateral', the HFF shall not make claims against borrowers individually if a house or apartment which stands as a security for a HFF loan is sold or auctioned as a part of collection proceedings and the price does not cover the claim of the HFF. The remaining debt does not accumulate interest and is not subject to index linkage. If the borrower wants to obtain a new loan from the HFF during a period of 5 years after the sale or the auction, he/she can pay up the remaining debt by paying half the nominal amount, upon which the HFF is authorised to write off the other half according to Article 5. As stated in Article 6, five years after an apartment or a house is sold or auctioned as a part of collection proceedings, the HFF can write off the remaining debt if the borrower shows himself/herself unable to pay.

With regard to the HFF's more detailed financial figures, the Authority's annulled Decision was based on the following information, which was submitted by the Icelandic Government in the initial notification:

([1]) The above wording reflects the situation prior to 1 July 2004, i.e. prior to the entering into force of Act No 57/2004. Article 10 of the Housing Act was amended by Article 4 of Act No 57/2004. According to this amendment, the HFF finances its tasks with the income from the fund's equity capital (i.e. the payments, interest and indexation of granted loans), by issue and sale of HFF bonds and by borrowing as provided for in the Budget Act at any particular time and by service charges as provided for in Article 49.

— **Housing Bonds**

As described above, the lending rate under the Housing Bond system was set at 5,10 % in real terms. According to the Icelandic Government, the margin of 0,35 percentage points was supposed to cover operational costs, losses on loans and to ensure a certain return on the HFF's capital. The Housing Bonds carried an implicit State guarantee, due to the State ownership of the HFF. The HFF was not subject to a State guarantee fee under Article 7 of Act No 121/1997 on State Guarantees.

— **Housing Authority Bonds**

Housing Authority Bonds were bonds issued in the name of the HFF, which the fund sold on the general market to raise capital for its operations (i.e. to finance the HFF's other loan categories, see above). Housing Authority Bonds were indexed through the Consumer Price Index and carried a fixed real interest of 2,7 %. The loan periods of the Housing Authority Bonds were 24 or 42 years. The HFF charged a commission of 0,35 percentage points on the loan, which was the same as in the case of the Housing Bonds.

— **Losses on loans**

According to the Icelandic Government, since the HFF's general policy was to provide loans to everyone everywhere, given some basic conditions, one could expect that the HFF would be vulnerable to losses on loans. In order to cover losses on loans, the HFF reserved some provisions every year. Loan-loss provision as a percentage of total loans has been quite stable around 0,20 %. For example, actual losses were 0,29 % in 2001 and 0,10 % in 2002.

— **Salary and administrative expenses**

The Icelandic Government submitted that salaries and administrative expenses of the HFF were ISK 617 million in 1999 and increased to ISK 742 million in 2002. These were the total salary and administrative costs for the whole HFF and all its functions, not only the lending operations.

— **Direct interest support**

The HFF received some interest support from the State to cover obligations resulting from lending below market rates at 3,5 % and 4,5 % for rented housing for low income families. The support varied through the years and was ISK 9 million in 2001 and 71 million in 2002.

— **Tax exemptions**

The HFF does not pay any corporate tax or property tax. The Icelandic Government submitted that the HFF did not pay what would have amounted to ISK 335 million in corporate tax and 417 million ISK in property tax for the years 1999 to 2002. According to the Icelandic Government, these advantages were used to strengthen the HFF's equity and provide for losses. The Icelandic Government stated that the foregone tax revenue had to be weighted against the need for the HFF to cover losses amounting to ISK 1 715 million for the same period.

— **Profits and dividends**

The HFF is charged with preserving and earning a return on the funds it supervises (Article 11 of the Housing Act) ([1]). The Icelandic Government stated that the HFF did not pay any dividends to its owners. The return was solely intended to sustain the HFF's lending operations and cover losses on loans.

— **Other aspects**

It was not foreseen that the Icelandic Government provided funds for the operation of the Housing Bond system. Furthermore, the Icelandic Government argued that the HFF was not a credit institution and therefore not subject to the rules of a 'regular credit institution' with regard to capital adequacy requirements and minimum solvency ratios.

([1]) This is the wording prior to 1 July 2004. After that date Article 5 of Act No 57/2004 amended Article 11 of the Housing Act and, *inter alia*, changed the title of that Article to: *Management of Assets and Liabilities* (this translation has been provided by the Icelandic Government).

— **HFF's key financial figures**

The HFF's key financial figures for the years 1999 to 2002 were as follows:

TABLE 1

HFF's key financial figures

	1999	2000	2001	2002
Net operating income before loss provisions	859	1 031	278	2 009
Loss provisions	592	563	652	748
Operating profit/loss	267	468	-374	1 261
Actual losses on loans	258	48	1 022	387
Total assets	279 187	311 036	362 262	401 722
Loans	264 952	298 694	355 569	392 926
Equity	7 560	8 353	8 684	9 946
Equity in % of total assets	2,71 %	2,69 %	2,40 %	2,48 %
Return on equity	3,53 %	5,60 %	-4,31 %	12,68 %

Numbers in ISK 1 000
Source: Central Bank of Iceland and HFF's Annual Reports 1999 — 2002

— **Some of the changes introduced in 2004**

The Icelandic Government submitted that the lending rate of the HFF, as of 1 July 2004, was decided on the basis of the HFF's net capital costs. According to Article 13 of Regulation No 522/2004, the rate was determined in the following manner:

'HFF mortgages shall be price-indexed by the Consumer Price Index calculated and published by Statistics Iceland as provided for in Article 1 of the Consumer Price Index Act, No 12/1995. The board of the Housing Financing Fund shall determine the interest rate of HFF mortgages with a view to the costs of financing in regular issues of HFF bonds and financing costs due to loans paid up, plus interest additions, cf. Article 3' [1].

The Icelandic Government also pointed out that, in principle, the HFF is required to operate at a pre-determined profit margin. However, this profit margin does not aim to create a dividend for the HFF's owner, as that is not allowed by law, but rather to create and maintain a 'safety net' in order to ensure that the HFF will be able to honour its obligations. The HFF's capital adequacy ratio (CAD) was around 5 % and therefore did not constitute a change in the HFF operation or its business strategy.

4. Icelandic market for house financing and possible trade effects

4.1. *Situation before August 2004*

The Icelandic market for mortgage loans was largely divided between three main actors. These were the HFF (previously the State Housing Agency), the pension funds and other private credit institutions. Between 1997 and 2003, the State Housing system had a market share of about 77,5 % to 79 %. The rest was shared between the pension funds (approximately 13 % to 17 %) and the commercial banks and savings banks (approximately 4,5 % to 8 %). The banks did, however, provide certain services for the HFF, such as being the sole agents for evaluating borrowers for the HFF. Until a process of privatisation was completed in 2002 — 2003, most of the commercial banks were controlled by the State as majority shareholder.

The Icelandic Government stated that private banks almost exclusively restricted lending for housing purchases to property around the Reykjavik area. The Icelandic Government stressed that the HFF is the only lender which offered loans on equal terms which are universally accessible throughout the Icelandic territory. When lending is broken down by geographic areas the trend shows that the further one moves outside of Reykjavik the higher the proportion of the HFF lending gets.

[1] This translation was provided by the Icelandic Government.

SBV has submitted some documentation during the EFTA Court proceedings, which, in SBV's opinion, demonstrated that the commercial banks have granted affordable loans outside the Reykjavik area during the period between 1999 and August 2004.

As regards the financial institutions' interest rates charged on loans, the Icelandic Government provided in the initial notification lending rates of banks and pension funds for the years 1999 to 2003, which showed an average lending rate in real terms of approximately 7,4 %.

The Icelandic Government further presented, in the initial notification, average funding rates by financial institutions in the Icelandic housing finance market for the years 1999 to 2003. The information showed average funding rates for banks (real interest rates) of 6,43 %, for pension funds of 3,50 % and for the HFF of 4,75 %.

According to information submitted by SBV, all commercial banks in Iceland, savings banks, pension funds and some mortgage companies offered long-term housing loans to the public. According to SBV, these loans carried a real interest rate of between 5,9 % and 7,9 % depending on the security.

According to the Icelandic Government, the housing loan market for individuals is by its nature a local market and does 'normally' not involve any direct cross-border transactions. The Icelandic Government stressed that no foreign banks are granting mortgage loans in ISK to Icelandic households. Furthermore, it was stated, in the initial notification, that there were currently no foreign financial institutions or representative offices of foreign financial institutions in Iceland. It was moreover pointed out that the Icelandic economy was very limited in size. The limited number and small size of transactions in trade in the foreign exchange markets of the ISK did not warrant interest from foreign banks. The special geography and the scattered population outside Reykjavik further reduced the foreign interest for lending to the Icelandic housing market.

4.2. *Situation after August 2004*

During the court proceedings, SBV argued that the market situation in Iceland changed in summer 2004. According to SBV, commercial banks have offered competitive rates compared to HFF rates and have gained market shares. SBV stated in its application to the EFTA Court that '[…] *commercial banks in Iceland have demonstrated, through recent cuts in interest rates, that they would be both willing and able to provide general loans on similar terms (or even better) then HFF*'. It was, for example, submitted that since summer 2004, the gap between commercial banks and the HFF has completely disappeared, as the banks have reduced their interest rates on long-term housing loans to 4,2 % due to their improved refinancing conditions.

