REPORT FOR THE HEARING

in Case E-2/05

APPLICATION to the Court pursuant to Article 1(2), second subparagraph of Part I of Protocol 3 to the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice in the case between

EFTA Surveillance Authority

and

The Republic of Iceland

seeking an order from the Court that the Republic of Iceland has failed to fulfil its obligations under points 2, 3 and 4 of the EFTA Surveillance Authority's Decision No 21/04/COL of 25 February 2004 with regard to International Trading Companies.

I Introduction

1. The case essentially concerns the question of whether the Republic of Iceland (hereinafter the "Defendant") fulfilled its obligations under the EFTA Surveillance Authority's (hereinafter the "Applicant") Decision No 21/04/COL of 25 February 2004[1] (hereinafter the "Decision") to terminate tax measures considered State aid incompatible with the functioning of the EEA Agreement within the meaning of Article 61 EEA and to take all necessary measures to recover that aid from the beneficiary.

II Legal background

2. Article 3 EEA reads as follows:

The Contracting Parties shall take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of this Agreement.

They shall abstain from any measure which could jeopardize the attainment of the objectives of this Agreement.

[1] OJ 2004 C 319, p. 7.

Moreover, they shall facilitate cooperation within the framework of this Agreement.

3. Article 1(2) subparagraphs 1 and 2 of Part I of Protocol 3 to the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice (hereinafter "Protocol 3 SCA") reads as follows:

If, after giving notice to the parties concerned to submit their comments, the EFTA Surveillance Authority finds that aid granted by an EFTA State or through EFTA State resources is not compatible with the functioning of the EEA Agreement having regard to Article 61 of the EEA Agreement, or that such aid is being misused, it shall decide that the EFTA State concerned shall abolish or alter such aid within a period of time to be determined by the Authority.

If the EFTA State concerned does not comply with this decision within the prescribed time, the EFTA Surveillance Authority or any other interested EFTA State may, in derogation from Articles 31 and 32 of this Agreement, refer the matter to the EFTA Court directly.

4. Article 7(6) and (7) of Part II of Protocol 3 SCA read as follows:

6. Decisions taken pursuant to paragraphs 2, 3, 4 and 5 shall be taken as soon as the doubts referred to in Article 4(4) of this Chapter have been removed. The EFTA Surveillance Authority shall as far as possible endeavour to adopt a decision within a period of 18 months from the opening of the procedure. This time limit may be extended by common agreement between the EFTA Surveillance Authority and the EFTA State concerned.

7. Once the time limit referred to in paragraph 6 has expired, and should the EFTA State concerned so request, the EFTA Surveillance Authority shall, within two months, take a decision on the basis of the information available to it. If appropriate, where the information provided is not sufficient to establish compatibility, the EFTA Surveillance Authority shall take a negative decision.

5. Article 14(1) of Part II of Protocol 3 SCA reads as follows:

Where 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.

III Factual background

6. On 10 March 1999, the Icelandic Parliament adopted Act No 31/1999 on International Trading Companies (hereinafter "ITCs"), laying down terms and conditions for the establishment and registry in Iceland of a new type of limited liability company created for offshore trading centres, the so-called International Trading Companies. These companies are supposed to be mainly involved in

international trade activities. Together with Act No 29/1999, which amended various fiscal acts to include rules applicable to ITCs, the bill was part of a legislative package for the promotion of the establishment of ITCs in Iceland. The package entailed that ITCs became subject to payment of a lower corporate income tax than generally applicable to undertakings in Iceland (5% of net earnings, as compared to 30% of net earnings, through 31 December 2001, and 18% thereafter). Furthermore, they obtained full exemption from payment of net wealth tax (compared to 1.2% through 31 December 2001, and 0.6% thereafter) and partial exemption from payment of stamp duty.

7. The adoption of this legislative package was preceded by a meeting with the Applicant on 23 June 1998 in Brussels. The legislation was not notified to the Applicant after its adoption. When the Applicant became aware of its existence, it conducted a preliminary assessment concluding that the special tax treatment of ITCs might constitute State aid within the meaning of Article 61(1) EEA. Following an exchange of letters with the Defendant, the Applicant opened the formal investigation procedure provided for in Article 1(2) of Protocol 3 SCA on 6 December 2001.[2]

8. On 25 February 2004, the Applicant adopted the Decision, where it found that the tax measures in favour of ITCs constituted State aid according to Article 61(1) EEA and that the aid was unlawful on procedural grounds, as it had never been notified to the Applicant. Moreover, it concluded that the aid was incompatible with the EEA Agreement. Finally, applying Article 14 of Part II of Protocol 3 SCA, the Applicant came to the conclusion that the aid should be recovered from the beneficiaries as from the fiscal year 1999. The relevant operative part of the Decision reads as follows:

> *1. The tax measures in favour of ITCs enacted in Iceland with Act No. 31/1999 and Act No. 29/1999 and related legislation constitute state aid within the meaning of Article 61 of the EEA Agreement. The tax regime applicable to ITCs in Iceland is incompatible with the functioning of the EEA Agreement.*
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> *2. Iceland shall terminate the tax measures referred to in point 1.*
>
> *3. Iceland shall take all necessary measures to recover from the beneficiary the aid referred to in point 1 and unlawfully made available to the beneficiary, deducting any repayment already made to the respective authorities.*
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> *Recovery shall be accomplished without delay and in accordance with the procedures of national law provided that they allow the immediate and effective execution of the decision. The aid to be recovered shall include interest from the date on which it was at the disposal of the beneficiary until the date of its recovery. Interest shall be calculated on the basis of the reference rate set by the Authority and shall be net of interest that has already been charged by the respective authorities.*

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[2] OJ 2002 C 87, p. 10.

