



REPORT FOR THE HEARING

in Case E-6/98

- revised - *

DIRECT ACTION brought under Article 36 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice by the Government of Norway for annulment of the Decision of 2 July 1998 of the EFTA Surveillance Authority in the case between

The Government of Norway

and

EFTA Surveillance Authority

I. Facts and procedure

1. Under the National Insurance Act of 28 February 1997 (*Folketrygdloven*), replacing a former act of 17 June 1966, all persons residing or working in Norway are subject to a compulsory insurance scheme under which employees and employers pay social security contributions, calculated in relation to gross salaries. The scheme covers benefits such as pensions, rehabilitation, medical care, wage compensation and unemployment benefits. Social security contribution rates are decided annually by the Norwegian parliament as part of the fiscal budget. Both revenues and expenditure items are fully integrated into the fiscal budget.

2. The contributions levied on employers are calculated on the basis of the individual employee's gross salary income. A system of regionally differentiated tax rates ranging from 0 to 14.1% is in place, with the tax rate depending on the tax zone where the employee has his or her registered permanent residence. The system of regionally differentiated tax rates was introduced in 1975 and various adjustments have been made since then. The geographical scope of the tax zones was last revised in 1988. Since 1 January 1995, the applicable tax rates have been the following:

* Amendments to paragraphs 32, 34 and 59.

Zone 1: Central municipalities in southern Norway	14.1 per cent
Zone 2: Rural districts in southern Norway	10.6 per cent
Zone 3: Coastal area mid-Norway	6.4 per cent
Zone 4: Northern Norway (except zone 5)	5.1 per cent
Zone 5: Spitzbergen/Finnmark/Northern part of Troms	0 per cent

3. The system applies to all employees both in the private and the public sector except for the central government, which pays the maximum rate regardless of the residence of the employees. It applies to foreign employees residing in Norway if they are covered by the national social security system. The Norwegian authorities further describe the system as being automatically applied on the basis of objective criteria, unlimited in time, and neutral with respect to type of industry, company size, economic activity, form of ownership and the location of the enterprise.

4. In letters dated 16 June and 30 August 1995, the EFTA Surveillance Authority asked the Norwegian Government to submit full details on the existing scheme for social security taxation in Norway, in particular on the system of regionally differentiated social security contributions paid by employers, with a view to examining the compatibility of the system with Article 61 of the Agreement on the European Economic Area (hereinafter variously the “EEA Agreement” and “EEA”).

5. The Norwegian Government responded in letters of 5 and 19 September 1995. In the period up to March 1997, the EFTA Surveillance Authority and the Norwegian authorities held a number of informal meetings aimed at elucidating the nature of the Norwegian scheme for social security taxation.

6. Concluding that the scheme of regionally differentiated social security contributions in Norway involved State aid within the meaning of Article 61(1) EEA and that a general exemption was not warranted, the EFTA Surveillance Authority, in a letter dated 14 May 1997, proposed appropriate measures to Norway, in accordance with Article 1(1) of Protocol 3 to the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice (hereinafter the “Surveillance and Court Agreement”).

7. By a letter of 11 July 1997, the Norwegian Government responded that they could not concur with the EFTA Surveillance Authority’s proposal for appropriate measures, *inter alia* because the rules in question were part of the general taxation system and thus fell outside the scope of Article 61(1) EEA.

8. The EFTA Surveillance Authority’s decision to open the procedure provided for in Article 1(2) of Protocol 3 to the Surveillance and Court Agreement was taken on 19 November 1998 and published on 5 February 1998.¹ The European Commission was informed, in accordance with Protocol 27 to the EEA Agreement, by means of a copy of the decision. Comments were received

¹ 1998 OJ C 38, p. 6, 5.2.98 and the EEA Supplement thereto.

from the Commission on 5 March 1998 and observations from Norway concerning the letter of the Commission on 20 April 1998.

9. On 2 July 1998, the EFTA Surveillance Authority rendered its decision (hereinafter the “Decision”) in accordance with Article 1(2) of Protocol 3 to the Surveillance and Court Agreement

10. The EFTA Surveillance Authority referred to its finding that if the Norwegian authorities, after having received the EFTA Surveillance Authority’s proposal for appropriate measures, notified an area to be designated for regional transport aid, the whole of the counties of Finnmark, Troms, Nordland and Sogn og Fjordane, and the parts of Nord-Trøndelag, which were part of tax zones 2 to 4, might be considered eligible for regional transport aid. However, the EFTA Surveillance Authority was not convinced by the information before it that regional transport aid was justified for all municipalities presently covered by tax zone 2 in the counties of Rogaland, Hordaland, Møre og Romsdal and Hedmark.

11. The EFTA Surveillance Authority had further examined the information supplied by Norway concerning indirect compensation for additional transport costs obtained by the system of lower tax rates in zones 2 to 5, and accepted that data presented by Norway showed that manufacturing enterprises located in these zones faced significant additional transport costs which were not overcompensated by the financial benefits associated with the lower social security contribution rates in those regions. A general reduction in the existing level of indirect compensation for additional transport costs was therefore not proposed by the EFTA Surveillance Authority. As for future schemes, the EFTA Surveillance Authority stressed that these would have to be limited in time and not be more favourable than existing schemes.

12. Finally, the EFTA Surveillance Authority considered the conditions related to certain sectors, where specific sectoral rules on State aid apply,² enterprises with no alternative location³ and the service sector and came to the conclusion that many of these activities would have to be subject to the tax rate applied in tax zone 1 for all employees.

13. The operative part of the Decision reads:

- “1. The system of regional differentiation of employers’ social security contributions in Norway is incompatible with the EEA Agreement in so far as,
 - a) it applies to activities not referred to in point b) below, unless it is confined to areas which have been notified to the Authority and found eligible for regional transport aid,

² Shipbuilding, ECSC steel industry, non-ECSC steel industry, textiles industry, synthetic fibres industry and motor vehicle industry.

³ Such as extractive industries and hydroelectric power stations.

