**JUDGMENT OF THE COURT**
7 April 2006

*(Action for annulment of a decision of the EFTA Surveillance Authority – State guarantee for a publicly owned institution – State aid – Services of General Economic Interest – Decision not to raise objections – Initiation of the formal investigation procedure – Admissibility)*

In Case E-9/04,

**The Bankers' and Securities' Dealers Association of Iceland,** represented by Dr. Hans-Jörg Niemeyer, Rechtsanwalt, Brussels, Belgium and Dr. Ralf Sauer, Rechtsanwalt, Berlin, Germany,

*Applicant,*

supported by **the European Banking Federation**, represented by Marc Pittie, Avocat, Brussels, Belgium,

*Intervener*,

v

**EFTA Surveillance Authority**, represented by Michael Sánchez Rydelski, Deputy Director, Legal & Executive Affairs, and Bjørnar Alterskjær, Officer, Legal & Executive Affairs, acting as Agents, Brussels, Belgium,

*Defendant*,

supported by **the Republic of Iceland**, represented by Finnur Þór Birgisson, First Secretary and Legal Officer, Ministry for Foreign Affairs, acting as Agent, and Peter Christian Dyrberg, acting as Counsel,

*Intervener*,

APPLICATION for the annulment of Decision No 213/04/COL of 11 August 2004 concerning the Icelandic Housing Financing Fund,

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THE COURT,

composed of: Carl Baudenbacher, President, Thorgeir Örlygsson and Henrik Bull (Judge-Rapporteur), Judges

Registrar: Henning Harborg,

having regard to the written pleadings of the parties and the written observations of the Kingdom of Norway, represented by Eyvin Sivertsen, Assistant Advocate, Office of the Attorney General, and Gry Karen Waage, Adviser, Ministry of Foreign Affairs, acting as Agents, and the written observations of the Commission of the European Communities, represented by Nicolas Khan, acting as Agent,

having regard to the Report for the Hearing,

having heard oral argument of the Applicant, the Defendant, the Interveners, the Kingdom of Norway and the Commission of the European Communities at the hearing on 17 January 2006,

gives the following

## Judgment

### I Factual background

1 For the past 50 years, public intervention in the Icelandic housing market has been aimed at encouraging private home ownership. In 1955, a basis for a systematic State involvement, both as regards policy making in the field of housing affairs and the provision of loans for private housing, was laid. The State Housing Agency (Húsnæðisstofnun ríkisins) was established by Act No 51/1980 and provided, *inter alia*, loans on preferential terms to private home buyers.

2 In 1986 the housing loan system underwent certain changes entailing, *inter alia*, that the pension funds undertook to provide partial funding of the system. The Icelandic banks generally did not provide funding for private housing. At this time, the State Housing Agency issued housing loans below market rates. This led to a substantial increase in demand, which in turn stretched the resources of the pension funds beyond their limits. In order to remedy this situation, and to generate more financial resources to finance housing, a housing bond system was introduced in 1989. The housing bond system generated funding for the provision of housing loans. The issuing of housing bonds and the operation of the system were entrusted to the State Housing Agency.

3 The housing bond system was not a traditional mortgage loan system but a bond swap system. Private home buyers issued a mortgage bond, which was secured against the property under purchase. The State Housing Agency then bought the mortgage bond from the private home buyer and paid for it by issuing a housing bond to the seller, who could sell the housing bond on the securities market, use it as means of payment or keep it.

4 The housing bonds had maximum loan periods of 40 years but were subject to prepayment without penalty. They were linked to the consumer price index and carried a fixed real interest of 4.75%. The housing bonds were secured by all the assets of the State Housing Agency, which consisted primarily of the collateral (the mortgage-secured bonds) that the Agency held in property. In addition, the housing bonds benefited from a guarantee of collection by the State.

5 The mortgage bonds had the same loan terms as the housing bonds, but with a fixed interest surcharge of 0.35 percentage points, to cover operational costs and expected losses on loans. This meant that the lending rate under the housing bond system was set at 5.10% in real terms.