4. Iceland shall inform the Authority, within two months of notification of this Decision, of the measures taken to comply with it.

9. The Defendant did not challenge the Decision before the Court pursuant to Article 36 SCA, nor did it inform the Applicant of any measures taken to comply with points 2 and 3 of the Decision within the deadline set forth in point 4. However, in a letter dated 27 April 2004, the Defendant, referring to the wording of point 4 of the Decision, informed the Applicant that Act No 31/1999 on ITCs had been abolished with effect from 1 January 2004. According to the abolishing act, no new operating licenses would be issued after 1 March 2004; and, ITCs already established may continue to operate under the old rules during a transition period ending 1 January 2008. At the time, 11 companies had a valid ITC operating license, of which 6 were active. In the same letter, the Defendant alleged flaws in the administrative procedure leading up to the Decision. It also maintained that following the abolition of Act No 13/1999, any potential tax advantage enjoyed by ITC legislation is likely to be below the *de minimis* threshold. With regard to the order of recovery, the Defendant claimed violation of the principle of protection of legitimate expectations, referring to Article 14(1) of Council Regulation (EC) No 659/1999, the judgment of the Court of Justice of the European Communities in *Van den Bergh*,[3] and two decisions taken by the Commission of the European Communities where recovery had not been ordered.[4] In closing, the Defendant expressed its willingness to discuss the issues mentioned above at a meeting with the Applicant, should the latter desire such a meeting.

10. By letter dated 17 May 2004, the Applicant made clear that it had perceived the Defendant's previous letter to the effect "that it [the Defendant] does not intend to comply with the Authority's decision" and reminded the Defendant that an EFTA State cannot, after the lapse of the two-month deadline provided for in Article 36 SCA, contest the legality of a decision taken by the EFTA Surveillance Authority but can only claim that implementation of the decision is absolutely impossible. The Applicant also referred to the remedy provided for in the second subparagraph of Article 1(2) of Part I of Protocol 3 SCA, but asked the Defendant to reconsider its position first. With a view to seeking an amicable solution to the case, the Applicant dealt with the arguments presented by the Defendant in the letter dated 27 April 2004. With regard to a *de minimis* threshold allegedly provided for in the act abolishing Act No 13/1999, the Applicant indicated that it could accept this amendment as a measure implementing the Decision for the future, provided that the threshold is applied correctly and takes into account any aid measures the beneficiary ITCs may receive. The Applicant, however, referring to Article 3 EEA, insisted that any aid

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[3] Case 265/85 *Van den Bergh* v *Commission* [1987] ECR 1155, para 44.

[4] Commission Decision of 17 February 2003 on the State aid implemented by the Netherlands for international financing activities (2003/515/EC); Commission Decision of 24 June 2003 on the aid scheme implemented by Belgium – Tax ruling system for United States foreign sales corporations (2004/77/EC).

granted to ITCs during the fiscal years 1999 to 2003 must be recovered. It also rejected the Defendant's invocation of legitimate expectations as a matter of principle and denied such expectations on the part of aid recipients, arguing that diligent businesspersons should normally be able to determine whether the procedure laid down in Protocol 3 SCA was observed.

11. Following a meeting in Reykjavik on 26 May 2004, the Applicant, in a letter dated 16 July 2004, again called on the Defendant to recover the granted aid and submit information on measures adopted before 30 August 2004. The possibility of bringing the case to the Court under Article 1(2) of Part I of Protocol 3 SCA was mentioned. The Defendant replied by letter of 16 August 2004 in which it asked for a meeting in order to comply with the Applicant's request. This meeting took place in Brussels on 13 September 2004.

12. By a letter dated 1 October 2004, the Defendant submitted a "possible implementation scheme" as a proposal for how to calculate the aid element as a prerequisite for recovery, and asked for continued cooperation with the Applicant with a view to overcoming difficulties in implementing the Decision.[5] The Defendant suggested that the *de minimis* rule could not only apply to tax advantages granted after the Decision, but also to the fiscal years 1999 to 2003. Furthermore, the Defendant argued that an estimation of the total tax burden of ITCs in past and future has to take into account the taxation of dividends in the hands of shareholders. The Defendant enclosed calculations of tax advantages for each of the ITCs that had received an operating license, for both a "worst case scenario" not including the taxation of dividends, and a "best case scenario" including the taxation of dividends. According to the "best case scenario", favoured by the Defendant, there is no State aid involved in the period 1999-2002, and consequently nothing to recover. Under the "worst case scenario", a possible State aid element for the period 1999-2002 was found in one case, namely for the company Unifish ITC. As to the period from 2003 to 1 January 2008, the Defendant proposed to implement the Decision "by notifying the ITCs about the *de minimis* rule and by monitoring, with regular reports to the Authority, that the *de minimis* threshold shall under no circumstances be exceeded". Finally, the Defendant made it clear that under the notion of cooperation with the Applicant, it expected the latter's response to its proposals.