- b) it allows for the following kind of enterprises to benefit from the lower social security contribution rates applied in zones 2-5,
- enterprises engaged in Production and distribution of electricity (NACE 40.1)
 - enterprises engaged in Extraction of crude petroleum and gas (NACE 11.10)
 - enterprises engaged in Service activities incidental to oil and gas extraction excluding surveying (NACE 11.20)
 - enterprises engaged in Mining of metal ores (NACE 13)
 - enterprises engaged in activities related to the extraction of the industrial minerals Nefeline syenite (HS 2529.3000) and Olivine (HS 2517.49100)
 - enterprises covered by the act referred to in point 1b of Annex XV to the EEA Agreement (Council Directive 90/684/EEC on aid to shipbuilding)
 - enterprises engaged in production of ECSC steel,
 - enterprises with more than 50 employees engaged in Freight transport by road (NACE 60.24)
 - enterprises engaged in the Telecommunications (NACE 64.20) sector
 - enterprises having branch offices established abroad or otherwise being engaged in cross-border activities related to the following sectors, namely, Financial intermediation (NACE 65), Insurance and pension funding (NACE 66), and Services auxiliary to financial intermediation (NACE 67), with the exception of branch offices only providing local services.
2. For the system of regionally differentiated social security contributions from employers to be adapted in such a way that it would become compatible with the rules on regional transport aid as reflected in the Authority's State Aid Guidelines and allow the Authority to carry out its surveillance functions in accordance with Article 1 of Protocol 3 to the Surveillance and Court Agreement, in addition to the adjustments required by points 1 (a) and (b) of this decision, the following conditions would have to be complied with:
- a) The applicability of the system would have to be limited in time, not going beyond 31 December 2003. Before that time, a request for extension may be submitted for examination by the Authority.
- b) The Norwegian Government would be required to submit detailed annual reports on the aid scheme in accordance with the format indicated in Annex III of the State Aid Guidelines. As foreseen in Chapter 32 of the State Aid Guidelines, those reports would have to cover two financial years and be submitted to the Authority not later than six months after the end of the financial year. The first report is to be submitted before 1 July 2000.

- c) In accordance with the rules on regional transport aid, the detailed annual reports would have to show, in addition to information required according to point (b), the operation of an aid-per-kilometre ratio, or of an aid-per-kilometre and an aid-per-unit ratio.
 - d) The detailed annual reports would also have to contain, in addition to information required according to points (a) and (c), the estimated amounts of indirect compensation for additional transport costs in the form of lower social security contributions received by enterprises in the sectors covered by special notification requirements (motor vehicle industry, synthetic fibre industry and non-ECSC steel industry).
 - e) For production covered by the specific sectoral rules related to synthetic fibres, motor vehicles and non-ECSC steel, the Norwegian Government would have to notify the Authority of any recipients of aid benefiting from the lower social security contribution rates in zones 2-5.
 - f) The Norwegian authorities would have to introduce specific rules to ensure that overcompensation due to the cumulation of regional transport aid from different sources will not occur.
3. Norway shall take the necessary measures to ensure that the aid which the Authority has found incompatible with the functioning of EEA Agreement is not awarded after 31 December 1998 and, where applicable, that the conditions in point 2 of this decision are complied with. It shall inform the Authority forthwith of the measures taken.
 4. This decision is addressed to Norway. The Norwegian Government shall be informed by means of a letter containing a copy of this decision.”

14. By an application of 2 September 1998, lodged at the Court Registry on the same day, the Government of Norway (hereinafter the “Applicant”) brought an action under Article 36 of the Surveillance and Court Agreement for annulment of the above-mentioned Decision. The application is based on the grounds of infringements of the EEA Agreement, *i.e.* error in the application of Article 61(1) EEA, and infringement of a procedural requirement, *i.e.* that the EFTA Surveillance Authority has not provided adequate statements of reasons as required by Article 16 of the Surveillance and Court Agreement.

15. The Defence of the EFTA Surveillance Authority, dated 28 October 1998, was received at the Court Registry on 29 October 1998. A Reply from the Applicant was received on 1 December 1998. A Rejoinder from the EFTA Surveillance Authority was received on 21 January 1999.

16. On 16 November 1998, the Applicant applied for suspension of the application of the Decision until the Court had delivered its judgment in the main case, pursuant to Article 40 of the Surveillance and Court Agreement. In its observations received on 25 November 1998, the EFTA Surveillance Authority stated that a suspension was not permitted under the relevant rules. The Court

heard the representatives of the Applicant and the EFTA Surveillance Authority on 10 December 1998 and on the following day ordered the suspension of the application of the Decision until delivery of judgment.

II. Form of order sought by the parties

17. The Applicant claims that the EFTA Court should:

- annul the Decision of the EFTA Surveillance Authority of 2 July 1997 (Dec. No. 165/98/COL), and
- order the EFTA Surveillance Authority to bear the Applicant's costs.

18. The EFTA Surveillance Authority contends that the EFTA Court should:

- dismiss the application as unfounded, and
- order the Applicant to pay the costs.

III. Legal background

The EEA Agreement

19. Article 61 EEA provides:

“1. 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.

2. The following shall be compatible with the functioning of this Agreement:

- (a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;
- (b) aid to make good the damage caused by natural disasters or exceptional occurrences;
- (c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division.

3. The following may be considered to be compatible with the functioning of this Agreement:

- (a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;
- (b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of an EC Member State or an EFTA State;
- (c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;
- (d) such other categories of aid as may be specified by the EEA Joint Committee in accordance with Part VII.”

The Guidelines of the EFTA Surveillance Authority

20. On 19 January 1994, the EFTA Surveillance Authority adopted “Procedural and Substantive Rules in the Field of State Aid: Guidelines on the application and interpretation of Articles 61 and 62 of the EEA Agreement and Article 1 of Protocol 3 to the Surveillance and Court Agreement”.⁴ At the time of the Decision, Section 28.2. laid down rules for the application of Article 61(3) (c) EEA regarding *inter alia* criteria for transport aid.

IV. 28.2. METHOD FOR THE APPLICATION OF ARTICLE 61(3)(C) TO NATIONAL REGIONAL AID

(...)