6 The Act on Housing Affairs No 44/1998 (the "Housing Act") entered into force on 1 January 1999 and established the Housing Financing Fund (the "HFF") (Íbúðalánasjóður). It took over all assets and obligations of the State Housing Agency, including the tasks of issuing housing bonds and providing housing loans through the bond-swap system. The HFF is an independent State-owned institution and the State carries full liability for obligations undertaken by it. The HFF does not pay any corporate tax or property tax.

7 The Housing Act was amended by Act No 57/2004, which entered into force on 1 July 2004. A number of changes were made to the housing loan system, *inter alia* the system of swapping mortgage bonds for housing bonds was abolished. However, the general purpose and structure of the system remained the same as further described in paragraphs 8 and 9. After 1 July 2004, loans have been paid out in cash to home buyers and secured by mortgages in the property under purchase.

8 At the time when the EFTA Surveillance Authority (hereinafter "ESA") adopted the decision at issue in the present case, the HFF provided three categories of loans. First, it provided *general loans* to individuals for the purchase, renovation or construction of residential housing. Second, the HFF provided *supplementary loans* awarded to individuals with low income and limited assets upon referral from the housing committee of a municipality. Finally, the HFF provided *loans for rental housing* to municipalities, associations and companies for the construction or purchase of residential housing to be rented out. The *supplementary loans* were later abolished by Act No 120/2004, which entered into force on 3 December 2004.

9 The *general loans* described above are available on equal terms to all residents in Iceland, regardless of nationality, on the conditions laid down in and pursuant to

the Housing Act. The loans are not limited to persons with income below a certain income bracket or with limited assets.

10 Prior to the amendments of 1 July 2004, the *supplementary loans* and the *loans for rental housing* were not financed through housing bonds, but through a separate class of bonds issued by the HFF. As of 1 July 2004, the HFF stopped issuing both the separate class of bonds and the housing bonds. The main means of funding the HFF became the HFF bonds. Unlike the housing bonds, which were subject to prepayment without penalty, the HFF bonds are non-callable. As loans from the HFF are still subject to prepayment without penalty, the interest surcharge paid by borrowers was increased from 0.35 to 0.6 percentage points as of 1 July 2004, in order to take account of the new risk created by the mismatch in optionality between assets and liabilities. However, as the HFF bonds are issued in classes with varying interest rates depending on the market situation, the interest rates charged to HFF borrowers fluctuate.

11 The housing financing system previously operated by the State Housing Agency and currently by the HFF has a large share of the market for mortgage-secured loans for residential housing in Iceland. Between 1997 and 2003, the system had a market share of about 77.5% to 79%. The rest was shared between the pension funds (roughly 13% to 17%) and the commercial banks and savings banks (roughly 4.5% to 8%). The banks did, however, provide certain services for the HFF, such as being the sole agents for evaluating borrowers for the HFF. Until a process of privatisation was completed in 2002–2003, most of the commercial banks were controlled by the State as majority shareholder.

12 Under the bond-swap system, a mortgage bond was exchanged for a housing bond for an amount up to 70% of a dwelling's appraised market value if the applicant was buying or building his first dwelling, but otherwise for up to 65% (the "relative lending cap"). The loans were also limited in relation to the fire insurance value, which was often lower than the market value. After the amendments to the Housing Act on 1 July 2004, the relative lending cap stayed the same. The relative lending cap has later been raised to 90% with Act No 120/2004, amending the Housing Act, which entered into force on 3 December 2004 (i.e. after ESA adopted the decision at issue in the present case).

13 In addition to the relative lending cap in terms of percentage of the dwelling's value, the Housing Act, both under the bond-swap system and after the amendments of 1 July 2004, states that a maximum lending cap is to be specified in regulations (the "absolute lending cap"). As specified in Regulation No 521/2004, which entered into force on 1 July 2004, the absolute lending cap was ISK 9.7 million for new housing and ISK 9.2 million for existing housing. Regulation No 959/2004 replaced Regulation No 521/2004 on 6 December 2004 and the absolute lending cap was raised to ISK 14.9 million (later to ISK 15.9 million) for both new and existing housing.