13. By a letter dated 18 November 2004, the Applicant acknowledged the difficulties encountered by the Defendant in the implementation of the Decision. However, it maintained that only the so-called "worst case scenario" calculation method is in line with the wording of the Decision, where the suggestion to take into account the rules applying to taxation of dividends had already been rejected. Having evaluated the calculation made by the Defendant on this premise, the Applicant basically requested the missing figures for the fiscal year 2003, a specification of how much of the benefits received by each company

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5 With regard to such cooperation, reference was made to Case C-99/02 *Commission* v *Italy* [2004] ECR I-3353.

could possibly fall outside the scope of the recovery order (for example because it concerns trade in fish), a list with the precise amount to be recovered from each undertaking, and an explanation as to how recovery will be effected. As regards the application and monitoring of the *de minimis* rule provided for in Article 2 of Commission Regulation (EC) No 69/2001 on the application of *de minimis* aid, the Defendant was requested to clarify how this is to be regulated by law, since no reference to the *de minimis* rules could be found in the act abolishing Act No 13/1999. Finally, the Applicant found fault with granting existing ITCs a transition period by the abolition act, and requested information on legal amendments proposed to the Icelandic Parliament for the complete and immediate abolition of the ITC scheme to the extent the scheme resulted in the granting of aid above the *de minimis* threshold. A time limit of 20 working days was set for the submission of the information requested. Again, the Applicant mentioned possible enforcement action "if no satisfactory answer about the time plan and the proposals foreseen for the amendment of the legislation is provided to the Authority within the requested time limit".

14. Following a request from the Defendant, the Applicant later extended the deadline to 17 January 2005. The Defendant did not reply within this time limit.

IV Procedure before the Court

15. Against the background of these circumstances, the Applicant filed the application at issue here, which was registered at the Court on 10 February 2005.

V Forms of order sought

16. The Applicant claims that the Court should:

(i) *declare that by failing to abolish and recover within the prescribed period the aid provided for under the tax schemes declared incompatible with the EEA Agreement by Decision No 21/04/COL of 25 February 2004, the Republic of Iceland has failed to fulfil its obligations under Articles 2, 3 and 4 of said Decision;*

(ii) *order the Republic of Iceland to bear the costs.*

17. The Defendant claims that the Court should:

(i) *dismiss the application as unfounded;*

(ii) *order the EFTA Surveillance Authority to bear the costs.*

18. The Commission of the European Communities submits that the Court should declare that Iceland has failed to fulfil its obligations under Articles 2, 3, and 4 of the Decision and that the Court should order Iceland to bear the costs.

VI Written submissions

19. Written arguments have been received from the parties:

- the Applicant represented by Niels Fenger, Director, and Bjørnar Alterskjær, Officer, Legal and Executive Affairs, acting as Agents;

- the Defendant, represented by Finnur Þór Birgisson, First Secretary and Legal Officer, Ministry for Foreign Affairs, acting as Agent, assisted by Ingvi Már Pálsson, Legal Officer, Ministry of Finance.

20. Pursuant to Article 20 of the Statute of the EFTA Court, written observations have been received from:

- the Commission of the European Communities, represented by Tibor Scharf, Member of its Legal Service, acting as Agent.

VII Summary of the arguments

The Applicant

21. The Applicant recalls the principles established by the Court of Justice of the European Communities in cases concerning non-compliance with State aid decisions in proceedings under Article 88(2) EC, the provision mirroring Article 1(2) of Part I of Protocol 3 SCA. As regards the relevant date for the purposes of an infringement, steps taken after the elapse of the time limit set in a decision are not to be taken into account. At most, such steps may play a role when determining whether, at the end of the period set, it was absolutely impossible to proceed to recovery of the aid.[6] It further follows from the case law that the validity of a State aid decision cannot be called into question by the State concerned in legal proceedings on non-compliance, when the time limit to contest the decision has expired.[7] The only defence left to the State in opposing an application brought under Article 88(2) EC is to plead that is was absolutely impossible for it to implement the decision properly.[8] The condition of absolute impossibility is not satisfied where the defendant government merely informs the competition authority of implementation difficulties without taking any real, specific steps to recover the aid and without proposing any alternative

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6 Case C-499/99 *Commission* v *Spain* [2002] ECR I-6031, para 28; Case C-378/98 *Commission* v *Belgium* [2001] ECR I-5107, para 26-28; and, paras 22 and 28 of Advocate General Tizzano's Opinion in the latter case.