According to a Icelandic news agency ([1]), the price of residential property in the Reykjavík area has risen by 67 % since August 2004, when the commercial banks entered the mortgage market.

5. **Alternatives to the HFF system**

In the procedure leading up to the annulled Decision, the Icelandic Government discussed possible alternatives to the HFF system. The Icelandic Government stated, *inter alia*, that abandoning Government intervention in house financing would lead to considerable changes for lower and middle income families, increase division between the Reykjavik area and the rest of the country and dramatically reduce the number of families able to purchase housing on the market. Alternatively, entrusting banks to lend with the same favourable conditions would not be possible without massive direct State aid.

The Icelandic Government discussed, in the initial notification of 20 November 2003, the following alternative models:

— The HFF would be turned into a limited liability company, wholly owned by the State, either as a profit or a non-profit entity. This was considered the most obvious solution in order to dispense with the State aid. In the Icelandic Government's view, interest rates would increase — more if the company was supposed to earn profits — but the change would not have any effect on competition between credit institutions, except the change would raise the HFF's interest rates so much as to make bank loans or bonds issued by the banks competitive. In the Icelandic Government's view, this would have no effect on trade among the Contracting Parties.

([1]) NFS, 10 May 2006.
www.visir.is/apps/pbcs.dll/article?AID=/20060510/FRETTIR01/60510079/1091

— The HFF would be auctioned off to the highest bidder, with a universal service obligation and a continued State guarantee on the bonds. It is highly likely that the highest bidder would be a credit institution, as the HFF's assets would raise CAD ratio and improve credit ratings. The HFF's assets are similar to the assets of the biggest Icelandic bank. This change would have great influence on the national banking market and put the successful bank in a dominant position on the national market. This would create the risk of transfer of profits from the issuance of bonds to other operations. This would have serious effects on the interests of the other Contracting Parties, as this would in effect foreclose the Icelandic market under existing competitive circumstances.

— The HFF would be sold jointly to the domestic banks. This would be better for the banks not successful in an auction, but would foreclose the domestic banking market.

— The HFF would be dismantled and its assets auctioned off, at the same time as a new system for State intervention in housing purchase would be introduced.

— The last model was proposed by SBV to the Icelandic Government (so-called 'whole sale model'). This proposal foresaw that the HFF ceased direct lending to home buyers, but continued to fund lending by the banks to individuals. The commercial banks would each lend to individuals, but the HFF would fund that lending through monthly bond issuance by the HFF, with State guarantee, the outcome of which would then govern the rates applicable to the housing loans lent by the banks, plus the banks operating margin. A prerequisite for this solution to work would be the HFF's agreement to accept to be in general last in line of priority mortgages up to the 90 % limit, allowing the banks lending opportunities ahead of that percentage. This would enable the banks to grant 90 % loans, as the HFF would carry the principal risk of losses.

II. **APPRECIATION**

1. **State aid within the meaning of Article 61(1) of the EEA Agreement**

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

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

This implies that for measures to be classified as State aid within the meaning of Article 61(1) of the EEA Agreement, they must be granted by the State or through State resources, confer an advantage on the recipient, be liable to affect trade between the Contracting Parties and distort competition.

Beforehand, it needs to be clarified whether the HFF is subject to the application of Article 61(1) of the EEA Agreement, since it has been argued by the Icelandic Government, in the initial notification, that the HFF could not be qualified as an undertaking in the meaning of that Article.

Firstly, the HFF is a separate State-owned institution set up by law, having its own board of directors and annual accounts. Secondly and more importantly, the Court of Justice of the European Communities (hereinafter referred to as 'the Court of Justice') has repeatedly defined the concept of an undertaking as any entity engaged in an economic activity, which is any activity which offers goods or services on a given market, regardless of its legal status and the way in which it is financed ([1]). Although the Icelandic Government considers the HFF not to be a separate undertaking, as it operates only as a '*branch of the State itself*', the Authority takes the view that the HFF is engaged in an economic activity. The economic activity consists of offering services on the market for housing mortgage loans, i.e. long-term house financing (for residential accommodation). Therefore, it is the Authority's preliminary conclusion that the HFF has to be qualified as an undertaking in the sense of Article 61(1) of the EEA Agreement.

([1]) Case C-118/85 *Commission* v *Italy* [1987] ECR 2599; Case C-41/90 *Klaus Höfner and Fritz Elser* v *Macrotron GmbH* [1991] ECR I-1979; Case C-69/91 *Decoster* [1993] ECR I-5335. See similar Case E-4/97 *Norwegian Bankers' Association* v *EFTA Surveillance Authority* [1999] Report of the EFTA Court, page 3, paragraph 30.

1.1. *Transfer of State resources and thereby favouring certain undertakings*

In order to qualify as State aid, the HFF system must imply a transfer of State resources and thereby confer on the Housing Financing Fund an advantage that relieves it of charges that are normally borne from its budget.

1.1.1. ***The Altmark conditions***

The Icelandic Government argued initially in its notification that the HFF system does not constitute State aid, because the system would, *inter alia*, not confer any advantage on the HFF. In this respect, the Icelandic Government referred to the *Altmark* ruling [1] of the Court of Justice and argued that the HFF system would comply with all of the four criteria that the Court of Justice established in that ruling.

It needs to be recalled that the Court of Justice has established the following conditions, which need to be fulfilled cumulatively, for a State measure to escape the classification of State aid. These conditions are:

— First, the recipient undertaking must actually have public service obligations to discharge, and the obligations must be clearly defined.

— Second, the parameters on the basis of which the compensation is calculated must be established in advance in an objective and transparent manner, to avoid it conferring an economic advantage which may favour the recipient undertaking over competing undertakings.

— Third, the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations.

— Fourth, where the undertaking which is to discharge public service obligations, in a specific case, is not chosen pursuant to a public procurement procedure which would allow for the selection of the tenderer capable of providing those services at the least cost to the community, the level of compensation needed must be determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with means so as to be able to meet the necessary public service requirements, would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit for discharging the obligations.

It is the Authority's preliminary opinion that the HFF system neither complies with the second nor with the fourth condition [2]. Concerning the second condition, the Icelandic authorities did not establish *in advance*, and in an objective and transparent manner, the parameters on the basis of which the compensation was to be calculated, in order to avoid conferring an economic advantage, which may favour the HFF over competing undertakings. The Icelandic Government has not demonstrated that such an *ex ante* assessment has taken place in an objective and transparent manner. To establish the parameters for the calculation of the compensation would have required quantifying the costs incurred in discharging the public service obligation in advance and comparing them with the possible benefits that the HFF enjoys. However, such quantification of costs has not taken place. Based on that shortcoming, it is not apparent from the outset what the level of compensation will amount to, since the isolated costs incurred in discharging the public service obligation have not been identified. Furthermore, with regard to the fourth condition, the HFF has neither been chosen by way of a public procurement procedure nor did the Icelandic authorities determine the level of compensation by way of a comparison between the HFF and a privately run 'reference company', taking into account the relevant receipts and a reasonable profit for discharging the obligations.

Since the HFF system seems not to comply with all of the above mentioned conditions, there is a presumption that the HFF system involves State aid, if the conditions of Article 61(1) of the EEA Agreement are met.

1.1.2. ***Possible State aid elements***

The State guarantee

The HFF enjoys an implicit State guarantee for all of its securities. The State guarantee results in a more favourable credit rating for its bonds than bonds issued by private undertakings. This leads to cheaper funding costs for the HFF. Private credit institutions do not benefit from such a State guarantee. The State guarantee confers an advantage on the HFF compared to private credit institutions. The HFF is not subject to a State guarantee fee under Article 7 of Act No 121/1997 on State Guarantees. Hence, the Icelandic State is foregoing revenue it would normally collect. Since the HFF is not paying a premium for the State guarantee it enjoys, it is the Authority's preliminary conclusion that the State guarantee, without any sort of premium to be paid, implies a transfer of State resources which favours the HFF.

[1] Case C-280/00 *Altmark Trans GmbH* [2003] ECR I-7747.

[2] With regard to the question whether the HFF is actually entrusted with public service obligations, see the discussion below in section II.3.2.1.

Interest support

The HFF received interest support from the State to cover obligations resulting from lending below market rates at 3,5 % and 4,5 % for rented housing for low income families. The support has varied through the years. It was ISK 9 million in 2001 and 71 million in 2002. This interest support is financed by State resources. It is the Authority's preliminary conclusion that the interest support constitutes an aid element. The Authority is not in possession of any up-dated figures with regard to the interest support for the years 2003 to 2006. If interest support was granted in these years, the Authority would qualify such support, in light of the above assessment, as a transfer of State resources which favours the HFF.