14 With the entry into force of Regulation No 522/2004 on 1 July 2004, a limit was set of two dwellings for each borrower financed through HFF general loans.

However, under exceptional circumstances a third dwelling can be permitted. Before that date, there was no such limit. There is no rule which limits the size or value of dwellings for which HFF general loans are available. The absolute lending cap limits the amount the HFF will lend, leaving the borrower to find top-up financing from other sources. Both under the bond-swap system and the loan system in operation from 1 July 2004, borrowers have the option of prepayment without penalty.

## II Relevant law

*EEA law*

15 Article 59(2) of the Agreement on the European Economic Area (hereinafter "EEA" or the "EEA Agreement") reads as follows:

> Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Agreement, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Contracting Parties.

16 Article 61 EEA reads as follows:

> 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.

17 Article 16 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice (hereinafter "SCA") reads as follows:

> Decisions of the EFTA Surveillance Authority shall state the reasons on which they are based.

18 Article 36(2) SCA reads as follows:

> Any natural or legal person may, under the same conditions, institute proceedings before the EFTA Court against a decision of the EFTA Surveillance Authority addressed to that person or against a decision addressed to another person, if it is of direct and individual concern to the former.

19 The first subparagraph of Article 1(2) in Part I of Protocol 3 to the SCA (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.

20 Article 4(3) and 4(4) in Part II of Protocol 3 SCA reads as follows:

> 3. Where the EFTA Surveillance Authority, after a preliminary examination, finds that no doubts are raised as to the compatibility with the functioning of the EEA Agreement of a notified measure, in so far as it falls within the scope of Article 61(1) of the EEA Agreement, it shall decide that the measure is compatible with the functioning of the EEA Agreement (hereinafter referred to as a 'decision not to raise objections'). The decision shall specify which exception under the EEA Agreement has been applied.
>
> 4. Where the EFTA Surveillance Authority, after a preliminary examination, finds that doubts are raised as to the compatibility with the functioning of the EEA Agreement of a notified measure, it shall decide to initiate proceedings pursuant to Article 1(2) in Part I (hereinafter referred to as a 'decision to initiate the formal investigation procedure').

21 Article 13(1) in Part II of Protocol 3 SCA reads as follows:

> The examination of possible unlawful aid shall result in a decision pursuant to Article 4(2), (3) or (4) of this Chapter. In the case of decisions to initiate the formal investigation procedure, proceedings shall be closed by means of a decision pursuant to Article 7 of this Chapter. If an EFTA State fails to comply with an information injunction, that decision shall be taken on the basis of the information available.

*National law*

22 The HFF is governed by the Housing Act, as amended, and various regulations, *inter alia* Regulation No 544/2004 on "the Financing and Risk Management of the Housing Financing Fund", Regulation No 522/2004 on "Borrowers' Mortgages and HFF Bonds" and Regulation No 521/2004 on "Loan Proportions and Maximum Amounts of Borrowers' Mortgages". According to Article 3 of the Housing Act, the HFF is accountable to the Minister of Social Affairs, who appoints its Board of Directors in accordance with Article 7 of the Housing Act.

23 The purpose of the HFF is described in Article 1 of the Housing Act and its main tasks are specified in Article 9 of the Act. Article 1 reads as follows:

> "The purpose of this act is to promote, through the granting of loans and organisation of matters relating to housing, that Icelanders will enjoy security and equal rights as regards housing, and that funds are provided in the specific purpose of increasing people's chances of acquiring or renting housing on manageable terms."

24 As mentioned in paragraph 8 above, the HFF provided three different categories of loans, as listed in Article 15 of the Housing Act, at the time when ESA adopted the decision at issue in the present case. First, it provided general loans to individuals for the purchase, construction or renovation of residential housing. Second, the HFF provided supplementary loans confined to individuals with low income for construction or purchase of their own residential housing. Finally, the HFF provided loans for rental housing to municipalities, associations and companies for the construction or purchase of residential housing to be rented out.