7 Case 156/77 *Commission* v *Belgium* [1978] ECR 1881, para 21; Case 52/84 *Commission* v *Belgium* [1986] ECR 89, para 13; Case 52/83 *Commission* v *France* [1983] ECR 3707, para 10; and, Case C-183/91 *Commission* v *Greece* [1993] ECR I-3131, para 10.

8 Case 52/84 *Commission* v *Belgium*, para 14; Case C-348/93 *Commission* v *Italy* [1995] ECR I-673, para 16; Case C-349/93 *Commission* v *Italy* [1995] ECR I-343, para 12; Case C-350/93 *Commission* v *Italy* [1995] ECR I-699, para 13; and, Case C-261/99 *Commission* v *France* [2001] ECR I-2537, para 23.

arrangements for implementing the decision.[9] Neither do alleged difficulties in determining the amount of aid, in themselves, show that it was absolutely impossible to recover the aid,[10] nor is the initiation of consultations concerning the procedure for recovering the aid sufficient.[11] It further follows from the case law of the Court of Justice of the European Communities that a State that has granted aid without making notification may not plead the legitimate expectations of recipients in order to justify a failure to comply with its implementing obligations.[12] Finally, a government's complaint regarding an alleged failure to cooperate in good faith cannot affect its failure to comply with a State aid decision.[13]

22. Applying this case law to the present case, the Applicant argues that within the two month time limit set in point 4 of the Decision, the Defendant had not made the necessary changes in legislation to terminate the relevant tax measures nor taken any steps to recover from the beneficiaries aid already granted. In particular, the Defendant has still not abolished the aid scheme or even presented a bill to the Icelandic Parliament proposing its termination. The allegations regarding violation of procedural and substantive rules pertain to the validity of the Decision, which the Defendant cannot challenge after the expiry of the time limit in Article 36 SCA. Furthermore, no difficulties in implementing the Decision that could possibly justify non-compliance have been notified. The correspondence exchanged and the meetings held after the elapse of the two month time limit give no reason for believing that compliance with the Decision has been absolutely impossible. As regards point 2 of the Decision, the Defendant has not suggested that it has been impossible to introduce a law that ends the aid measure or ensures that the aid would not exceed the *de minimis* rules, but has merely advanced reasons as to why it did not find this suitable and convenient. The alleged difficulties in calculating the relevant aid amount as a prerequisite for recovery seem, in the Applicant's view, to relate to disagreement with the State aid assessment in the Decision. In any case, potential difficulties encountered regarding the calculation of the amount to recover cannot lead to the conclusion that recovery was absolutely impossible. Moreover, the Defendant has in fact already identified all the aid beneficiaries by name and partly provided calculations over the amounts that have to be recovered.[14] Finally, the Defendant may not plead potential legitimate expectations of recipients in order to justify a failure to comply with the obligations to implement the recovery order.

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9 Case C-280/95 *Commission* v *Italy* [1998] ECR I-259, paras 14-15; Case 94/87 *Commission* v *Germany* [1989] ECR 175, para 10; and, Case C-183/91 *Commission* v *Greece*, para 20.

10 Case C-378/98 *Commission* v *Belgium*, paras 41 and 42; Case C-280/95 *Commission* v *Italy*, para 23.

11 Case C-404/00 *Commission* v *Spain* [2003] ECR I-6695, paras 47-48.

12 Case C-5/89 *Commission* v *Germany* [1990] ECR I-3437, para 17, Case C-183/91 *Commission* v *Greece*, para 18; and, Case C-99/02 *Commission* v *Italy*, para 21.

13 Case C-209/00 *Commission* v *Germany* [2002] ECR I-11695, para 72.

14 Reference is made to Case C-280/95 *Commission* v *Italy*.

23. The Applicant rejects the Defendant's plea that the Decision is flawed to an extent that it must be considered non-existent. There is a presumption that a decision adopted is legally valid until it is declared void or withdrawn, even if the decision should be irregular or unlawful.[15] Any irregularity must be abnormally gross, obvious,[16] manifest and to be detected by reading the decision. In other words, a decision will only be non-existent in exceptional and quite extreme cases. Consequently, allegations that a Community act is non-existent have been rejected by the Court of Justice of the European Communities in all cases but one.[17] More specifically, arguments regarding non-existence are to be rejected according to the case law of that court when the State, in proceedings leading up to the judicial dispute itself, accepted its existence,[18] like in the case at hand, where the Defendant in the entire pre-litigation procedure treated the Decision as existing and informed the Applicant several times that it intended to comply with it.