Exemptions from corporate and property tax

The HFF is exempted from corporate tax and property tax. The HFF has not paid what would have amounted to ISK 335 million in corporate tax and 417 million ISK in property tax for the years 1999 to 2002. Thus, the Icelandic State has foregone income, which under normal circumstances would have been charged to the HFF's budget. It is the Authority's preliminary conclusion that the exemptions from corporate and property tax constitute aid elements. The Authority is not in possession of any up-dated figures for the years 2003 to 2006. Any forgone tax for these years would qualify, in light of the above assessment, as a transfer of State resources which favours the HFF.

No dividend payments

The HFF is charged with preserving and earning a return on the funds it supervises. The return is intended to sustain the operations of the HFF. The HFF is, however, not required to pay out any dividends to its owner.

A normal market investor requires a sufficient return on his capital. It is the Authority's preliminary view that the fact that the HFF is *per se* relieved from paying out any dividends to its owner might imply that it is generating not a sufficient return on capital a normal market investor would expect and that this might imply foregone revenues for the State and thereby a transfer of State resources which favours the HFF.

Not covered by capital adequacy requirements and minimum solvency ratio rules

The Icelandic Government argued that the special status of the HFF implied that it was not subject to the same rules ([1]) as private credit institutions, as regards capital adequacy requirements and minimum solvency ratio rules.

However, if the HFF were covered by the same rules as private credit institutions, then an exemption from these rules could imply State aid.

Capital adequacy requirements and minimum solvency ratio rules for credit institutions are contained in the Act referred to in point 14 of Chapter II(i) of Annex IX to the EEA Agreement (hereinafter referred to as 'the Banking Directive') ([2]). In this context, the Authority notes that the adaptation text ([3]) to Article 2(3) of the Banking Directive explicitly exempted from the scope of that Directive in Iceland the '*Byggingarsjóðir ríkisins*' (literally translated 'the State's Building Funds' ([4])). The Icelandic Government stated that this term was traditionally used for the funds operated by the predecessor of the HFF, namely the State Housing Board, which comprised the State Housing Fund and the Workers' Building Fund. The HFF was established by taking over all assets and obligations of the State Housing Board.

Furthermore, Article 1(1) of the Banking Directive defines a credit institution as '*an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account* […]'. Given the way the HFF's financing mechanism operates, the Authority cannot see how the HFF could be classified as a credit institution in the meaning of the Banking Directive because the HFF is not receiving any deposits or other repayable funds from the public.

In light of the above and for the limited purpose of identifying possible State aid elements, it is the Authority's preliminary conclusion that the HFF is not covered by the scope of the Banking Directive. The HFF is therefore not subject to the same rules as private credit institutions as regards capital adequacy requirements and minimum solvency ratio rules. Since the HFF is not subject to these rules, it is consequently not relieved of charges that it would normally bear from its own budget. Hence, excluding the HFF from these requirements seems not to entail an aid element.

([1]) The Icelandic Government referred in this context to Directive 2000/12/EC on credit institutions.
([2]) Directive 2000/12/EC of the European Parliament and the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions (OJ L 126, 26.5.2000, p. 1), as amended.
([3]) The adaptation text mentioned in point 14(a) of Chapter II(i) of Annex IX to the EEA Agreement.
([4]) This translation has been provided by the Icelandic Government.

In any event, even if the HFF should have been subject to these rules, an exemption from these rules seems not to imply that any State resources have been transferred to the HFF. A transfer of State resources is, however, a necessary condition, in order to qualify a measure as State aid in the meaning of Article 61(1) of the EEA Agreement ([1]).

1.2. *Distortion of competition and effect on trade between Contracting Parties*

The granting of loans for financing purchases of residential accommodation is a financial service which, in the present market circumstances, is predominantly of a local character and normally does not involve any direct cross-border transactions. Distortion of competition arising from financial advantages accorded to the HFF operating such services seems therefore *prima facie* likely to have only limited direct trade effects. However, it cannot be excluded that the aid, which is involved in the HFF system, threatens to distort competition between banks in the European Economic Area, by making it more difficult for them to enter the Icelandic housing mortgage loan market. Such a potential effect on trade is sufficient for State aid to be caught by Article 61(1) of the EEA Agreement.

1.3. *Conclusion*

In light of the above, it is the Authority's preliminary conclusion that the HFF system involves State aid within the meaning of Article 61(1) of the EEA Agreement. To enable the Authority to calculate the amount of potential State aid involved, it is necessary, in the course of this formal investigation procedure, to obtain up-dated figures concerning the HFF's financing mechanisms.

2. **Notification requirement and Standstill obligation**

Pursuant to Article 1(3) in Part I of Protocol 3 to the Surveillance and Court Agreement, 'the EFTA Surveillance Authority shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid (…). The State concerned shall not put its proposed measures into effect until the procedure has resulted in a final decision'.

The above notification requirement and standstill obligation concern 'new aid'. On the other hand, 'existing aid' can be granted until the Authority finds the aid in question to be incompatible with the functioning of the EEA Agreement.

The HFF system was not notified to the Authority. The HFF was established and entered into force on 1 January 1999, i.e. after the entry into force of the EEA Agreement, taking over all assets and obligations of its predecessor, the State Housing Agency. In this context, the Icelandic Government argued that the HFF system had to be classified as existing aid.

The Authority does not share this point of view. In deciding whether or not an aid scheme is to be regarded as 'new aid' or 'existing aid', the Authority examines the relevant legal provisions providing for the aid in question and in particular the entry into force of these provisions.

In such cases the Authority is not obliged to carry out an economic analysis of the measure in question as compared to aid schemes which were in place prior to the introduction of the new legal provisions. This view is confirmed by the ruling of the Court of Justice in *Namur-Les Assurances*. In that ruling the Court held 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*' ([2])(emphasis added).

The fact that the HFF system is the result of alterations to an old system, by merging different legal entities, and that a complete new law was adopted, which repealed the previous State Housing system, and which forms the legal basis of the HFF and the loan system, are sufficient grounds to classify the entire HFF system as 'new aid' within the meaning of Article 1(3) in Part I and Article 1(c) in Part II of Protocol 3 to the Surveillance and Court Agreement ([3]).

([1]) Case C-379/98 *PreussenElektra AG* v *Schleswag* [2002] ECR I-2099.

([2]) Case C-44/93 *Namur-Les Assurances du Crédit SA* [1994] ECR I-3829, paragraph 28.

([3]) Furthermore, Article 4(1), first sentence, of the Authority's Decision No 195/04/COL of 14 July 2004 states that '[f]*or the purposes of Article 1(c) in Part II of Protocol 3 to the Surveillance and Court Agreement, an alteration to existing aid is any change, other than modifications of a purely formal or administrative nature which cannot affect the evaluation of the compatibility of the aid measure with the common market*'.

Therefore, it is the Authority's preliminary conclusion that the HFF system, established in 1999, constitutes 'new aid', which, pursuant to Article 1(3) in Part I of Protocol 3 of the Surveillance and Court Agreement, should have been notified to the Authority in advance ([1]). Since the HFF system was not notified to the Authority, it is considered to constitute 'aid unlawful on procedural grounds', in accordance with Articles 1 (f) and 10 *et seq*. in Part II of Protocol 3 to the Surveillance and Court Agreement ([2]). It should be recalled that any unlawful aid, which is finally not declared compatible with the functioning of the EEA Agreement, is subject to recovery, in accordance with Article 14 in Part II of Protocol 3 to the Surveillance and Court Agreement. This issue will be further addressed below in section II.4. of this Decision.

3. **Compatibility of the aid**

The Authority cannot declare State aid compatible with the functioning of the EEA Agreement, if that aid would infringe other provisions of the EEA Agreement. SBV submitted in its initial complaint that the '*Housing Financing Fund is incompatible with the EEA Agreement, in particular the competition rules, the rules on State aid, free movement of services, capital and the freedom of establishment*'.

In relation to the competition rules, the free movement of services, capital and the freedom of establishment, the Authority assessed these allegations and restated in its annulled Decision that they were unfounded.

With regard to the alleged infringement of some of 'the four freedoms', the Authority found that it was the State aid which created the possible hindrances to the free movement of services, capital and establishment. The effect of these possible hindrances was indissolubly linked to the objective of the State aid. Therefore, the Authority concluded that the case should be assessed under the *lex specialis* of the State aid rules and that the rules on the 'four freedoms' should not be applicable ([3]).

This view was confirmed by the EFTA Court in this judgment of 7 April 2006, when it held that:

> '*With regard to the effects that the HFF general loans scheme may have on the free movement of services and capital and the right of establishment, the Court holds that any such effects would indeed seem inherent in the State-supportive elements of the HFF system and therefore are so indissolubly linked to the object of the aid that it is impossible to evaluate them separately (see to this effect Case 74/76 Iannelli & Volpi SpA v Ditta Paolo Meroni [1977] ECR 557, at paragraph 14).*' ([4])

With regard to the alleged infringement of the competition rules (the complainant alleged in particular an infringement of Articles 59(1) and 54 of the EEA Agreement), the Authority stated in the annulled Decision that SBV's complaint did not warrant the initiation of formal proceedings, since SBV did not substantiate that the HFF abused or will abuse its position as a consequence of the legislative framework by which it was governed.