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

26 According to Article 19(2) of the Housing Act, as it read when the decision was adopted by ESA, the lending cap was 70% of the appraised value of a property if the borrower was buying or building his first dwelling. Otherwise it was 65%. According to Article 3 of Regulation No 521/2004 the absolute lending cap was set at ISK 9.7 million for new housing and ISK 9.2 million for existing housing.

27 Article 21(1) of Regulation No 522/2004 on "Borrowers' Mortgages and HFF Bonds" introduced a limit of two dwellings for each borrower financed through HFF general loans. However, in exceptional circumstances the HFF can finance a third dwelling according to Article 21(2) to a borrower in a special situation. The board of the HFF shall issue rules in further detail on the conditions in which this exemption may be granted.

28 According to Article 10 of the Housing Act, the HFF's means of financing its tasks are as follows: by return on the Fund's own capital, i.e. instalments, interest and price indexation payments on extended loans; by issue and sale of HFF bonds and by borrowing as may be provided for in the Budget Act at any particular time; and finally, by service charges as provided for in Article 49 of the Housing Act.

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

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

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

## III The administrative procedure and the contested decision

32 By letter of 20 November 2003 the Government of Iceland, pursuant to Article 1(3) in Part I of Protocol 3 SCA, notified the EFTA Surveillance Authority of an intended increase of lending by the HFF up to 90% of the purchase price of housing.

33 Pursuant to Article 5(1) in Part II of Protocol 3 SCA, ESA sent a letter dated 23 January 2004, requesting additional information from the Government of Iceland, to which the latter replied by letter of 11 March 2004.

34 By letter of 29 January 2004, the Bankers' and Securities' Dealers Association of Iceland (hereinafter the "SBV") informed ESA of the situation on the Icelandic market for home loans and expressed its view that the HFF system constituted an infringement of the EEA Agreement. The SBV is the business association of the three commercial banks in Iceland, namely Íslandsbanki, Landsbanki and KB Bank, and Sparisjóđabanki which comprises more than 20 local savings banks in Iceland and acts as their service and clearing bank. It subsequently, by letter of 20 April 2004, lodged a complaint alleging that the Icelandic legislation on the operation of the HFF was incompatible with the EEA Agreement, particularly the competition rules, the rules on State aid, free movement of services and capital and the freedom of establishment.

35 Based on Article 5(1) in Part II of Protocol 3 SCA, ESA sent a letter dated 14 May 2004 to the Government of Iceland requesting, for a second time, additional information and clarification, and in which it forwarded a copy of the complaint received from the SBV. The notification was discussed between representatives of the Icelandic Government, the HFF and the ESA during a State aid meeting in Reykjavík on 26 May 2004. The Government of Iceland subsequently replied to the second request for information in letters received by ESA on 11 June 2004 and on 1 July 2004. By an electronic mail message of 7 July 2004, the Government forwarded the national legislation in question as well as further documents and information to ESA.

36 The SBV's complaint was discussed at a meeting in Brussels on 14 June 2004 between representatives of the SBV and ESA. In a written statement of 23 June 2004, ESA informed the SBV that it saw no reason to take further action on the latter's complaint with regard to the alleged abuse of the dominant position of the HFF. By letter of 1 July 2004, ESA informed the SBV that ESA had not been able to detect any incompatibility of the HFF system with the four freedoms. In its view, possible restrictions were so indissolubly linked to the object of the State aid that it was impossible to evaluate them separately. By letters of 27 July 2004 and 23 August 2004, ESA informed the SBV that ESA had closed the case with regard to the competition issues and the alleged violation of the four freedoms, respectively.