24. As regards the alleged excessive length of procedure, the Applicant submits that the time limit laid down in Article 7(6) of Part II of Protocol 3 SCA is an objective to be observed and not a mandatory time limit. In any event, even a breach of procedural rules on the part of the Applicant could only have led to the annulment of the Decision, but could not make it non-existent. Case 223/85 concerned an annulment action and not non-existence of a decision. In fact, the annulment of the decision in that case implies that the decision was regarded as existing. Subsequent case law shows, moreover, that Case 223/85 has to be regarded as exceptional.[19] Concerning the argument that the Applicant neither advised on the remedies available and the time limit to observe in proceedings before the Court, the Applicant denies the existence of such an obligation.[20] Again, even if it existed, a breach would not make the Decision non-existent. Finally, as regards the alleged lack of competence for including trading activities in goods not covered by the EEA Agreement, the Applicant maintains that the Decision assessed an aid scheme and not the particular activities in which the aid recipients were engaged. The Decision is to be understood with the implicit proviso that it does not apply to aid falling outside the scope of the EEA Agreement. The precise delimitation of the scope of a decision can reasonably be discussed and clarified in connection with its implementation, as the Defendant and the Applicant sought to do in relation to several points. Any dispute could

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15 Case 137/92 P *Commission* v *BASF and others* [1994] ECR I-2555, para 48.

16 Case T-156/89 *Valverde Mordt* v *Court of Justice* [1991] ECR II-407, para 84.

17 Case 1 and 14/57 *Usines à tubes de la Sarre* v *ECSC High Authority* [1957] ECR 105 (English special edition).

18 Case 226/87 *Commission* v *Greece* [1988] ECR I-3611, para 16.

19 Case C-334/99 *Germany* v *Commission* [2003] ECR I-1139, para 35.

20 Reference is made to Cases C-153/98 P *Guérin Automobiles EURL* v *Commission* [1999] ECR I-1441, para 13-16, and T-145/98 *ADT* v *Commission* [2000] ECR II-387, para 206-212 regarding individuals, which should, a fortiori, be applied to States who presumably know their rights and obligations under the EEA Agreement.

also be brought before the Court pursuant to Article 36 SCA, but cannot affect the existence of the Decision.

25. Responding to the Defendant's allegation that it had already fulfilled its obligations under the Decision, the Applicant concedes that it has, in principle, accepted that the Defendant could implement point 2 of the Decision by changing the abolishing act so that it would include a legal provision that would guarantee that no aid would be granted exceeding the *de minimis* threshold. It has, however, never accepted that merely monitoring that no ITC receives aid exceeding that threshold would fulfil the Decision. The ITC scheme gives the undertakings concerned a right to special tax treatment regardless of whether this will include an aid element and of how big that aid element may be. Therefore, the ITC scheme does not comply with the conditions of the *de minimis* regulation which is why it has to be abolished in total or be amended so that it cannot result in aid granted above the limit. That the Defendant implemented the *de minimis* regulation and has the power to recover aid exceeding the threshold does not suffice for implementing the Decision. Furthermore, the Defendant has not suggested that it has informed the ITCs that the tax rules should now have the character of *de minimis* aid and obtained from them full information about other *de minimis* aid received during the previous three years, least of all before the elapse of the deadline for complying with the Decision.

26. Regarding the Defendant's argument that even under its "worst case scenario" method, it fulfilled the obligation to recover aid since only one recipient, doing business that falls outside the scope of the Agreement, had received aid, the Applicant reiterates that the "best case scenario" method contradicts the Decision. As for the "worst case scenario" calculation, however, the Defendant has not taken any steps to examine before 25 April 2004 whether an application of a *de minimis* regime, off-setting the amount of aid illegally granted, could imply that no ITC would have to pay back the incompatible aid. But not even the information given after the expiry of the time limit contained sufficient information to conclude how much aid the different recipients have received and continue to receive. Thus, it is still not possible to conclude that a grant of *de minimis* aid could have resulted in a situation where no ITC would have to pay back the aid.

27. As regards the Defendant's claim that it has actively been pursuing a dialogue with the Applicant and that it therefore must be deemed to have fulfilled its obligations under point 4 of the Decision, the Applicant recalls that the Defendant remained silent until the expiry of the date set in the Decision and even in the letter dated 1 October 2004 only offered preliminary examinations and did not inform the Applicant of any plan to abolish the incompatible tax rules.

28. In response to the Defendant's contention that it was absolutely impossible to implement the Decision, the Applicant maintains that doubts as to how the incompatible aid scheme could be changed in a way that would make it

possible to continue as a new *de minimis* scheme are not sufficient to prove that it was absolutely impossible to terminate the scheme by introducing new legislation. As to possible problems in calculating the aid as a basis for recovery, the Defendant should have informed the Applicant before the compliance date and was, under the case law of the Court of Justice of the European Communities, obliged to take specific steps to implement the recovery decision against the aid recipients before that date. As it failed to do so, the Defendant cannot claim impossibility. That the Applicant has breached its duty of genuine cooperation is disputed, even though it cannot be brought forward to justify the breach of the Defendant's implementation obligations.