In light of the above, it is the Authority's preliminary view that it sees no reasons why it should deviate from it original assessment on these points.

3.1. *Article 61 paragraphs (2) or (3) of the EEA Agreement*

The Icelandic Government argued, in the initial notification, that the derogation under Article 61(2)(a) of the EEA Agreement applies to the case at hand. The intervention of the State in the housing market through the HFF is, according to the Icelandic Government, based on particular social objectives and is limited in scope. The Icelandic Government submitted that the privilege accorded to the HFF, through the implicit State guarantee on the Bonds, does not in any way benefit the HFF, but only the recipients of funding from the HFF.

([1]) The European Commission Decision No 2005/842/EC of 28 November 2005 on the application of Article 86(2) EC (which corresponds to Article 59(2) of the EEA Agreement) to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest (OJ L 312, 29.11.2005, page 67) lays down the conditions under which certain types of public service compensation constitutes State aid compatible with Article 86(2) EC and exempts compensation satisfying those conditions from the prior notification requirement. The Decision has not yet been incorporated into the EEA Agreement. Public service compensation which constitutes State aid and does not fall within the scope of Decision No 2005/842/EC will still be subject to the prior notification requirement, also after that Decision has been incorporated into the EEA Agreement. In any event, it should be noted that, with regard to house financing, Article 2(1)(b) of Commission Decision No 2005/842/EC only exempts public service compensation granted to social housing undertakings. Recital 16 of Commission Decision No 2005/842/EC further specifies that social housing undertakings should be understood as meaning '*… undertakings in charge of social housing providing housing for disadvantaged citizens or socially less advantaged groups, which due to solvability constraints are unable to obtain housing at market conditions…*'.

([2]) Since the Authority's Decision No 213/04/COL was annulled by the EFTA Court's judgment of 7 April 2006 in Case E-9/04, the aid granted under the HFF system remains unlawful aid.

([3]) With regard to the relationship between the State aid rules and the provisions of the 'four freedoms', see for example Case 74/76 *Ianelli & Volpi v Meroni* [1977] ECR 557.

([4]) Case E-9/04, cited above, paragraph 82.

Article 61(2)(a) of the EEA Agreement declares State aid compatible with the functioning of the EEA Agreement, if the aid has a social character and is granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned.

In the Authority's preliminary view, this derogation is not applicable to the case at hand. The aid is granted to the HFF, which is considered to be an undertaking in the meaning of Article 61(1) of the EEA Agreement (see above in section II.1), and not directly to individual consumers. Furthermore, consumers are bound to finance their housing by the HFF, in order to enjoy favourable conditions. Consumers are not free to benefit from State aid by their own choice of financial institution. Hence, the State aid is not granted without discrimination related to the origin, in this case, of the service concerned. Therefore, the aid is not neutral with respect to the operators in the market for house financing ([1]).

With regard to the other derogations mentioned in Article 61, paragraphs (2) and (3), of the EEA Agreement, the Authority takes the preliminary view that none of them are relevant to the case at hand. For example, although it is one of the objectives of the HFF to ensure territorial cohesion, it is not its primary goal to serve as an instrument for regional development. The HFF system is based on the universality objective and grants housing finance under the same conditions throughout Iceland, regardless of the region.

3.2. *Article 59(2) of the EEA Agreement*

State aid may be declared compatible with the EEA Agreement under Article 59(2) of the EEA Agreement ([2]) if it is necessary to the operation of the services of general economic interest and does not affect the development of trade to such an extent as would be contrary to the interests of the Contracting Parties.

The following conditions must be satisfied in the present case, in order for Article 59(2) of the EEA Agreement to apply:

— The service in question must be a service of general economic interest and must be accurately defined by the State (see below in point 3.2.1).

— The undertaking in question must be entrusted by the State with the provision of such service (see below in point 3.2.1).

— The application of the rules of the EEA Agreement must obstruct the performance, in law and fact, of the particular tasks assigned to undertakings entrusted with the operation of services of general economic interest (see below in point 3.2.2).

— The derogation must not affect the development of trade within the EEA to an extent that would be contrary to the interest of the Contracting Parties (see below in point 3.2.3).

In the context of assessing the HFF system under Article 59(2) of the EEA Agreement, the Authority will also apply Chapter 18C of the State Aid Guidelines. The purpose of Chapter 18C is to spell out the conditions under which State aid can be found compatible with the functioning of the EEA Agreement pursuant to Article 59(2) of the EEA Agreement.

As stated in point 24 of section 18C.5 of the State Aid Guidelines, Chapter 18C will apply as of the day of adoption by the Authority. The Authority adopted Chapter 18C on 20 December 2005. Furthermore, point 25 of section 18C.5 of the State Aid Guidelines states:

'The Authority will apply the provisions of these guidelines to all aid projects notified to it and will take a decision on those projects after adoption of the guidelines, even if the projects were notified prior to adoption. In case of non-notified aid, the Authority will apply:

— The provisions of these guidelines if the aid was granted after the adoption of these guidelines;

— The provisions in force at the time the aid was granted, in all other cases'.

Thus, the Authority will take Chapter 18C of the State Aid Guidelines into account in its future assessment ([3]).

([1]) See similar Case E-4/97, cited above, paragraph 30.
([2]) Which corresponds to Article 86(2) EC.
([3]) Since the Authority's Decision No 213/04/COL was annulled by the EFTA Court's judgment of 7 April 2006 in Case E-9/04, the aid granted under the HFF system remains unlawful aid (see above section II.2).

3.2.1. *Definition of service of general economic interest and entrustment*

The concept of service in the general economic interest means, among other things, that the State assigns 'particular tasks' to an undertaking ([1]). In order to qualify for classification as service of general economic interest, a service must have certain characteristics, the most important of which is that the service provided can not be provided in the same manner on the market and that the service should be clearly defined ([2]).

As an exception to the main rule in Article 59(1) of the EEA Agreement ([3]), the concept of 'services of general economic interest' must be interpreted restrictively ([4]) and applies only to activities of direct benefit to the public. Still, States remain free, in principle and where no common policy is established, to designate which services they consider to be of general economic interest and to organize these services as they see fit, subject to the rules of the EEA Agreement and the specific conditions laid down in Article 59(2) of the EEA Agreement ([5]). States may take account of objectives pertaining to their national policy when defining the service of general economic interest which they entrust to certain undertakings ([6]). Thus, the competence to define such services lies with the States, subject to scrutiny by the Authority. This scrutiny must essentially be conducted on a case-by-case basis.

In this assessment, the nature of the undertaking entrusted with the service is not of decisive importance, nor whether the undertaking is entrusted with exclusive rights, but rather the essence of the service deemed to be of general economic interest and the special characteristics of this interest that distinguish it from the general economic interest of other economic activities ([7]). In conducting such analysis the Authority has to consider the nature of the service, as well as the extent to which the same service is provided by the market on the same conditions, and in the case of a universal service, particularly, the State's legitimate objective to ensure continuity of service on acceptable conditions throughout its territory ([8]).

The annulled Decision

As mentioned above (in section I.3.2), the HFF granted, at the time the annulled Decision was adopted, loans in the form of general loans, additional loans and loans for rental housing. The annulled Decision accepted all three lending activities as services of general economic interest.

The relevant part of the annulled Decision reads as follows:

'In this respect, the so-called "Husbanken-case" is of importance, as it also concerned the relationship between Article 59(2) of the EEA Agreement and State aid to a public undertaking with a view to provide cheap housing loans […]. In that case, the EFTA Court found that the services concerned were covered by Article 59(2) of the EEA Agreement, since the services concerned were specifically defined by Norway, limited to certain categories of houses and available to everyone on an equal basis. That the loans in the "Husbanken-case" were not restricted to people in weak financial situations could not, as had been argued by the applicant, lead to another result.

The Icelandic housing policy dates back more than 50 years and is based on the political goal to encourage private home ownership. To this end, public intervention in the Icelandic housing market has been aimed at making private housing affordable to a bigger proportion of the public. The HFF is the financing instrument whereby the Icelandic State pursues its public housing policy objectives. The Housing Act […] entrusts the HFF with the management and implementation of the housing affairs and lays down in detail the tasks of the HFF, the objectives and the HFF's financing mechanisms. The Icelandic State uses the HFF to channel capital to the housing sector and to provide house financing on more advantageous terms than are available on the open Icelandic capital market. The HFF is obliged to provide house financing at affordable tariffs and on equal conditions, irrespective of the profitability of individual operations […].

([1]) See for example: Case 10/71 *Muller* [1971] ECR 723; Case 127/73 *BRT* v *SABAM* [1974] ECR 313; Case 7/82 *GVL* [1983] ECR 483; Case C-393/92 *Almelo* [1994] ECR I-1520; Case C-266/96 *Corsica Ferries* [1998] ECR I-3949.

([2]) Communication from the Commission — Services of General Interest in Europe (OJ C 17, 19.1.2001, p. 7), see paragraph 14 (hereinafter referred to as 'Services of General Interest').