28.2.3.* First stage of analysis with regard to regions with a very low population density**

28.2.3.1. Population density threshold

- (1) In order to take account of special regional development problems arising out of demography, regions corresponding to NUTS Level III regions with a population density of less than 12.5 per square kilometre may also be considered eligible for regional aid under the exemption set out in Article 61(3)(c).
- (2) The introduction of this threshold for the interpretation and application of Article 61(3)(c) of the EEA Agreement with regard to regional aid may be based on the grounds set out below:
- (3) The Joint Declaration on Article 61(3)(c) of the EEA Agreement acknowledges the fact that the indicators used in the first stage of the method do not properly reflect the regional problems specific to certain

⁴ 1994 OJ L 231, p. 1, 19.1.94. Amendments were made to Chapter 28 on 20 July 1994, 1994 OJ L 240, p. 33, 20.7.94 (EEA Supplement 15 September 1994 No. 34, p. 29). Chapter 28 was repealed by a decision of 4 November 1998.

Contracting Parties, particularly the Nordic countries (Norway, Sweden, Finland and Iceland). In these countries there are important aspects of the regional situation which the indicators are supposed to describe and which fall outside the scope of the method of analysis of eligibility as described in Section 28.2.2. of these guidelines.

- (4) These shortcomings are in a large part due to a number of special features shared by the Nordic countries: they derive from geography - the remote northern location of some areas, harsh weather conditions and very long distances inside the national borders of the country concerned - and from the very low population density in some parts. These are specific factors which are not reflected in the statistical indicators used in Section 28.2.2.
- (5) A test of eligibility must therefore be used which reflects these problems. Such a test should be of general application, i.e. potentially applicable to any country. It should also be integrated into the method for the application of Article 61(3)(c) of the EEA Agreement in order not to disrupt the method of assessing regional aid. If it is to be an objective test which is valid *erga omnes*, it must be an alternative to the unemployment and GDP tests used in the first stage of the method. This would mean that any region corresponding to NUTS Level III region presenting the required level of unemployment or GDP or satisfying the new test could be accepted as qualifying for regional aid in the appropriate circumstances and subject to approval by the EFTA Surveillance Authority.
- (6) On those grounds, it could be held that a population density threshold of less than 12.5 per km² reflects the addressed regional problems in an appropriate manner. All regions corresponding to NUTS Level III regions with a population density below that figure may then qualify for the exemption for regional aid laid down in Article 61(3)(c) of the EEA Agreement, subject to assessment and decision by the EFTA Surveillance Authority.

28.2.3.2. *Criteria for transport aid*

- (1) The population density test may provide a satisfactory response to the problem of underpopulation in certain regions, but it does not address another regional handicap specific to the Nordic countries, namely the extra costs to firms caused by very long distances and harsh weather conditions. These factors affect regional development in two ways: they may induce firms in such regions to relocate to less remote areas which hold out better prospects for economic activity and they might dissuade firms from locating in such outlying areas.
- (2) The EFTA Surveillance Authority could therefore decide to authorise aid to firms aimed at providing partial compensation for the additional cost of transport, on a limited basis and at its discretion, in order to safeguard the common interest. Such compensation must however comply with the following conditions:

- Aid may be given only to firms located in areas qualifying for regional aid on the basis of the population density test.
- Aid must serve only to compensate for the additional cost of transport. The EFTA State concerned will have to show that compensation is needed on objective grounds. There must never be overcompensation. Account will have to be taken here of other schemes of assistance to transport, notably under Articles 49 and 51 of the EEA Agreement.
- Aid may be given only in respect of the extra cost of transport of goods inside the national borders of the country concerned. It must not be allowed to become export aid.
- Aid must be objectively quantifiable in advance, on the basis of an aid-per-kilometre ratio or on the basis of an aid-per-kilometre and an aid-per-unit-weight ratio, and there must be an annual report drawn up which, among other things, shows the operation of the ratio or ratios.
- The estimate of additional cost must be based on the most economical form of transport and the shortest route between the place of production or processing and commercial outlets.
- No aid may be given towards the transport or transmission of the products of enterprises without an alternative location (products of the extractive industries, hydroelectric power stations, etc.).
- Transport aid given to firms in industries which the EFTA Surveillance Authority considers sensitive (motor vehicles, textiles, synthetic fibres, ECSC products and non-ECSC steel) are subject to the sectoral rules for the industry concerned and must in particular respect the specific notification obligations stipulated in the relevant chapters of these guidelines or in the Act referred to in point 1a of Annex XV to the EEA Agreement.¹
- Agricultural products within the scope of Annex II to the EC Treaty, and falling within the scope of the EEA Agreement are not covered by this measure.²
- Any plans to put into effect new schemes or to amend existing schemes of assistance to transport should contain a limitation in time and should never be more favourable than existing schemes in the relevant EFTA State.

(3) The EFTA Surveillance Authority aims at reviewing the existing schemes of assistance to transport on the basis of these criteria within three years from the entry into force of the EEA Agreement.

* 28.2.3. inserted as new section by EFTA Surveillance Authority Decision of 20 July 1994.

** This section corresponds to the Commission Notice on changes to the method for the application of Article 92(3)(c) of the EC Treaty to regional aid, adopted by the European Commission on 1 June 1994.

¹ Commission Decision 3855/91/ECSC of 27 November 1991 establishing Community rules for aid to the steel industry (1991 OJ L 362, p. 57, 31.12.91).

² The corresponding condition in the Commission Notice referred to in footnote 1 reads as follows: "les produits agricoles relevant de l'Annexe II du Traité CE, autres que les produits de la pêche, ne sont pas couverts par les present dispositions". The different condition in the present State Aid Guidelines is due to the fact that the EFTA Surveillance Authority lacks competence in respect of State aid in the fisheries sector.

IV. Written Observations

21. 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 James M. Flett, member of its Legal Service, acting as Agent.