37 On 11 August 2004, ESA adopted Decision No 213/04/COL (hereinafter the "contested decision"). In this decision, ESA concluded that, contrary to what the Republic of Iceland had asserted, the HFF system involved State aid within the meaning of Article 61(1) EEA. ESA furthermore found that the HFF system, established in 1999, constituted "new aid" which should have been notified to ESA pursuant to Article 1(3) in Part I of Protocol 3 SCA. However, ESA concluded that the aid in question was justified under Article 59(2) EEA. The operative part of the contested decision, point 1, reads as follows:

The EFTA Surveillance Authority has decided to declare the house financing mechanisms provided for by the Icelandic authorities in favour of the Housing Financing Fund to be compatible with the State aid rules according to Article 59(2) of the EEA Agreement.

## IV Procedure and forms of order sought

38 By an application lodged at the Registry of the Court on 23 November 2004, the Bankers' and Securities' Dealers Association of Iceland brought an action under Article 36 SCA for annulment of the EFTA Surveillance Authority's Decision No 213/04/COL of 11 August 2004 concerning the Icelandic Housing Financing Fund. The statement of defence from the EFTA Surveillance Authority was registered at the Court on 20 January 2005.

39 The Bankers' and Securities' Dealers Association of Iceland (hereinafter the "Applicant") claims that the Court should:

- annul the EFTA Surveillance Authority's Decision No 213/04/COL of 11 August 2004 concerning the Icelandic Housing Financing Fund; and

- order the EFTA Surveillance Authority to bear the costs.

40 The application for annulment of the contested decision is based on three pleas in law:

- that the EFTA Surveillance Authority failed to initiate a formal investigation procedure pursuant to Article 1(2) in Part I of Protocol 3 SCA, cf. Article (4)(4) in Part II of Protocol 3 SCA, although it was obliged to do so;

- that the EFTA Surveillance Authority failed to provide adequate reasons as required by Article 16 SCA; and

- that the EFTA Surveillance Authority interpreted and applied Article 59(2) EEA incorrectly.

41 The EFTA Surveillance Authority (hereinafter the "Defendant") claims that the Court should:

- dismiss the application as unfounded; and

- order the Applicant to pay the costs.

42 The Applicant's reply to the statement of defence was registered at the Court on 24 March 2005. A statement in intervention from the Republic of Iceland was registered on 18 May 2005. A rejoinder from the Defendant was registered on 1 June 2005. Furthermore, a reply from the Applicant to the statement in intervention from the Republic of Iceland was registered on 24 June 2005. A statement in intervention from the European Banking Federation was registered

on 12 July 2005. A reply from the Defendant to this intervention was registered on 15 September 2005 and a reply from the Applicant to the same intervention was registered on 16 September 2005.

43 The Kingdom of Norway and the Commission of the European Communities, respectively, submitted written observations registered at the Court on 15 February 2005.

44 The parties presented oral argument and replied to questions put to them by the Court at the hearing on 17 January 2006 in Luxembourg.

45 Reference is made to the Report for the Hearing for a fuller account of the facts, the procedure and the pleas and arguments of the parties, which are mentioned or discussed hereinafter only in so far as is necessary for the reasoning of the Court.

## V Admissibility

*Arguments of the parties*

46 The Commission of the European Communities (hereinafter the "Commission") claims that the application is admissible only with respect to the plea that ESA failed to initiate the formal investigation procedure. Conversely, the Commission submits that, with respect to the two other pleas put forward by the Applicant, the application is inadmissible. While not having addressed the question of admissibility in its defence, ESA stated in its rejoinder that it concurs with the Commission's view. The Republic of Iceland asserts that the Applicant does not fulfil the requirements for *locus standi* under Article 36(2) SCA as set out in the *Plaumann* case (Case 25/62 *Plaumann* v *Commission* [1963] ECR 199) with regard to the corresponding provision of Article 230(4) EC, and that the application is therefore inadmissible in its entirety. In the alternative, the Republic of Iceland argues that the application is admissible only with respect to the first plea.