([3]) The main rule in Article 59(1) of the EEA Agreement states that in the case of public undertakings and undertakings to which EC Member States or EFTA States grant special or exclusive rights, the Contracting Parties shall ensure that there is neither enacted nor maintained in force any measure contrary to the rules contained in the EEA Agreement, in particular to those rules provided for in Articles 4 and 53 to 63.

([4]) See Case C-242/95 *GT-Link A/S* v *De Danske Statsbaner* [1997] ECR I-4449, paragraph 50; Case T-260/94 *Air Inter* [1997] ECR II-147, paragraph 135; Case C-159/94 *Commission* v *France* [1997] ECR I-5815, paragraph 53.

([5]) See in this context for example: Services of General Interest, cited above, paragraph 22; Case T-106/95 *FFSA* [1997] ECR II-229, paragraph 192. As stated by Advocate General Léger in his opinion in Case C-438/02 *Åklagaren* v *Krister Hanner* [2005] ECR I-4551, paragraph 139: '*…it falls to the Member States to define the content of their services of general economic interest and, in so doing, they enjoy considerable leeway since the Court and the Commission will intervene only in order to penalise manifest errors of assessment*'.

([6]) Case E-9/04, cited above, paragraph 67.

([7]) Case E-4/97, cited above, paragraph 47.

([8]) See in this context: Report of the European Commission to the Council of Ministers: Service of general economic interest in the banking sector (adopted by the Commission on 17.6.1998 and presented to the ECOFIN Council on 23.11.1998). Services of General Interest, cited above, paragraph 10.

The loan system is available to everyone on equal terms and applies to the entire territory of Iceland, including sparsely populated areas, where asset evaluations differ compared to more densely populated areas. Thus, the HFF provides a universal service throughout Iceland on equal conditions. No private credit institution would be in the position to offer mortgage secured loans on equal conditions throughout the entire territory of Iceland. Asset evaluations differ between the Reykjavik area and sparsely populated areas. Prices and securities in real estate differ depending on where the dwelling is located in Iceland. In the Authority's opinion, this aim to correct regional imbalances must be considered as a task of general economic interest in the sense of Article 59(2) of the EEA Agreement both for the so-called additional loans and for the general loans.

The HFF's loan system contains also certain social dimensions. This is of course especially so for the additional loans. However, as the HFF loans will continue to be subject to a lending cap in the form of a maximum amount available, also the general loans entail a social element. These loans aim at financing housing that corresponds to the price of average apartments in Iceland. The HFF's loans alone will not be sufficient to finance high priced property. The relative advantage to house owners, due to the cheap loans that the HHF can offer, is accordingly inversely proportionate to the amounts they wish to loan and thereby, also to the price of the house. In this respect, the Authority has no reason to contest the notified increase in lending terms, since this increase is necessary to, inter alia, take account of inflation in housing prices in recent years.

Additionally, the Icelandic Government has introduced a new provision to the effect that HFF's loans will be limited to two dwellings for each applicant. In exceptional circumstances, a loan for a third dwelling could be authorised, but it would be up to the Board of Directors to define the precise rules for such an exception.

In light of the above, the Authority concludes that the HFF is entrusted with services of general economic interest, given their social and universal dimension, distinguishable from the economic interest of other economic activities, within the meaning of Article 59(2) of the EEA Agreement.'

The EFTA Court's ruling

SBV's application to the EFTA Court, concerning doubts as to whether HFF loans could qualify as a service of general economic interest, was limited to the general loans scheme. The EFTA Court consequently limited its review on the general loans and did not address the other two loan schemes.

With regard to the question, whether the HFF general loans scheme could qualify as a service of general economic interest, the EFTA Court held:

'The tasks of the HFF are defined in the Housing Act and further laid down by Regulations and ministerial decisions. The HFF general loans system is intended to promote security and equal rights as regards housing in Iceland by providing loans on manageable terms to the general public throughout the territory of Iceland and thereby foster private home ownership. This goes beyond the normal economic interest of operators in the financial sector. A service with this objective may qualify as a service of general economic interest justifying State aid, provided that the service fulfils the requirements laid down in Article 59(2) EEA. In that respect, the presumptions or conditions under which the HFF system operates (cf. Case E-4/97 Husbanken II, at paragraph 48) will be addressed below.' [1]

When the EFTA Court later turned in its judgment to the presumptions or conditions under which the HFF system operates, it held:

'[…] it is necessary to address the question of whether the conditions under which the loans were granted did not go beyond what was necessary for HFF to perform the tasks entrusted to it. The Court recalls that the ultimate aim of the State's intervention in lending services through the general loans scheme is to foster private home ownership in Iceland through lending on "manageable terms". A service rendered with such an objective may, as has been stated above, be considered legitimate under Article 59(2) EEA. However, ESA has to make sure that public intervention does not, in reality, pursue other goals than those defined by Icelandic law or exceed what is necessary to achieve the defined goal.

In that regard, the Court notes that unlike the cost and size limitations practiced by the Norwegian Husbanken in Case E-4/97 Husbanken II, the HFF's relative and absolute lending caps do not limit the subsidised lending scheme to dwellings which fulfil certain criteria. They only limit the amount one may borrow from the HFF for any dwelling, regardless of the value or size of that dwelling. There is no limit as to how big or valuable a dwelling may be and still be eligible for a general loan under the HFF scheme; there are only limits to how much the HFF may grant as a general loan.

[1] Case E-9/04, cited above, paragraph 68.

Moreover, the HFF general loans scheme is not limited to the financing of one unit of residential housing for each borrower. This means that in principle the system may provide financing for houses or apartments build or purchased for investment purposes. In 2004, a general limit of two units was introduced. As the Government of Iceland has pointed out, there may be social policy reasons why certain persons need to own more than one unit. The provision of more than one loan to the same person has not, however, been made dependent on that person fulfilling any criteria relating to such reasons.

These features mean that in principle the HFF general loans scheme provides subsidised financing, up to a certain limit, for any house or apartment regardless of size and value, and also for construction or purchase of residential units for investment purposes. The scheme is not formally limited to assisting the average citizen in financing his or her own dwelling. Even if it may be so that few people have in fact exploited these features of the system, they raise questions under Article 59(2) EEA. The Court recalls in this context that the HFF scheme is intended to promote security and equal rights as regards housing by providing loans on manageable terms. Whether the above-mentioned features of the aid system at stake go beyond this is not clear. That warrants an in-depth assessment, with the opportunity for interested parties to comment. […]' ([1])

Consequences for the Authority's assessment

In its initial assessment, the Authority placed emphasis on three elements, in order to qualify HFF general loans as services of general economic interest:

— First, the element of affordable house financing. In other words, the fact that the Icelandic State has used its more favourable credit rating to raise money at lower cost than the banks could have done, thereby fulfilling the obligation to provide residents in Iceland with affordable house financing on 'manageable terms'.

— Second, the element of territorial cohesion. The HFF general loans ensured territorial cohesion, because they provided affordable house financing on equal terms throughout the entire Icelandic territory. Commercial banks were not granting loans at affordable rates outside the Reykjavik area.

— Third, a social element. The Authority endorsed an underlying social motivation of HFF's general loans to support only 'average housing'.

With regard to the first element of affordable house financing, the Authority understands that the EFTA Court did not rule out *per se* that State intervention in lending services through general loans, which pursues the objective of fostering private home ownership through lending on 'manageable terms' may be considered legitimate under Article 59(2) of the EEA Agreement. In this respect, it is also important to note that the EFTA Court clarified in its judgment that the Contracting Parties enjoy a margin of discretion in deciding what 'manageable terms' should mean in relation to a housing financing scheme which qualifies as a service of general economic interest ([2]). In this respect, it is the Authority's preliminary view that until August 2004 commercial banks in Iceland have not offered house financing on 'manageable terms'. As confirmed in the judgment of 7 April 2006, SBV stated that its members were only from August 2004 onwards able to match the interest rate of HFF general loans ([3]). Concerning the element of affordable house financing, the Authority needs up-dated information on the development on the Icelandic mortgage market after the annulled Decision was taken, in order to assess to what extent commercial banks have offered mortgage secured loans on terms the Icelandic State would consider as manageable.

With regard to the second element of territorial cohesion, it is the Authority's preliminary conclusion that this element is an important factor to assess whether the HFF general loans system can qualify as a service of general economic interest. It is the Authority's opinion that SBV has not submitted any tangible evidence during the EFTA Court proceedings, which demonstrated that the commercial banks have offered and actually granted loans on 'manageable terms' outside the Reykjavik area during the period between 1999 and August 2004. Furthermore, in the Authority's view, SBV has submitted so far no evidence which showed that commercial banks have offered and granted loans on 'manageable terms' outside the Reykjavik area after August 2004.

Finally, with regard to the social element, the EFTA Court raised concerns whether the current conditions ensure that the general loans are formally limited to assisting the 'average citizen in financing his or her own dwelling'. The EFTA Court criticized that the current features imply that in principle the HFF general loans scheme provides subsidised financing, up to a certain limit, for any house or apartment regardless of size and value, and also for construction or purchase of residential units for investment purposes. In light of the EFTA Court's conclusions on this point, doubts are raised whether the conditions for the lending services through general loans pursue a sufficiently restricted social objective.