V. Submissions of the Parties

22. The Applicant bases its application for annulment on the ground that the EFTA Surveillance Authority erroneously applied the Agreement. The Applicant claims, principally, that the system is a part of the general tax system in Norway and is sufficiently general in nature so as not to involve State aid favouring certain undertakings within the meaning of Article 61(1) EEA. Subsidiarily, the Applicant claims that, as the EFTA Surveillance Authority failed to decide which parts of the system “affect trade between Contracting Parties” and thus infringe Article 61(1) EEA, the entire Decision must be annulled.

23. Secondly, the Applicant submits that the EFTA Surveillance Authority has not provided adequate statements of reasons according to Article 16 of the Surveillance and Court Agreement on the two points identified in the first submission.

The first submission – infringement of Article 61 EEA

a) A general measure

The Applicant

24. The Applicant submits that the involvement of some sort of *tangible and gratuitous benefit or advantage* for someone is a fundamental and crucial element in the notion of aid.⁵ Taxation, however, is not usually considered to be a benefit for private parties, nor are exemptions from tax burdens or tax concessions, unless they are considered in comparison with other persons.

⁵ Case 78/76 *Steinike und Weinlig v Germany* [1977] ECR 595, para. 22 and Case 61/79 *Amministrazione delle finanze dello Stato v Denkavit Italiana* [1980] ECR 1205, para. 31.

According to the Applicant, in cases of tax advantages, the notion of aid itself involves a criterion of discrimination or selectivity, capable of distinguishing these cases from other State aid cases.

25. The Applicant maintains that various selective elements are inherent in any tax system which, by nature and/or by policy, necessarily create different effects not only between different undertakings or persons, but also between different sectors of the economy and different regions of a State. It cannot be the intention that the notion of aid in Article 61(1) EEA and Article 92(1) of the Treaty Establishing the European Community (hereinafter variously the “EC Treaty” and “EC”) include all tax measures where it is possible to identify an effect which differs from one enterprise to another. The question must rather be *what criteria a given form of selectivity may or may not be based on*.

26. The case law of the Court of Justice of the European Communities (hereinafter the “ECJ”) has established that, when a selective element of a taxation system is identified, a *justification test* is applied to determine whether or not that particular selective measure constitutes State aid.⁶ The Applicant submits that this test should be viewed similarly to justification tests under other provisions of the EC Treaty, which prohibit discrimination.⁷

27. The case law of the ECJ shows that tax exemptions granted on an individual basis to certain undertakings or to certain sectors are prohibited, especially when the measure in question is oriented towards one or more export sectors.⁸ The Applicant maintains that a regional element is neither necessary nor sufficient in order to establish “aid...favouring certain undertakings”. Cases where regional differentiation are seen as a basis for selectivity all involve schemes which are targeted to specific sectors or individual enterprises.⁹ However, a given differentiation is permitted when it is general and based on objective criteria.¹⁰ The legal status of cases that are not covered by either of these categories is uncertain and relevant case law sparse.

28. The Applicant submits that the EFTA Surveillance Authority has failed to apply the justification test properly, as shown by its consideration *that the selectivity criterion is fulfilled inter alia when the effect of the measure is to favour enterprises located in certain regions as opposed to a majority of*

⁶ Case 173/73 *Italy v Commission* [1974] ECR 709; Joined Cases C-72 and C-73/91 *Sloman Neptune v Bodo Ziesemer* [1993] ECR I-887.

⁷ For example Articles 4, 10, 13, 14, 16, 27, 36, 40 and 69(1) EEA.

⁸ See Case 173/73 *Italy v Commission*, see footnote 6.

⁹ See Joined Cases 6 and 11/69 *Commission v France* [1969] ECR 523; Case 70/72 *Commission v Germany* [1973] ECR 813; Case 248/84 *Germany v Commission* [1987] ECR 4013; Case 310/85 *Deufil v Commission* [1987] ECR 901 and Commission decision in the *Mezzogiorno* case, see footnote 17.

¹⁰ See Case 173/73 *Italy v Commission* and Joined Cases C-72 and C-73/91 *Sloman Neptune*, see footnote 6.

enterprises in other regions which are not able to benefit from the measure. The Applicant questions whether a measure that applies to all enterprises in a particular geographical area of the State is covered by Article 61(1) EEA at all. In any event, the justification test applies, as it does when selectivity is based on sectors.

29. The Applicant maintains that the decisive factor is not the effects on different undertakings, but rather the general nature of the criterion applied, as shown in the EC Commission decision in *Maribel Quater*, where a reduction in social security contributions for all companies employing manual workers was found to be a general measure and not aid because of its general nature and automatic application.¹¹ The conclusion of the Commission is in line with its *Notice on monitoring of State aid and reduction of labour costs* of 18 June 1996¹² and the *Working paper on the differences between State aid and general measures* from 1995, of DG IV of the EC Commission.¹³

30. The Norwegian scheme is neutral with respect to the type of industry, company size, occupation and form of ownership as well as to the location of the enterprises. The Norwegian scheme is thus, in the view of the Applicant, similar to the scheme under consideration in the *Maribel Quater* case, *i.e. a general measure and not aid because of its general nature and automatic application and the fact that it does not discriminate a priori between sectors.* Unlike the Italian scheme under consideration in the case *Italy v Commission*,¹⁴ the Norwegian scheme comprises all sectors of the economy and is by no means aimed at or designed to favour only those industries or undertakings exposed to intra-EEA trade.

31. Further, the Applicant states that the EFTA Surveillance Authority has, erroneously, failed to include employment policy considerations as part of its assessment. The Norwegian scheme divides the work force into five categories which correspond to five tax rates. The objective is to strengthen employment and settlement in outlying districts. In the view of the Applicant, the scheme contributes to these objectives by granting employees resident in zones 2 to 5 an advantage on the labour market. The system has a redistribution effect favouring these categories of workers by granting firms employing them an advantage through the system. The objectives pursued through the scheme, *i.e.* maintaining settlement patterns, income equalization and employment equalization throughout the country must be viewed as *legitimate aims* capable of justifying the fact that the effect of the scheme may differ from one undertaking to another. This is so because of the special problems Norway faces, *inter alia* on the labour

¹¹ See a decision of the EC Commission, *Maribel Quater*, not published. Annex 13 to Application.