47 The Commission submits that the mere fact that an Applicant may be considered to be a party concerned within the meaning of Article 88(2) EC (corresponding to Article 1(2) in Part I of Protocol 3 SCA) does not render it individually concerned for the purposes of Article 230(4) EC, corresponding to Article 36(2) SCA, and refers to Cases T-188/95 *Waterleiding Maatschappij "Noord-West Brabant" NV* v *Commission* [1998] ECR II-3713 at paragraph 54 and T-266/94 *Skibsværftsforeningen* v *Commission* [1996] ECR II-1399, at paragraph 45. According to the Commission, referring in particular to Case C-78/03 P *Commission* v *Aktionsgemeinschaft Recht und Eigentum*, judgment of 13 December 2005, not yet reported, at paragraphs 35–37, the Applicant would have to satisfy the test developed by the Court of Justice of the European Communities in *Plaumann* in order for all its pleas to be entertained.

48 The Applicant, supported by the European Banking Federation, claims that it fulfils the requirements for *locus standi* under Article 36(2) SCA, in that the

contested decision is of "direct and individual concern" to it. The Applicant disagrees with the Commission that different standards of admissibility apply with regard to the first plea (failure to initiate the formal investigation procedure) and the other two pleas (failure to provide adequate reasons and incorrect interpretation and application of Article 59(2) EEA). The Applicant asserts, in essence, that by seeking annulment of the contested decision also on the ground that ESA was in breach of its obligation to initiate the formal investigation procedure pursuant to Article 1(2) in Part I of Protocol 3 SCA, its status as a "party concerned" under that provision suffices for it to have *locus standi* under Article 36(2) SCA in respect of all three of its pleas.

49 With regard to its assertion that it is a "party concerned" under Article 1(2) in Part I of Protocol 3 SCA, the Applicant relies on the following facts: that it filed a complaint against the State aid provided to the HFF; that it participated actively in the preliminary examination by ESA in the matter now before the Court; and that the position of the members of the SBV as competitors on the housing financing market is strongly affected by the backing of the HFF through State guarantees.

50 The Applicant claims, in the alternative, that even if the Court were to follow the Commission's view regarding the application of the *Plaumann* test in respect of the second and third plea, it would still have *locus standi* in this respect. In the view of the Applicant, the SBV fulfils the requirement according to which undertakings are recognised as being individually concerned by a decision where those undertakings have played a significant role in the procedure leading to the decision, and provided that their position on the market is significantly affected by the aid which is the subject of the decision. In that respect, the Applicant refers to Case E-4/97 *Norwegian Bankers' Association* v *EFTA Surveillance Authority* [1999] EFTA Court Report 1, at paragraph 32; and Cases 169/84 *Cofaz* v *Commission* [1986] ECR 391, at paragraphs 24 and 25; C-106/98 P *Comité d'entreprise* v *Commission* [2000] ECR I-3659, at paragraphs 40 and 41; Joined Cases T-447/93, 448/93 and 449/93 [1995] ECR II-1971, at paragraphs 35 and 37; and T-36/99 *Lenzing* v *Commission*, judgment of 21 October 2004, not yet reported, at paragraphs 85–88. The Commission contests that the Applicant fulfils the requirements for *locus standi* on this basis and refers to *Aktionsgemeinschaft Recht und Eigentum*, cited above, at paragraphs 56–58 and 72.

*Findings of the Court*

51 In cases where ESA finds, on the basis of the preliminary examination only and without initiating the formal investigation procedure under Article 1(2) in Part I of Protocol 3 SCA, that aid is compatible with the EEA Agreement, the persons intended to benefit from the procedural guarantees inherent in the formal investigation procedure may secure compliance therewith only if they are able to challenge that decision. An action for the annulment of such a decision brought by one of the "parties concerned" within the meaning of Article 1(2) in Part I of Protocol 3 SCA should therefore be declared admissible. See to this effect Cases

E-4/97 *Norwegian Bankers' Association* v *EFTA Surveillance Authority* [1998] EFTA Court Report 38 (ruling on admissibility), at paragraph 26; and E-2/02 *Technologien Bau- und Wirtschaftsberatung GmbH and Bellona Foundation v EFTA Surveillance Authority* [2003] EFTA Court Report 52, at paragraph 45).