([1]) Case E-9/04, cited above, paragraphs 76 to 79.
([2]) Case E-9/04, cited above, paragraph 71. See in this context also below section II.3.2.2 of this decision.
([3]) Case E-9/04, cited above, paragraph 74.

Additional Loans and Loans for rental housing

With regard to additional loans, the Authority takes the preliminary view that these loans could be declared as services of general economic interests. Additional loans were granted to individuals with low income and limited assets for the construction or purchase of their own residential housing. Finally, concerning loans for rental housing to municipalities, associations and companies for the construction or purchase of residential housing to be rented out, the Authority takes the preliminary view that these loans might be qualified as services of general economic interests, if they pursue a sufficiently restricted social objective, in line with the concerns raised above, or if the private market is not providing for such kind of loans. To arrive at a final conclusion on these points the Authority would need up-dated information.

Section 18C.2.3 of the State Aid Guidelines

With regard to unlawfully granted State aid under the HFF system after the 20th of December 2005 (see above sections II.2 and II.3.2 of this Decision), it should be recalled that point 11 in section 18C.2.3 of the State Aid Guidelines requires that the responsibility for operation of the service of general economic interest must be entrusted to the undertaking concerned by way of one or more official acts, the form of which may be determined by each EFTA State. The act or acts must specify, in particular:

— the precise nature and the duration of the public service obligations;

— the undertaking(s) and territory concerned;

— the nature of any exclusive or special rights assigned to the undertaking;

— the parameters for calculating, controlling and reviewing the compensation;

— the arrangements for avoiding and repaying any overcompensation.

In the Authority's preliminary view, it is doubtful whether the HFF system complies with all of the above mentioned conditions, in particular with regard to the duration of the public service obligation and arrangements for avoiding and repaying any overcompensation.

3.2.2. ***Obstruction of the performance of the particular tasks***

Article 59(2) of the EEA Agreement states that the rules of the EEA Agreement (here the State aid rules) apply as long as this does not obstruct, in law and fact, the fulfilment of the task of general economic interest entrusted to the given undertaking. In other words, the derogation contained in Article 59(2) of the EEA Agreement is only applicable to the extent that it is necessary so that the undertaking in question can fulfil the task of general interest which has been conferred on it ([1]). This requirement of necessity is simply an expression of the principle of proportionality.

It is incumbent upon the State, which invokes Article 59(2) of the EEA Agreement, to demonstrate that this condition is met. Thus, the State must set out in detail the reasons for which, in the event of elimination of the measures, the performance of the tasks of general economic interest under economically acceptable conditions would, in its view, be jeopardized ([2]). However, that burden of proof cannot be so extensive as to require the EEA State to go even further and prove, positively, that no other conceivable measure could enable those tasks to be performed under the same conditions ([3]).

The annulled Decision

On these points, the annulled Decision stated:

'In the Authority's view, the HFF would not be able to perform the same level of services of general economic interest, described above, without any State support. However, the above mentioned proportionality test also requires that the State support for the obligation to render a service of general economic interest must be based on the costs of such specific service. Therefore, in the following it will be assessed whether the HFF's costs to render the service of general economic interest are overcompensated and whether the State support is limited to what is necessary for the HFF to perform the specific service in question.

([1]) See Case C-41/90, cited above, paragraph 24; and Case C-242/95, cited above, paragraph 54.
([2]) It is not necessary that the survival of the undertaking itself be threatened. See Case C-157/94 *Commission* v *The Netherlands* [1997] ECR I-5699, paragraph 43.
([3]) See Case C-159/94 *Commission* v *France* [1997] ECR I-5815, paragraphs 94 to 107.
Case E-4/97, cited above, paragraph 62.

As stated above, the implicit State guarantee, the exemptions from taxes, the abstention from paying any dividends and the interest support imply that the HFF receives State aid in the meaning of Article 61(1) of the EEA Agreement. On the other hand, the costs for the HFF can be said to be the interest support the final consumers get as a result of the HFF's lending activities. To the extent the HFF is able to be funded at lower costs than competing financial institutions, a benefit may be said to accrue to the HFF. Correspondingly, to the extent it is obliged to lend at lower rates than competing institutions, costs may be said to be incurred. In other words, as long as the HFF's is forced to lend at rates lower than market rates, it is forced to abstain from revenue.

While the HFF can raise money cheaply because of the State guarantee, it is not free to set interest rates to the public. Until the end of June 2004 it could only charge an interest rate on its loans that was 0,35 percentage points higher than its funding rate. As tables 2 and 3 above show, this margin was clearly lower than margins charged by other financial institutions. This means that low funding costs obtained by the HFF due to the State guarantee were transferred to the final consumers.

The charge of 0,35 percentage points was supposed to cover current operational costs of the HFF, provisions for losses on loans and to provide for a certain return on equity such that the HFF sustains its activity without drawing on direct State grants. Back in 1993 the margin was fixed at 0,25 percentage points. However, it turned out that this margin was a too small to cover losses on loans. Therefore, the margin was increased to 0,35 percentage points in 1994. A new review was undertaken in 1997. It was then concluded that the 0,35 % margin would be sufficient. Looking at developments for the years from 1999 to 2002, as shown in table 1 above, it also appears that this mark-up was appropriate to cover just operating expenditures, loss provisions and to yield a certain rather modest net profit, such that equity was kept rather stable in relation to total assets. Against this background the Authority concludes that the mark-up of 0,35 percentage points was and still is appropriate to just cover these different provisions.

The changes in the lending system as of 1 July 2004 have, introduced a new cost element that needs to be assessed. As of that date, the interest margin has been increased by 25 basis points. This increase stems from the fact that the previous bond swap system has been abolished and that direct cash lending has been introduced. As the Icelandic Government has pointed out, this implies that the HFF takes on new risks related to interest rate developments. Mortgage holders will, as before, have the possibility of prepayment of loans at par while the HFF cannot redeem its obligations in the same manner. Before 1 July 2004 HFF had the possibility to prepay its funding at par. The new situation creates new risks for HFF as developments in interest rates are uncertain. A fall in interest rates will normally increase prepayments while HFF does not have an identical means of adjusting its funding.

The value, or the cost, related to this new risk is naturally uncertain. The financial consultant estimated it to be in the range of 15 to 35 basis points. The Financial Supervisory Authority and the State Guarantee Fund have called for caution when fixing the additional mark-up to cover the risk. Under these circumstances, and also taking into account the new provisions on solvency ratio according to the Rules of the Financial Supervisory Authority, the Authority can accept that the increase in the interest rate margin for HFF with 0,25 percentage points is what is necessary to cover the costs of the new risks HFF is facing.

The Authority also takes note of the statement from the Icelandic Government that HFF's interest margin shall be reviewed regularly on the basis of HFF's performance and the risks it is facing at any given time. The Icelandic Government has also stated that building up funds inside HFF beyond what is required to maintain the solvency rate of 5 % is not the policy of the Government and would run counter to the expressed policy of enabling the borrowers to gain directly from the operation of the housing lending system.

According to the Icelandic Government, a common dividend requirement for Icelandic banks is some 15 % on equity. If the HFF were to be subject to a similar dividend policy and also subject to normal taxation, the interest mark-up would need to be increased correspondingly as the current margin would not provide for any means to cover such obligations. The Icelandic Government has estimated what the necessary interest mark-up would be in such a case, taking into account an 8 % capital adequacy ratio — instead of the current 5 % — and concluded that the mark-up would increase by 65 to 80 basis points above the current level. To the extent that the HFF were subject to the same taxation and dividend requirements as commercial banks, borrowing costs would increase for the ultimate borrowers, corresponding to what the State would charge in the form of taxes and dividends. When the Icelandic Government abstains from taxes and dividends in relation to the HFF, it is just to keep interest rates for house buyers low such that the Government is able to offer the service of general economic interest, namely to provide the Icelandic population with affordable housing.

As far as direct interest support is concerned, the HFF is obliged in certain conditions to grant interest support to low income families. To some extent such support has been granted by drawing on the Fund's own equity. In other instances the HFF has received direct contributions from the State. These contributions have been transferred directly to the beneficiaries and have not left the HFF with any extra financial means.

In light of the above and as demonstrated by the Icelandic Government, the mark-up of 0,35 percentage points applicable until 30 June 2004 and the mark-up of 0,60 percentage points thereafter can be justified as an appropriate margin to cover the expenses of running the HFF. In other words, it is reasonable to assume that the benefit of the HFF's low borrowing rate is fully transferred to the final consumers. The Authority has not detected any overcompensation to the HFF. The benefits it receives are passed on to the final consumers.

In conclusion, the Authority is of the view that the HFF's costs to render the service of general economic interest are not overcompensated and that the State support is limited to what is necessary for the HFF to perform the specific service in question'.

The EFTA Court ruling

With regard to possible doubts as to the proportionality assessment of HFF's general loans, the EFTA Court held:

'[…] This must include an assessment of whether the subsidised HFF general loans scheme is a suitable means of attaining its objective. There is no reason why a service which is not suitable to meet its aim should benefit from a derogation from the EEA rules. Furthermore, this also calls for an analysis of whether the HFF, or a different provider, could have provided loans at the same "manageable terms" as the HFF provided at the relevant time without, or with less State aid.