¹² See Annex 1 to the Statement of Reply.

¹³ Unofficial document, not published. Annex 15 to Application.

¹⁴ See footnote 6.

market, because of its geographical location, long distances, climate, population and settlement patterns.

The EFTA Surveillance Authority

32. The EFTA Surveillance Authority submits that, in order to be caught by Article 61(1) EEA, a measure must satisfy four conditions: (1) it must in one form or another confer an advantage on the recipient, (2) the advantage must be granted by the State or through State resources, (3) the measure must be selective in that it must favour certain undertakings or the production of certain goods, and (4) the measure must affect competition and trade between EEA States. The EFTA Surveillance Authority claims that all four criteria are fulfilled in the present case.

33. The EFTA Surveillance Authority submits that a distinction must be made between general measures applying equally to all undertakings in the State concerned, on the one hand, and selective measures implying a benefit for some, but not all, undertakings on the other. The language of Article 61(1) EEA and the case law of the ECJ support a broad interpretation of the provision to the effect that any selective measure entailing a benefit for some undertakings or groups or categories of undertakings should be capable of being considered State aid, irrespectively of how and why the distinction is made. It is settled case law that State aid measures are defined in relation to their effects and not their aims¹⁵ and there are indications that regional selection as such is sufficient to bring a measure within the scope of Article 92(1) EC.¹⁶ The practice of the EC Commission also reflects the view that selective reductions favouring certain firms compared with others in the same Member States do constitute aid, regardless of whether the selectivity is individual, sectoral or regional.¹⁷ Lastly, this view is reflected in the working paper of DG IV, referred to by the Applicant, and in the recent notice of the European Commission of 11 November 1998.¹⁸

34. The EFTA Surveillance Authority submits that it is not sufficient for a measure to fall outside the scope of Article 92(1) EC / Article 61(1) EEA, that it forms part of a general scheme¹⁹ and pursues similar and legitimate policy

¹⁵ See Case 173/73 *Italy v Commission*, see footnote 6, at para. 13.

¹⁶ See Joined Cases 6 and 11/69 *Commission v France*, footnote 9, at page 552; Case C-241/94 *France v Commission* [1996] ECR I-4551.

¹⁷ See Commission decision of 1 March 1995, *Mezzogiorno*, 1995 OJ L 265, p. 23, 8.11.95, para.10.

¹⁸ See footnote 13 *supra* and footnote 21 *infra*

¹⁹ See Case 310/85 *Deufile v Commission*, footnote 9, paras. 7-8; Case 173/73 *Italy v Commission*, footnote 6, at page 272 and para. 13.

objectives as are assigned to that scheme.²⁰ The EFTA Surveillance Authority submits that the ECJ has never found that a selective measure falls outside the scope of Article 92(1) EC on this ground.

35. While it is necessary to assess on a case-by-case basis whether a measure can be considered justified because of the nature or general scheme of the system to which it belongs, the EFTA Surveillance Authority submits that some general guidelines may be established.²¹ Thus, a measure which would only serve to ensure the proper functioning and the effectiveness of a general tax system (*e.g.* rules to avoid double taxation or tax avoidance) would not constitute State aid.²² On the other hand, a measure which would imply a distinct derogation from the general system with regard to the very element of that system that served to characterize it as being general in nature could not be considered justified on the basis of the nature or general scheme of the system itself. A derogation providing for regional differentiation of the rates could not be considered justified on the basis of the nature or general scheme of the system.

36. The EFTA Surveillance Authority maintains that a measure which grants a benefit to all undertakings in a certain region, but not to undertakings located outside that region, does *per se* amount to a favouring of certain undertakings within the meaning of Article 61(1) EEA. The EFTA Surveillance Authority further submits that an analysis such as that carried out by the Commission in the *Maribel Quater* case, referred to by the Applicant, is not applicable to the case at hand, as it is distinguishable on its merits.

37. The EFTA Surveillance Authority submits that the differentiated contribution system at issue in the present case was designed to benefit certain regions, since the selectivity criterion is directly linked to the favoured regions. Although the decisive factor is the place of residence of the employees rather than the location of undertaking, the differentiation confers a direct competitive advantage on undertakings in the favoured regions as compared to undertakings located elsewhere. The advantage, which was indeed the effect envisaged, is evidenced by the high level of correlation between the zone of location of an undertaking and the place of residence of its workforce shown in the

²⁰ See Case 173/73 *Italy v Commission*, see footnote 6.

²¹ In its Rejoinder, the EFTA Surveillance Authority has further referred to a new notice of the European Commission of 11 November 1998 on the application of the State aid rules to measures relating to direct business taxation, see Annex 2 to the Applicant's Reply.

²² Reference is made to the DG IV working paper, see footnote 13, at para. 23, and a decision of the Commission, 1996 OJ L 146, p. 42, 20.06.96.

Decision.²³ The distortive effects on competition lie in the very nature and design of the differentiation, rather than being an incidental result of it. The measure is therefore a regional aid measure derogating from the general system to which it belongs, and cannot be considered justified.

38. The EFTA Surveillance Authority notes that the Applicant has not questioned its assessment in Section III.3 of the Decision, regarding the extent to which the differentiated contribution system qualifies for the exemptions provided for in Article 61(3)(a) and (c) EEA. These provisions provide a basis for the exemption of aid measures designed to promote policy objectives of the kind referred to by the Applicant and which, in its view, should have been taken into account in determining whether the system constitutes State aid within the meaning of Article 61(1) EEA. The EFTA Surveillance Authority thus submits that the EFTA Surveillance Authority has in fact examined to what extent the system was justified on the basis of the policy objectives underlying it.