The Defendant

29. In support of its submission that the Court should dismiss the application as unfounded, the Defendant presents four pleas in law: Firstly, that the Decision contains such particularly serious and manifest defects that it should be deemed non-existent; secondly, that the Applicant, by unnecessarily delaying to adopt a decision in the case, created legitimate expectations on the part of the recipients of the aid, and has no authority to request the implementation of the Decision; thirdly, that the Defendant has already taken all the necessary measures to comply with the Decision; fourthly, that because of serious defects of the Decision, it is absolutely impossible to implement it, and the Applicant has taken insufficient steps to amend or clarify the Decision to make its implementation possible.

30. As regards the first plea, the alleged inexistence of the Decision,[21] the Defendant identifies two serious and manifest defects, and maintains that it has already drawn the Applicant's attention to them in the procedure preceding the action. The Applicant's contention that the Defendant had already accepted the existence of the Decision is therefore rejected. In any event, a State's reaction could not limit the Court's discretion as to reviewing the validity of a decision. The relevance of the findings in Case 226/87 to the present case is disputed.

31. First, the Applicant seriously breached procedural requirements and the principle of good administration in failing to adopt the Decision within the time limits described in Protocol 3 SCA. The Defendant did not receive any correspondence from the Applicant from the opening of the formal investigation procedure on 6 December 2001 until the adoption of the Decision on 25 February 2004, aside from a brief discussion of the case at a meeting in Reykjavík on 24 June 2002. A time period of 26 months is not in accordance with the time limit of 18 months laid down in Article 7(6) of Part II of Protocol 3 SCA. This provision is legally binding; to take another view would result in non-compliance having

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[21] In that respect, reference is made to Case C-15/85 *Consorzio Cooperative d'Abruzzo* v *Commission* [1987] ECR I-1005; Case 226/87 *Commission* v *Greece*, para 16; Case C-74/91 *Commission* v *Germany* [1992] ECR I-5437, para 11; Case C-404/97 *Commission* v *Portugal* [2000] ECR I-4897, para 34; and, Case C-404/00 *Commission* v *Spain*, para 41.

no consequence.[22] There is no justification for the extended delay since no third party had commented on the decision to initiate the formal investigation procedure, and no additional information was requested from the Defendant. Also, the Applicant did not seek an agreement with the Defendant to extend the time limit. Article 7(7) of Part II of Protocol 3 SCA applies only in such instances when there is insufficient information to adopt a firm decision, which was not the case. In any event, the provision does not oblige the State to request a decision but grants it a right to force a decision, the non-exercise of which does not relieve the Applicant from complying with Article 7(6) of Part II of Protocol 3 SCA. An extended delay in adopting a negative decision can establish legitimate expectations on the part of the beneficiaries, rendering the Decision unlawful and to be declared void.[23]

32. In addition, the Applicant was in breach of general principles of good administration by failing to properly advise on what means were available to contest the Decision, and the time limit available to initiate proceedings before the Court. Even though this alone does not constitute grounds for disregarding the Decision, the Defendant considers it an important element when determining what consequences should be attached to the serious and unjustified delay in adopting the Decision.

33. The second serious and manifest defect rendering the Decision nonexistent consists, according to the Defendant, in a manifest excess of the Applicant's competence by requiring the Defendant to recover aid granted to activities that fall outside the scope of the EEA Agreement, namely trading activities of ITCs in goods such as fish excluded from the product coverage in Article 8(3) EEA. The application of EEA State aid rules and with it the Applicant's competences are limited to the scope of the EEA Agreement.[24] The Applicant exceeded its competences by considering such trading activities "a service falling inside the scope of the EEA Agreement" in the Decision. This statement has a clear relevance for determining how the operating part of the Decision should be applied. However, trading activities must be considered to be inseparably linked to trade in those goods and are consequently excluded from the scope of EEA State aid rules.[25] The Applicant appears to have admitted this serious error in its letter of 18 November 2004. For the sake of legal certainty, this serious and manifest excess of competences renders the Decision non-existent. The Applicant's assertion that it assessed a general scheme and did not attempt to

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[22] In that regard, the Defendant rejects the relevance of Case C-334/99 *Germany* v *Commission*, as relied upon by the Applicant due to the difference in facts.

[23] Case C-223/85 *Rijn-Schelde-Verolme (RSV) Machinefabrieken en Scheepswerven NV* v *Commission* [1987] ECR I-4617, para 12, which applies to the present case regardless of the fact that it concerned an annulment action.

[24] In that regard, reference is made to Sánchez Rydelski, M., "The EEA State aid Regime", *The Law of State Aid in the European Union*, Oxford University Press, Oxford & New York, 2004.