52 As the SBV is an association of banks whose members are in competition with the HFF, it must be considered a party "concerned" within the meaning of Article 1(2) in Part I of Protocol 3 SCA. Since the SBV, by means of the present action, is seeking to safeguard its procedural rights, the Court finds that the application is admissible with respect to the plea that ESA failed to initiate the formal investigation procedure.

53 Only if the Court comes to the conclusion that the first plea is not well-founded will it become necessary to address the question of whether the application would also be admissible with respect to the other pleas.

## VI The first plea – failure to initiate the formal investigation procedure

*Arguments of the parties*

54 The Applicant essentially puts forward four arguments why ESA's evaluation of the HFF system must have raised serious difficulties, meaning that doubts as to the system's compatibility with Article 59(2) EEA remained at the end of the preliminary examination. Firstly, the Applicant points to the time it took ESA to come to a decision (almost 9 months from the registration of Iceland's notification). In that regard, the Applicant refers to the judgment of the Court of First Instance of the European Communities (hereinafter the "CFI") in Case T-73/98, *Société Chimique Prayon-Rupel SA* v *Commission*, [2001] ECR II-867, in which, according to the Applicant, that Court held that even seven months exceeds the normal time frame. Secondly, the Applicant submits that ESA deemed Iceland's notification to be incomplete, and that this prompted two rounds of additional information and clarification by Iceland. Thirdly, the Applicant is of the opinion that there was a need for more information from the Commission, the European Banking Association and other national banking associations in order to assess whether the HFF general loans scheme met the many criteria to be fulfilled under Article 59(2) EEA. Fourthly, ESA allegedly did not properly address the question of whether the scheme also violated the rules on free movement.

55 The European Banking Federation supports the Applicant's plea that a formal investigation procedure should have been initiated and submits that the compatibility assessment under Article 59(2) EEA entails several complex legal issues, such as the notion of a service of general economic interest, the extent to which costs for such a service are overcompensated by the public funding it receives, and whether the State measure has an effect on the development of trade contrary to the interest of the Contracting Parties.

56 The Commission is of the opinion that the HFF scheme raises serious difficulties, particularly with regard to proportionality, from the perspective of both its social and its territorial cohesion objectives. The Commission submits that for this reason the decision should be annulled.

57 The Defendant submits that the total time used in the case at hand very much reflects the average case-handling time in cases regarding unlawful aid, in which the competent authority decides not to open formal investigations. It points out that the judgment of the CFI in *Prayon-Rupel* concerned notified aid which was lawful on procedural grounds, and that for this reason a two months period for completing the preliminary examination applied which does not apply to the case at hand. In any case, ESA submits that it was able to render its decision (on 11 August 2004) within less than two months after it had received Iceland's answers (on 1 July 2004) to its last request for additional information, and that even the two months' period, when it applies, only runs from the receipt of a complete notification. ESA is also of the opinion that the two rounds of clarification do not demonstrate that there were any doubts at the end of the preliminary examination. ESA submits further, that it is under no obligation to consult with the Commission, but that in any case it may consult with the Commission without opening a formal investigation procedure. Furthermore, ESA contests that a formal investigation procedure would have unearthed any new information with regard to the factual situation, compared to the information that it had received during the preliminary examination, *inter alia* from the Applicant. Finally, ESA submits that its explanations on whether the HFF system infringed the four freedoms show that it had no difficulties in concluding that these allegations were unfounded.

58 The Republic of Iceland concurs with ESA with regard to why there were no doubts at the end of the preliminary examination which should have prompted the initiation of a formal investigation procedure.

59 The Kingdom of Norway also supports ESA with regard to the first plea and emphasises that the relevant provisions in Part II of Protocol 3 SCA must be interpreted in such a way as to permit ESA to conduct a diligent examination before deciding whether or not to initiate formal investigations. The time frame of the preliminary examination must be seen in this perspective.