The Commission of the European Communities

39. The Commission of the European Communities sets out observations on the scope of the judicial review to be carried out by the Court. In the context of the European Community, the Commission has a wide margin of discretion, the exercise of which involves economic and social assessments made in Community context. When a complex economic appraisal is needed, the Court must confine itself to verifying whether the Commission complied with the relevant rules governing procedure and the statement of reasons, whether the facts on which the contested finding was based have been accurately stated and whether there has been any manifest error of assessment or misuse of powers.²⁴ The Commission considers that in the present case a complex economic appraisal was needed as regards the applicability of Article 61(1) EEA, in particular given the abstract

²³ Reference is made to page 7, table 3, of the Decision.

Table 3 Revenue from employers' social security tax by tax zones NOK million (1994)

		Employees' zones of residence					Total
		Zone 1	Zone 2	Zone 3	Zone 4	Zone 5	
Location of employers	Zone 1	33916	750	8	73	0	34747
	Zone 2	322	3209	1	4	0	3537
	Zone 3	4	2	47	0	0	53
	Zone 4	71	11	1	1219	0	1302
	Zone 5	14	2	0	5	0	20
	Not stated	666	48	1	17	0	732
	Total	34993	4022	58	1318	0	40391

Source: Hervik, "Benefits from reduced pay-roll taxes in Norway"

²⁴ See Case C-56/93 *Belgium v Commission* [1996] ECR I-723.

character of the concept of the “nature or general scheme of the system”. It is for the Applicant to show that the EFTA Surveillance Authority has manifestly failed in its assessment.

40. The Commission of the European Communities submits that, in principle, geographical or regional selectivity is capable of constituting State aid within the meaning of Article 92(1) EC, and should not be treated differently than sectoral selectivity.²⁵ The Commission submits that the case law of the ECJ strongly implies that regional selectivity is in principle caught by Article 92(1) EC.²⁶

41. Like all derogations, an exception based on the nature or general scheme of the system should be interpreted restrictively. Once the requirements of Article 92(1) EC are met, there is a presumption of aid. A Member State seeking to rely on the derogation has the burden of proving that it applies.

42. The Commission doubts that the two elements of the test identified by the Applicant (see paragraphs 26 and 27 above) can be entirely dissociated. If the conclusion is reached that there is sectoral or regional selectivity, then it may be likely that the measure is not justified by the nature or general scheme of the system; favourable treatment indicates that the sector or region in question enjoys an economic advantage by comparison with other sectors or regions. On the other hand, when selectivity flows from a more abstract criteria, the possibility of justifying the measure by reference to the nature or general scheme of the system may warrant further consideration. The effects of the measure have to be determined, as does the issue of whether it leads to sectoral or regional advantages. Here the stated objectives do not carry decisive weight.

43. The Commission supports its view by an analysis of cases referred to by the Applicant, stressing in particular that two different cases should not be confused: on the one hand, export selectivity where, by definition, there is an effect on trade between Member States and, on the other, sectoral selectivity together with the presence of an effect on trade between Member States.²⁷

²⁵ The Commission refers to Articles 92(3) (a) and (c) EC, on sectoral and geographical selectivity respectively, the Articles suggesting that in both cases selectivity may be caught by Article 92(1); further the Commission refers to its own policy on assessment of regional aid and to paragraph 5 of the Commission’s Notice on monitoring of State aid and reduction of labour costs (See footnote 12). The Commission further draws attention to Joined Cases C-400/97 to C-402/97 *Administracion del Estado and Juntas Generales de Guipuzcoa, de Alava y de Vizcaya* (pending).

²⁶ Case 323/82 *Inter Mills v Commission* [1984] ECR 3809, para. 3; Case 234/84 *Belgium v Commission* [1986] ECR 2263, para. 17; Case 248/84 *Germany v Commission*, see footnote 9. See also Case 70/72 *Germany v Commission*, see footnote 9; Joined Cases 6 and 11/69 *Commission v France*, see footnote 9 and Case 310/85 *Deufile v Commission*, see footnote 9.

²⁷ The Commission analyses Joined Cases 6 and 11/69 *Commission v France*, see footnote 9; Case 173/73 *Italy v Commission*, see footnote 6; Case 203/82 *Commission v Italy* [1983] ECR 2525; Joined Cases C-72 and C-73/91 *Sloman Neptun*, see footnote 6, and the decision in *Maribel Quater*, see footnote 11.

44. While the scheme under consideration refers to the more abstract criterion of the place of residence of the employee, this criterion has been found to translate into or correlate with regional selectivity in about 90% of cases. Thus, the Commission disagrees with the assertion that the criterion selected by the State is neutral and objective viewed from the position of the competing enterprises. Neither does the Commission agree with the statement that the Norwegian measure is targeted at certain categories of employees as, in fact, the measure has its principal effects in relation to undertakings located in certain regions.

45. The Commission agrees with the EFTA Surveillance Authority on the regional selectivity effect and that lower rates cannot be justified by the nature or general scheme of the system. The Commission submits that the Applicant has not demonstrated that the EFTA Surveillance Authority manifestly erred in its appreciation of the facts.

b) Effects on trade between Contracting Parties

The Applicant

46. If the Court finds that the EFTA Surveillance Authority correctly found that the criterion of selectivity was fulfilled, the Applicant submits that the Decision must be annulled, as it does not define which parts of the system affect trade between the Contracting Parties.

47. The Applicant submits that, to establish a breach of Article 61(1) EEA, it is necessary to show that the aided undertakings or products are competing in intra-EEA trade with other undertakings or products.²⁸ More specifically, trade must be affected to some extent, cf. the *de minimis* rule, according to which Article 92(1) EC is inapplicable if there is a lack of noticeable effect on trade, set at ECU 100 000 per firm over a period of three years.²⁹ Secondly, the assessment must be on an undertaking-by-undertaking or at least sector-by-sector basis. Where many undertakings in various sectors benefit from an aid scheme, the fact that certain recipients compete in intra-EEA trade does not make the entire scheme incompatible with the Agreement.³⁰

²⁸ See Case 197/73 *Italy v Commission*, see footnote 6; Case 730/79 *Philip Morris v Commission* [1980] ECR 2671.

²⁹ See Chapter 12 of the State Aid Guidelines, adopted by the EFTA Surveillance Authority, cf. amendments of 15 May 1996, which establishes the same *de minimis* rule for the EEA.