Firstly, with regard to suitability, the Applicant has claimed that the low interest rate on HFF general loans has led to a general increase in prices for houses and apartments which neutralises the effects of the low interest rates, since purchasers need to borrow more money in order to buy a certain house or apartment than they would have had to with lower prices.

The Court does not find it doubtful that the low interest rate on HFF general loans did not lead to price increases which completely neutralised the effect of the low interest rate. With respect to any lesser effect on housing prices, regard must be had to the margin of discretion which the Contracting Parties must enjoy in deciding what "manageable terms" should mean in relation to a housing financing scheme which qualifies as a service of general economic interest. As a consequence, the Contracting Parties must also enjoy a margin of discretion in deciding what constitutes a sufficient effect of the low interest rates on the real burden on borrowers' economy. In the end, it is this burden that borrowers have to be able to manage. For that reason, as long as it is not established that the effect of the low interest rate on HFF general loans is completely neutralised by an increase in housing prices, the HFF general loan scheme must be considered suitable to meet its aim.

Secondly, as to the question of whether there were doubts that neither the HFF, nor a different provider, could have provided loans at the same "manageable terms" at the relevant time without, or with less, State aid, the Court recalls that the interest rates charged by the HFF for its general loans are calculated on the basis of its funding costs, with an added margin set by the Minister of Social Affairs. This margin was set at 0,6 percentage points from 1 July 2004, up from 0,35 percentage points. The funding costs consist mainly in the interest paid on bonds issued by the HFF. In this context, the HFF benefits from the State guarantee which follows from the State's unlimited liability for the HFF's debts as its owner.

The Court does not find it doubtful that the State aid provided to the HFF system did not go beyond what was necessary in the case at hand to allow the HFF to cover expected losses and operate the general loans system under economically acceptable conditions (see, for comparison, Case C-157/94, Commission v Netherlands [1997] ECR I-5699, at paragraphs 52 and 53). This does not mean, however, that the general loans system as operated by the HFF is necessarily compatible with the EEA Agreement.

With regard to the ability of any other provider to supply the same service as the HFF, but without State support, the Court recalls that Contracting Parties must be allowed a margin of discretion with regard to what exactly should be considered affordable terms in relation to such schemes. In this regard, a Contracting Party cannot be bound to what other Contracting Parties, in leaving this kind of housing financing completely to the market, implicitly consider acceptable. The Court does not find that it has been demonstrated that doubts existed as to whether the regular banks did match the HFF interest rate level on comparable loans in any part of Iceland prior to the annulled Decision, or would have been able to do so without State support. Indeed, the Applicant has stated that it was only from August 2004 onwards that the banks were able to match the interest rate of HFF general loans.

Neither does the Court find that it has been demonstrated that doubts existed as to whether an alternative model for State-supported housing financing through the banks, the so-called "whole-sale alternative", would enable the banks to provide the same loans as the HFF were providing at the relevant time without this support constituting State aid, or with less State aid and without the risk of cross-subsidisation.' [1]

[1] Case E-9/04, cited above, paragraphs 69 to 75.

Consequences for the Authority's assessment

The Court endorsed the Authority's initial assessment that there were no doubts that the commercial banks did not match the HFF interest rate level on comparable loans in any part of Iceland prior to the annulled Decision, or would have been able to do so without State support. SBV itself stated that it was only from August 2004 onwards that commercial banks were able to match the interest rate of HFF general loans. With regard to the developments on the Icelandic mortgage market after the annulled Decision was taken, the Authority would require up-dated information, in order to assess to what extent commercial banks have offered loans on terms that the Icelandic State would consider 'manageable'.

Should the Authority's assessment reveal that commercial banks have offered loans in the Reykjavik area since August 2004 on terms that the Icelandic State would consider 'manageable', concerns could be raised as to what extent the HFF needs to offer general loans within the Reykjavik area, in order to enable the HFF to grant general loans outside the Reykjavik area.

With regard to alternative models to the HFF system, it is the Authority's preliminary view that the presented models do not seem to be less distortive to competition.

Sections 18C.2.4 and 18C.3 of the State Aid Guidelines

With regard to unlawfully granted State aid under the HFF system after the 20th of December 2005 (see above sections II.2 and II.3.2 of this Decision), it should be recalled that point 18 in section 18C.2.4 of the State Aid Guidelines states that '[w]*hen a company carries out activities falling both inside and outside the scope of the service of general economic interest, the internal accounts must show separately the costs and receipts associated with the service of general economic interest and those associated with other services, as well as the parameters for allocating costs and revenues*'.

Furthermore, point 19 in section 18C.3 of the State Aid Guidelines states that '… *EFTA States must check regularly, or arrange for checks to be made, to ensure that there has been no over-compensation*'.

Without prejudice to the Authority's final Decision in the present case, for any HFF services which might fall outside the scope of services of general interest, the HFF would be required to comply with the above mentioned accounting requirements.

3.2.3. ***Development of trade and the interest of the Contracting Parties***

Article 59(2) of the EEA Agreement further involves an assessment of whether the specific service in question affects the development of trade to an extent contrary to the interests of the Contracting Parties ([1]). The Authority is charged with striking a balance between the right of Iceland to invoke the derogation and the interest of the Contracting Parties to avoid distortions of competition and restrictions to the 'four freedoms' ([2]).

This entails that it must be established that the performance of the service of general economic interest does not affect competition and unity of the market established by the EEA Agreement in a disproportionate manner. It is, however, not required that the measures adopted be the least restrictive possible ([3]). Rather, the test is of a negative nature: it examines whether the measure adopted is not disproportionate ([4]). This 'negative test' has once more been confirmed by the EFTA Court in its ruling of 7 April 2006 ([5]). A reasonable relationship between the aim and the means employed is satisfactory ([4]). Thus, the Authority does not have competence to strike down a measure that otherwise fulfils Article 59(2) of the EEA Agreement simply because the measure might, in some minor aspects and details, go further than what is strictly necessary to fulfil the aims behind it. It is for the States to define their policies and organize general interest services, leaving the Authority no power to take a position on the organization and scale of the service or the expediency of the political choice made. Even if it were successfully shown that the scheme in question were not an optimally efficient one, this alone would not lead to the conclusion that the distortive effects are necessarily disproportionate to the goals assigned.

([1]) In this context, it is interesting to note the opinion of Advocate General Léger in Case C-438/02, cited above, paragraph 143: '*Finally, the last condition in Article 86(2) EC requires that "[t]he development of trade must not be affected to such an extent as would be contrary to the interest of the Community". Even though the Court has not yet ruled on the meaning of that requirement, certain Advocates General have already adopted a position on the issue. In their view, effect on the development of intra-Community trade within the meaning of Article 86(2) EC, unlike the classic definition of the concept of "measures having an effect equivalent to a quantitative restriction", calls for proof that the measure in issue has in fact had a substantial effect on intra-Community trade. That assessment does seem to me to be supported by the wording of Article 86(2) EC*'.

([2]) See similar Case E-4/97, cited above, paragraph 70.

([3]) See for example: Case C-159/94, cited above; Case C-158/94 *Commission* v *Italy* [1997] ECR I-5789; Case C-157/94, cited above; Case E-9/04, cited above, paragraph 80.

([4]) Case E-4/97, cited above, paragraph 62.

([5]) Case E-9/04, cited above, paragraph 80.

The Authority's annulled Decision

On this point, the Authority concluded in its annulled Decision:

'The EEA Agreement establishes inter alia the general principles, both applicable to financial services, of the right of establishment for nationals of the EEA States and their freedom to provide services within the territory of the Contracting Parties. However, the secondary legislation which, under the EC Treaty and the EEA Agreement, has been adopted to make these basic provisions effective, does not extend to specialised housing finance institutions like the HFF(([1])). Consequently, such institutions are at present not able to benefit from the principles of mutual recognition and home country control contained in the banking legislation of the EEA Agreement. Therefore, due to different national credit rules and practices and the absence of effective harmonisation or mutual recognition at EEA level for such institutions, there continue to be considerable obstacles to effective cross-border operations in this area.

In most developed countries, including most parties to the EEA Agreement, Governments, both at central and local level, intervene in housing and housing finance markets. This intervention takes different forms from one State to another, depending, inter alia, on certain realities in the housing markets, in particular the pattern of housing tenure, and the objectives of the housing policy of the Governments concerned. There is, for instance, likely to be a relationship between the extent to which private individuals' home ownership is an objective of public housing policy and the scope of intervention by the Government concerned in housing finance; a Government that sees it as an important objective to its housing policy that as many households as possible own their own dwelling, like in Iceland, is likely to want to support the financing of such investments on a broad scale.

As already stated above, the Authority considers long-term house financing for residential accommodation to be the relevant market for the assessment in the present case.