[25] Reference is made to Case E-4/04 *Pedicel*, judgment of 25 February 2005, not yet published, para 34.

draw a precise line in individual cases does not find support in the explicit wording of the relevant part of the Decision, which is of a more general nature. The view that the passage in question was only meant to respond to an earlier argument made by the Defendant in a letter of 8 January 2002 is likewise rejected. While the Applicant was correct when it agreed at a later stage that the Decision could not be enforced against those ITCs that were only engaged in trade with goods falling outside the material scope of the EEA Agreement, this later acknowledgement cannot rectify the serious error made by the Applicant when it stated the opposite in the Decision. Finally, the Defendant holds the view that it can still claim non-existence of the Decision due to lack of competence, even though the Decision has not been challenged, since a decision *ultra vires* would lack all legal basis in the legal order created by the EEA Agreement.[26]

34. As a second plea in law, the Defendant submits in the alternative that the legitimate expectations created on the part of the beneficiaries by not complying with the time limit in Article 7(6) of Part II of Protocol 3 SCA should have prevented the Applicant from ordering recovery. In that regard, reference is made to Article 14(1) of Part II of Protocol 3 SCA, the judgment of the Court of Justice of the European Communities in Cases 223/85 and 265/85, and to the two decisions by the Commission of the European Communities already mentioned in the letter dated 27 April 2004. They contravene the Applicant's view that a State that has granted aid contrary to the procedural rules in Article 1 of Part I of Protocol 3 SCA may not plead potential legitimate expectations of recipients in order to justify its failure to comply with a recovery order. In the present case, it is not the Defendant's failure to formally notify that created legitimate expectations with the ITCs, but the Applicant's unjustified delay in the adoption of the Decision.

35. In its third plea in law, the Defendant alternatively alleges that it has already fulfilled its obligations under the Decision. Firstly, it had already abolished the Act in question even before the adoption of the Decision. In the letter dated 17 May 2004, the Applicant moreover acknowledged that the *de minimis* threshold could apply to the fiscal years 2004 to 2007, and thereby made it clear that it had no objections to a transition period as such. In fact, the Defendant has adequate means to ensure that any State aid granted to the ITCs does not exceed the applicable *de minimis* rules.[27] With the sufficient legal framework existing to monitor these rules, no further legislative measures are required and point 2 of the Decision is fulfilled. As regards the remaining dispute as to how to implement the *de minimis* requirement, the Defendant maintains that

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[26] Reference is made to Cases E-7/97 *Erla María Sveinbjörnsdóttir* v *The Government of Iceland* [1998] EFTA Court Report 62; E-2/03 *Ákæruvaldið* v *Ásgeir Logi Ásgeirsson, Axel Pétur Ásgeirsson and Helgi Pétursson* [2003] EFTA Court Report 185; and, Joined Cases 6 and 11/69 *Commission* v *French Republic* [1969] ECR 523.

[27] In this context, the Defendant notes that the Commission Regulation (EC) No 69/2001 on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid was implemented into the Icelandic legal order with Regulation No 904/2002 of 16 December 2002. Further reference is made to Article 47 of the Competition Act No 8/1993.

it lies within its discretion to choose the necessary legislative method, as long the objective pursued is achieved.[28] Requiring a further amendment of the Defendant's internal legislation is therefore disproportionate.

36. Secondly, the Defendant argues that even allowing for the calculation method required by the Applicant, no ITC has been granted State aid exceeding the *de minimis* threshold. Consequently, there is no aid to be recovered from the ITCs. As point 3 of the Decision requires recovery of aid only insofar as it has been granted, the Defendant cannot be deemed to have failed to comply with it. Accordingly, the Defendant regarded the recovery part of the Decision as being properly carried out and implemented by the calculations submitted with the letter dated 1 October 2004. As to the calculation method chosen ("best case scenario"), the Defendant maintains that taking into account all the elements of the ITCs' tax regimes, including advantages, but also disadvantages such as the special rules on withholding tax on dividends, is in line with previous decisions adopted by the Applicant[29] as well as Chapter 17B of the State Aid Guidelines. Requiring any other form of calculation methodology, as done by the Applicant in the letter dated 18 November 2004, is considered illogical and inconsistent. But even under the "worst case scenario", the only ITC benefiting from State aid in 1999-2002 was Unifish, which is engaged in trade in fish and therefore falls outside the scope of the Decision. In conclusion, under any calculation method, there is nothing to be recovered for previous years from the ITCs in question.

37. Thirdly, the Defendant contends that the Applicant has been informed of every step taken as regards the ITC system and has therefore properly notified these measures as required under point 4 of the Decision. The Defendant has been actively pushing the dialogue with the Applicant on what measures have been adopted. Full notification of the measures taken within the two month time limit was absolutely impossible due to serious defects of the Decision. The Applicant has in fact acknowledged these difficulties in its letter of 18 November 2004. In particular, the Decision is so obscure that it had subsequently to be substantially clarified (e.g. whether it would accept that the *de minimis* rules would apply to the ITCs) or extensively amended (e.g. whether the Decision affected State aid granted to activities of ITCs in trade in fish) by the Applicant. Insisting on a notification of concrete measures taken within the two month time limit would be akin to requiring the Defendant to foresee what position the Applicant would take on specific issues that were either imprecisely or incorrectly addressed in the Decision. Given the fact that the Applicant exceeded its time limit for adopting the Decision by more than 8 months, the Defendant furthermore fails to see how a delay of two days can be of such critical relevance that it is sufficient to determine that it was in breach of its obligations when it initiated consultation by letter of 27 April 2004.

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[28] Case C-209/00 *Commission* v *Germany*, para 34, and Case C-404/00 *Commission* v *Spain*, para 24.