³⁰ See Case 173/73 *Italy v Commission*, see footnote 3, at para. 19; Case 310/85 *Deufil v Commission*, see footnote 9, at paras. 11-12; Case T-214/95 *Vlaams Gewest v Commission* [1998] ECR II-717, at paras. 52-53.

48. The Applicant maintains that it is undisputed that many undertakings benefiting from lower social security contribution rates in zones 2 to 5 cannot have the potential to affect intra-EEA trade and that the EFTA Surveillance Authority accepts the fact that lower rates apply to a range of economic activities sheltered from international competition. However, the EFTA Surveillance Authority finds the entire system as such incompatible with the Agreement. As Article 61(1) EEA only prohibits State aid “in so far as” trade between the Contracting Parties is affected, the EFTA Surveillance Authority has misapplied Article 61(1) EEA and the Decision must be annulled in its entirety.

49. The Applicant submits that it is clearly necessary to draw the line as to the scope of Article 61(1) EEA applied to the Norwegian scheme, and submits that it is for the EFTA Surveillance Authority and not for the Court to make that assessment under Article 5(2)(a) of the Surveillance and Court Agreement.

The EFTA Surveillance Authority

50. The EFTA Surveillance Authority points out that State aid may take the form of a specific measure or an aid scheme. The EFTA Surveillance Authority’s examination of the compatibility with the EEA Agreement of an aid scheme relate to the scheme itself and not to any individual aid granted under the scheme. For the scheme to be approved, it has to be compatible with the Agreement in all respects and, if it leaves room for the granting of aid incompatible with the Agreement, it cannot be considered compatible unless altered so as to eliminate the possibility of granting such aid. Further, partial approval is possible if the scheme contains criteria on which separation between the compatible and incompatible parts can be made, and aid schemes can be approved subject to conditions.

51. Monitoring of State aid under the EEA Agreement depends on co-operation with the State concerned, and the justification and information necessary in order for the scheme to be approved in part or subject to conditions will first of all have to be provided by the State.

52. With regard to determining whether an aid scheme affects competition and trade between EEA States, the assessment will normally have to be made in the abstract on the basis of the characteristics of the scheme as such, rather than on the basis of the actual situation of any potential recipient, which would include *inter alia* an analysis of the market.³¹

53. A decision declaring an existing aid scheme incompatible with the EEA Agreement is constitutive and brings into force, as of the date set for compliance, the implied prohibition in Article 61(1) EEA. Such a decision does not affect

³¹ Case C-248/84, *Germany v Commission*, see footnote 9, at para. 18.

grants of aid already made under the scheme, nor does it imply any formal determination of the compatibility with the Agreement of any further grants under the scheme. However, after the date set for compliance, the aid will not constitute existing aid but rather new aid and will fall under the procedure laid down in Article 61(3) EEA. Accordingly, aid granted without prior authorization will, provided that the aid falls within the scope of Article 61(1) EEA, be illegal.

54. The EFTA Surveillance Authority submits that the contention of the Applicant to the effect that the EFTA Surveillance Authority misapplied Article 61(1) EEA by finding the system as such incompatible with the EEA Agreement, regardless of the situation of undertakings not operating in intra-EEA competition, and that it exceeded its powers by subjecting the benefits enjoyed by such undertakings to notification or other obligations, is based on a misconception of the scope and implications of the Decision.

55. First, the only effect of the Decision is that, after 31 December 1998, a benefit under the system can no longer be considered existing aid within the meaning of Article 61(1) EEA. While this means in principle that any benefit granted under the system after the set date will be illegal unless notified and authorized, this applies only to benefits constituting aid within the meaning of Article 61(1) EEA. Thus, in respect of benefits falling outside the scope of the Agreement, the finding in no way alters the situation prevailing prior to the Decision. Secondly, as regards the necessary adjustments to the system required by the EFTA Surveillance Authority, they are not obligations imposed on Norway, but only indications as to what would be required in case Norway, in order to comply with the Decision, were to opt for retaining the system rather than replacing or abolishing it. If benefits under the altered system did not affect or threaten to affect trade, but nevertheless were subject to the reporting condition or other conditions, this would not be a result of the Decision of the EFTA Surveillance Authority but of the fact that the system submitted for approval included both aid and benefits not constituting aid.

The Commission of the European Communities

56. The Commission submits that the existence of an economic activity is a prerequisite for the application of Article 61(1) EEA. Once an economic activity has been identified, there is a strong presumption that the aid distorts competition, representing as it does the intervention of the State in the operation of the market. Thus the Commission contests the view that “undertakings sheltered from all competition” necessarily fall outside the scope of Article 61(1) EEA. An undertaking which is sheltered from competition as a result of measures taken by the State might nevertheless be engaged in economic activity, and as such will be subject to the discipline of Article 61(1) EEA. To what extent the scheme involves aid to certain beneficiaries that are not engaged in economic activity is in any event immaterial, as the scheme in question involves, in the

Commission's submission, in very large measure, undertakings engaged in economic activity and aid that would distort competition.

57. The EFTA Surveillance Authority has the power to conduct the analysis under Article 61(1) EEA by reference to a scheme (regime or system) expressed in the abstract, rather than by reference to specific undertakings. This is confirmed by Article 62(1) EEA, the practice of the Commission and the case law of the ECJ.³² In such an analysis, the EFTA Surveillance Authority should not approve a scheme unless the terms of the scheme are sufficiently precise so as to make it impossible in law for an aid to be granted under the scheme that would not be consistent with the State aid rules.

58. As to the Applicant's assertion that the EFTA Surveillance Authority should have approved the scheme in so far as it relates to aid to beneficiaries which does not distort or threaten to distort competition, the Commission observes *inter alia* the wide margin of discretion the EFTA Surveillance Authority is allowed in deciding the terms on which it is prepared to authorize a scheme. In the light of the wide concept of economic activity, the Commission further submits that it is likely that the group of such beneficiaries would be small.