As submitted by the Icelandic Government, the Icelandic market for mortgage loans is largely divided between three main actors. These are the HFF, the pension funds and other private credit institutions. The HFF had, in 2002, a market share of approximately 78 % of that market. The market share of pension funds was, in 2002, approximately 17 %. The remaining 5 % was taken by private credit institutions. The Icelandic Government submitted figures showing that the HFF had, in 2002, a total amount of ISK 382 billion in mortgage loans, compared to ISK 84 billion of the pension funds and ISK 27 billion of private banks ([2]).

The granting of loans for financing purchases of residential accommodation is a financial service which, in the present market conditions, is predominantly of a local character and normally does not involve any direct cross-border transactions. Distortion of competition arising from financial advantages accorded to the HFF operating such services are therefore prima facie likely to have only limited direct trade effects.

The HFF is not entitled to grant any loans for the financing of dwellings outside Iceland. The HFF's activities are, as laid down in the Housing Act, targeted exclusively towards promoting Icelandic housing policy.

Today no foreign banks are granting cross-border mortgage loans in ISK to Icelandic households. Furthermore, there are currently no foreign financial institutions or representative offices of foreign financial institutions in Iceland. The Icelandic economy is very limited in size. The limited number and small size of transactions in trade in the foreign exchange markets of the ISK warrants only limited interest from foreign banks. The special geography and the scattered population outside the Reykjavik area further reduces the foreign interest for lending to the Icelandic housing market. That foreign banks do not even operate representative offices in Iceland underpins the lack of interest in the Icelandic financial market. In the absence of any "flourishing" financial activities of foreign banks on the Icelandic market outside the particular market for long term housing loans, it can therefore hardly be argued that it is the State aid to the HFF which prevents foreign banks from entering the Icelandic financial market.

In the light of the above, given the limited size of the Icelandic housing market, with its special geographic and demographic features, the Authority is of the opinion that the HFF's financing mechanism does not affect the development of trade to an extent contrary to the interests of the Contracting Parties.'

The EFTA Court's ruling

With regard to the assessment of whether HFF general loans did not affected the development of trade contrary to the interest of the Contracting Parties, the EFTA Court held:

'As part of the assessment of whether the scheme did not affect the development of trade to such an extent as would be contrary to the interest of the Contracting Parties, the relevant market must be defined. ESA considered "long-term house financing for residential accommodation" to be the relevant product market (see section II point 3.2.3 of the annulled Decision). It is not obvious to the Court that the assessment should be limited in scope in

([1]) See similar Case E-4/97, cited above, paragraph 63.

([2]) Sources: The Central Bank of Iceland and the HFF.

this way, excluding the possible effects of the aid granted to the HFF on other parts of the EEA internal market, in particular the financial markets. For that reason, the definition of the relevant market in this particular case is also an issue which interested parties ought to be able to comment upon in a formal investigation procedure. The further assessment of the consequences of the HFF general loan system on the development of trade will depend to a considerable extent on the definition of the relevant market which the formal investigation procedure will lead to.' (1)

Consequences for the Authority's assessment

In light of the EFTA Court's conclusions on this point, the Authority would require for its further assessment information as to what extent the aid granted to the HFF could affect other parts of the EEA internal market, in particular other financial markets, such as, for example, the private lending market.

3.3. *Conclusion*

Doubts are raised, in light of the EFTA Court's ruling of 7 April 2006, whether the HFF system, partly or in its entirety, can be declared compatible with the State aid rules, according to Article 59(2) of the EEA Agreement.

4. **Recovery**

According to Article 14(1) in Part II of Protocol 3 to the Surveillance and Court Agreement, '[w]*here negative decisions are taken in cases of unlawful aid, the EFTA Surveillance Authority shall decide that the EFTA State concerned shall take all necessary measures to recover the aid from the beneficiary (hereinafter referred to as a "recovery decision"). The EFTA Surveillance Authority shall not require recovery of the aid if this would be contrary to a general principle of EEA law*'.

In other words, any unlawful aid which cannot be declared compatible with the State aid rules will be subject to recovery. In case of recovery, it is the Authority's preliminary view that, in the case at hand, no legitimate expectations could be invoked, which would preclude the recovery.

According to settled case-law, '[…] *undertakings to which an aid has been granted may not, in principle, entertain a legitimate expectation that the aid is lawful unless it has been granted in compliance with the procedure laid down in that article. A diligent businessman should normally be able to determine whether that procedure has been followed*' (2).

However, a recipient of illegally granted aid is not precluded from relying on exceptional circumstances on the basis of which it had legitimately assumed the aid to be lawful and thus declining to refund that aid (3). Because the aid at stake was not notified in advance, it is necessary to examine whether the Authority's favourable Decision No 213/04/COL, which approved the HFF system, is to be regarded as an 'exceptional circumstance' within the meaning of the case-law referred to. Such an assessment must be made in the light of the purpose of the protection of legitimate expectations.

In the Authority's view, the judicial review by the Community Courts or the EFTA Court of decisions concerning State aid cannot be regarded as an exceptional and unforeseeable event, forming as it does an integral and essential part of the system established by the EC Treaty and the corresponding provisions in the EEA Agreement and the Surveillance and Court Agreement for that purpose. A diligent businessman should be well aware of the fact that a decision, to the effect that a State measure is declared compatible, is, within the time-limit of two months referred to in Article 230 EC and Article 36 of the Surveillance and Court Agreement, liable to be challenged before the Community Courts or the EFTA Court.

The Court of Justice itself has, moreover, and indeed recently, stated that '[…] *in view of the mandatory nature of the supervision of State aid by the Commission under Article 88 EC, undertakings to which aid has been granted cannot, in principle, entertain a legitimate expectation that the aid is lawful unless it has been granted by the procedure laid down in that article […] It follows that so long as the Commission has not taken a decision approving aid and so long as the period for bringing an action against such a decision has not expired, the recipient cannot be sure as to the lawfulness of the proposed aid which alone is capable of giving rise to a legitimate expectation on his part*' (4).

(1) Case E-9/04, cited above, paragraph 81.
(2) Case C-5/89 *Commission* v *Germany* [1990] ECR I-3437, paragraph 14; Case C-169/95 *Spain* v *Commission* [1997] ECR I-135, paragraph 51.
(3) Case C-5/89, cited above, paragraph 16.
(4) Case C-91/01 *Italy* v *Commission* [2004] ECR I-4355, paragraphs 65 and 66.

Subsequently, to the same effect, in *Spain* v *Commission*, the Court made it clear that '[t]*he fact that the Commission initially decided not to raise any objections to the aid in issue cannot be regarded as capable of having caused the recipient undertaking to entertain any legitimate expectation since that decision was challenged in due time before the Court, which annulled it. However regrettable it may be, the Commission's error cannot erase the consequences of the unlawful conduct of the Kingdom of Spain*' ([1]).

Any argument to the contrary would render ineffective the review conducted by the Community judicature and the EFTA Court of the legality of a positive State aid decisions. If it were to be concluded that such a decision automatically gives rise to legitimate expectations on the part of the recipients, competitors of those recipients or other third parties harmed by the decision would have no interest in attacking the vitiated measure. That is because any annulment of a positive State aid decision would ultimately become a 'pyrrhic victory', since the negative effects of the decision could never be eliminated ([2]).

The Authority, therefore, preliminarily considers that the adoption of a favourable decision by the Authority regarding aid cannot in itself be regarded as an event which causes the recipient of that aid to entertain legitimate expectations as to its lawfulness.

5. **Conclusion**

It is the Authority's preliminary conclusion that the HFF system constitutes unlawful aid on procedural grounds. Doubts are raised whether the HFF system, either partly or in its entirety, can be declared compatible with the State aid rules, according to Article 59(2) of the EEA Agreement. Any unlawful aid which ultimately will be declared incompatible with the State aid rules will be subject to recovery.

HAS ADOPTED THIS DECISION:

1. The Authority has decided to open the formal investigation procedure provided for in Article 1(2) in Part I of Protocol 3 to the Surveillance and Court Agreement with regard to the Icelandic Housing Financing Fund.
2. The Icelandic Government is requested, pursuant to Article 6 in Part II of Protocol 3 to the Surveillance and Court Agreement, to submit its comments on the opening of the formal investigation procedure within two month from the notification of this Decision and to provide all such information as may help to assess the aid measure.
3. Other EFTA States, EC Member States, and interested parties shall be informed by the publishing of this Decision in its authentic language version, accompanied by a meaningful summary in languages other than the authentic language version, in the EEA Section of the *Official Journal of the European Union* and the EEA Supplement thereto, inviting them to submit comments within one month from the date of publication.
4. This Decision is addressed to the Republic of Iceland.
5. This Decision is authentic in the English language.

Done at Brussels, 21 June 2006

For the EFTA Surveillance Authority

B. T. GRYDELAND
President

K. JAEGER
College Member

([1]) Case C-169/95 *Spain* v *Commission* [1997] ECR I-135, paragraph 53.
([2]) See in this context: Opinion of Advocate General Tizzano delivered on 9 February 2006 in Joined Cases C-442/03 P and C-471/03 P *P&O European Ferries (Vizcaya) SA and Diputacion Foral de Vizcaya* v *Commission* (not yet reported), paragraphs 146 to 158.