[29] Decisions No 174/98/COL of 8 July 1998, and No 40/03/COL of 14 March 2003.

38. The fourth alternative plea in law to the effect that it was absolutely impossible for the Defendant to implement the Decision, is based on the three year *de minimis* period laid down in Article 2(2) of Commission Regulation No 69/2001, which is different for each of the ITCs in question, depending on when its operating license was issued. It is impossible to initiate direct recovery actions against a company which has, for example, recently acquired its ITC license, because it cannot be established until the end of the 3-year-period whether there is in fact State aid involved. Moreover, the Decision makes no reference to the applicability of the *de minimis* rule, and had to be amended later with regard to the lack of competence regarding companies trading in fish. However, it is indispensable that a State aid decision be sufficiently clear and unambiguous before the Applicant can instruct the State concerned to embark on its implementation.[30] A further difficulty in implementing the Decision is based on the fact that the Decision did not clearly specify how any possible aid should be calculated and is inconsistent with the earlier decisions mentioned above.

39. The Defendant informed the Applicant that it was in fact absolutely impossible to implement the Decision without further guidance and cooperation. As to the case law of the Court of Justice of the European Communities requiring specific steps to be taken to implement the recovery decision,[31] the Defendant reiterates that such steps were taken in the letter dated 1 October 2004.

40. Finally, the Defendant maintains that the Applicant has violated its “duty of genuine cooperation” and its duty to “work together in good faith with a view to overcoming the difficulties” [32] by referring the case to the Court when the Defendant assumed that the cooperation procedure was still under way. Furthermore, the Applicant has not sufficiently addressed the difficulties encountered in cooperation with the Defendant and has not given reasonable explanation why it considers the measures taken by the Defendant insufficient to implement the Decision, e.g regarding the monitoring of the *de minimis* rules. Instead of engaging in a “genuine cooperation”, the Applicant consistently threatened litigation. Therefore, the Defendant invites the Court to dismiss the application and instruct the Applicant to reinitiate consultations in order to overcome the difficulties encountered in implementing the Decision.

The Commission of the European Communities

41. At the outset, the Commission of the European Communities submits that by failing to seek the Decision’s annulment within the relevant time limit, the Defendant can no longer contest the legality of the Decision,[33] and that the

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30 Reference is made to Case C-70/72 *Commission* v *Germany* [1973] ECR-I 813, para 23.

31 Case C-280/95 *Commission* v *Italy*, paras 14-15; Case 94/87 *Commission* v *Germany*, para 10; and, Case C-183/91 *Commission* v *Greece*, para 20.

32 Case C-99/02 *Commission* v *Italy.*

33 Case 52/83 *Commission* v *France*, para 10.

discussion before the Court should therefore be restricted to whether or not the Decision was implemented. In the alternative, the Commission of the European Communities argues that there was no breach of procedural rules by the Applicant, namely Article 7(6) of Part II of Protocol 3 SCA, since the wording ("as far as possible endeavour") indicates that the 18 months mentioned therein are no more than an indicative time frame and can be extended.[34] In any event, a breach of procedural rules should have been challenged within the appropriate time frame, and the Defendant cannot now rely on it.

42. As to the (only possible) defence of absolute impossibility, the Commission of the European Communities argues that the threshold for such a finding must be a very high one. In the first place, steps to implement a decision must have been undertaken by the State in question since only once implementation has been tried can the absolute impossibility be discovered.[35] Simple information of legal, political or practical difficulties in implementing a State aid decision is not sufficient.[36] As there are no indications that the Defendant, in the present case, undertook any steps to implement the Decision, the defence of impossibility must fail. The Defendant has not complied with the requirements laid down in the case law of the Court of Justice of the European Communities[37] by its letter dated 1 October 2004, which was in any event made too late. Contrary to what it claims, the Defendant did not engage itself in any form of cooperation, but refrained from reacting in a meaningful way to the Applicant's comments in the letter of 18 November 2004.

43. Finally, the Commission of the European Communities points out that the grant of non-notified State aid cannot, according to the case law, create any legitimate expectations[38] for the recipients, as a diligent economic operator should be able to determine whether the State aid has been notified.

Carl Baudenbacher
Judge-Rapporteur

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[34] Case T-179/01 *Ferriere Nord* v *Commission*, judgment of 18 November 2004, not yet reported, para 69.

[35] Case C-310/99 *Italy* v *Commission* [2002] I-2289, para 105; Case C-280/95 *Commission* v *Italy*, paras 14-15.

[36] Case C-183/91 *Commission* v *Greece*, para 20; Case C-378/98 *Commission* v *Belgium*, para 32.

[37] Case C-269/99 *Commission* v *France* [2001]ECR I-2537, para 24.

[38] Joined Cases T-298/97, T-312/97, T-313/97, T-315/97, T-600/97 to T-607/97, T-1/98, T-3/98 to T-6/98, and T-23/98 *Alzetta* v *Commission* [2000] ECR II-2319, para 171.