59. It is, however, up to the Applicant to come forward with concrete suggestions about how to differentiate in practice between those beneficiaries under the scheme it considers caught by Article 61(1) EEA and those it considers not caught, if the Government wishes to pursue the line proposed by it. The Commission submits that the Applicant is estopped from pleading its own failure to so differentiate the aid in defence of the scheme as a whole. The Commission considers that the Applicant has no legal interest in annulment of the contested decision, because the contested decision, correctly interpreted, does not preclude the Applicant from continuing to grant assistance to certain beneficiaries in circumstances where there is no distortion of competition (or no effect on trade between contracting parties), and thus no aid within the meaning of Article 61(1) of the Agreement.

60. As regards the Applicant's arguments in relation to effect on trade between the Contracting Parties, the Commission submits that the Applicant does not accurately state the law. It is not necessary, in order for there to be an effect on trade between Contracting Parties, that the product or service in question is actually exported from or imported to the State concerned. It is sufficient if there are undertakings in other States that are in competition with the undertakings receiving the aid. In such a case, the aid strengthens the position of the recipient vis-à-vis its competitor in the other State and potentially reduces the possibilities for the competitor to enter the market of the aid recipient. Such aid is capable of affecting trade between Contracting Parties.

³² Case C-47/91 *Italy v Commission* ("*Italgrani*") [1994] ECR I-4635, at para. 21; Case 248/84 *Germany v Commission*, see footnote 9, at para. 18.

The second submission - failure to state reasons

The Applicant

61. The Applicant refers to Article 16 of the Surveillance and Court Agreement and the *Scottish Salmon Growers* case³³ and submits that the EFTA Surveillance Authority has failed to adequately explain, first, why the system in question is not sufficiently general and, secondly, why aid to undertakings sheltered from international competition is incompatible with the Agreement.

62. As regards the first point, the Applicant notes in particular that the EFTA Surveillance Authority has not explained why the neutral parameter applied (residence of the employee) and the policy considerations pursued by the Norwegian Government are of “no relevance”.

63. As regards the second point, the Applicant submits that it constitutes a breach of the EFTA Surveillance Authority’s obligation to set out the “principal issues of law” that the EFTA Surveillance Authority does not explain why aid to undertakings that are clearly not affected by intra-EEA competition falls within the scope of Article 61(1) EEA.

64. The EFTA Surveillance Authority further does not fulfil its obligation to set out the “principal issues of...fact” in relation to alleged distortion of competition. The EFTA Surveillance Authority must, in the submission of the Applicant, provide information on the existence of channels of trade in the sector concerned, the relevant market situation, the beneficiary’s share of the market and its export to other Contracting Parties.³⁴ The Applicant maintains that these questions are only briefly touched on by the EFTA Surveillance Authority, and only in so far as concerns a very few of the undertakings covered by the scheme.

65. The failure to draw the line as to which undertakings operate under conditions of intra-EEA trade and which fall outside the scope of Article 61(1) EEA is an infringement of the EFTA Surveillance Authority’s obligation to give clear decisions.³⁵

³³ Case E-2/92 *Scottish Salmon Growers Association v ESA* [1994-95] EFTA Court Rep. 59, at para. 25.

³⁴ See Joined Cases 296 and 318/82 *Netherlands and Leeuwarder Papierwarenfabriek v Commission* [1985] ECR 809.

³⁵ See *inter alia* Case 70/72 *Commission v Germany*, see footnote 9.

The EFTA Surveillance Authority

66. The EFTA Surveillance Authority submits that the reasons stated in the Decision were sufficient for the purposes of Article 16 of the Surveillance and Court Agreement. All relevant issues were adequately addressed, the EFTA Surveillance Authority's findings explicitly spelled out and the circumstances relied upon in making the findings clearly identified. This applies to the EFTA Surveillance Authority's reasoning with regard to the general nature of the system and the relevance of the policy considerations pursued by the Norwegian Government.

67. The Applicant's second point, that the EFTA Surveillance Authority did not explain why undertakings that clearly were not affected by intra-EEA competition fell within the scope of Article 61 EEA, reflects, in the submission of the EFTA Surveillance Authority, a misconception on the part of the Applicant. The reasons for the EFTA Surveillance Authority's finding that the differentiated contribution system affected trade are, in the EFTA Surveillance Authority's view, clearly sufficient for the purpose of Article 16 of the Surveillance and Court Agreement.

68. Third, the EFTA Surveillance Authority submits that, with regard to setting out the principal issues of fact, a different assessment is involved in cases concerning an aid system and an aid measure for the benefit of an identified recipient, such as the situation was in the case referred to by the Applicant.³⁶ In any case, the EFTA Surveillance Authority argues, the circumstances set out in the Decision were clearly sufficient both to meet the requirements indicated in *Leeuwarder* and for the purposes of Article 16 of the Surveillance and Court Agreement.

The Commission of the European Communities

69. The Commission submits that the Decision more than satisfies the requirements established by the case law with regard to the statement of reasons.³⁷ On the specific issues raised by the Applicant, the complaint that the Decision "does not explain why the neutral parameter applied is of no relevance" and that the Decision "does not explain why the policy considerations pursued by Norway are of no relevance", the Commission submits that the necessary

³⁶ Joined Cases 296 and 318/82 *Netherlands and Leeuwarder Papierwarenfabriek v Commission*, see footnote 34.

³⁷ Case C-56/93 *Belgium v Commission* [1996] ECR I-723, at para. 86; Case C-367/95 P *Commission v Sytraval and Brink's France* [1998] I-1719, at para. 63.

statements of fact and law are present, as well as the logical statements connecting them. As regards the reasoning concerning the effects on trade between Contracting Parties of the scheme as a whole, the Commission submits that the Applicant itself refers to the relevant part of the Decision, which more than satisfies the requirements of the case law.

70. The Commission notes that the Applicant seeks to introduce arguments that do not relate to the reasoning of the Decision, but in reality relate to the assessment by the EFTA Surveillance Authority of the facts. These two pleas should not be confused.³⁸

Thór Vilhjálmsson
Judge-Rapporteur

³⁸ See Case C-367/95 P *Commission v Sytraval and Brink's France*, see footnote 37.