*Findings of the Court*

*General remarks*

60 When reviewing new aid, the preliminary examination provided for under Article 1(3) in Part I of Protocol 3 SCA is intended merely to allow ESA to form a *prima facie* opinion on the partial or complete compatibility of the aid in question with the EEA State aid provisions. This examination must be distinguished from the investigation under Article 1(2) in Part I of the Protocol – the formal investigation procedure – which is designed to enable ESA to become fully informed of all the facts of the case and to protect the rights of parties concerned

by allowing them to make their views known (see Case E-2/02 *Technologien Bau- und Wirtschaftsberatung GmbH and Bellona Foundation* v *EFTA Surveillance Authority* [2003] EFTA Court Report 52, at paragraph 44). The preliminary examination does not include any obligation to give the parties concerned notice to submit their comments. In a formal investigation procedure, consultation is carried out by means of the decision to initiate a formal investigation being publicised in the Official Journal of the European Union. This decision shall call upon the parties concerned to submit their comments.

61 It is against this background that the requirement under Article 4(4) in Part II of Protocol 3 SCA to initiate a formal investigation procedure when "doubts are raised as to the compatibility with the functioning of the EEA Agreement", must be read. Therefore, when taking a decision in favour of an aid, ESA may restrict itself to the preliminary examination provided for under Article 1(3) in Part I of Protocol 3 SCA only if it is in a position to reach the firm view, following the initial investigation, that the measure cannot be classified as aid within the meaning of Article 61(1) EEA or that the measure, whilst constituting aid, is compatible with EEA rules. If the initial analysis should have led ESA to the opposite conclusion, ESA is under an obligation to carry out all the requisite consultations and to that end to initiate the formal investigation procedure pursuant to Article 1(2) in Part I of Protocol 3 SCA. The same applies if that analysis does not enable all the difficulties involved in determining whether the measure is compatible with the State aid rules to be overcome (see, for comparison, Case C-225/91 *Matra* v *Commission* [1993] ECR I-3203, at paragraph 33). This must also apply when the difficulties concern the application of Article 59(2) EEA.

62 In this context, not only difficulties in establishing the facts of the case are relevant but also difficulties with regard to points of law and economic and social assessments. Otherwise, interested parties would not be in a position to fully safeguard their interests, and ESA would lose potentially useful points of view. In particular cases which concern services of general economic interest and involve an assessment under Article 59(2) EEA may be complex in nature and also give rise to complicated questions of law.

63 The fact that some interested parties have been given the opportunity to submit information and make comments during the preliminary examination does not suspend the obligation to initiate a formal investigation procedure if at the end of the preliminary examination doubts still remain. Other interested parties may have been overlooked and, in any case, a formal investigation procedure may provide interested parties with a better basis to submit information and comments.

64 The notion of "doubts" under Article 4 in Part II of Protocol 3 SCA is an objective notion. The issue of whether or not doubts exist with regard to the facts, points of law or economic or social assessments requires investigation of both the content of the contested aid scheme and the circumstances under which it was adopted or operated. The investigation must be conducted objectively,

comparing the grounds of the decision with the information available to ESA when it took a decision on the compatibility of the disputed aid with the EEA Agreement. It follows that judicial review by the Court of the existence of "doubts" under Article 4 in Part II of Protocol 3 SCA will, by nature, go beyond simple consideration of whether or not there has been a manifest error of assessment by ESA in not initiating a formal investigation procedure (see, to that effect, Cases C-198/91 *Cook* v *Commission* [1993] ECR I-2487, at paragraphs 31 to 38; C-225/91 *Matra* v *Commission* [1993] ECR I-3203, at paragraphs 34 to 39; and T-73/98, *Société Chimique Prayon-Rupel SA* v *Commission* [2001] ECR II-867, at paragraph 47).

65 The Court must nevertheless take into account that ESA's role is limited to arresting manifest error by the EFTA States as concerns the issue of whether the service in question qualifies as a service of general economic interest. As a consequence of the discretion enjoyed by the Contracting Parties in deciding which services they consider to be of general economic interest, it is for the Court to examine only whether there were doubts that the State did not commit manifest error in deeming the service in question to be a service of general economic interest.

*Doubts as to whether the HFF scheme qualifies as a service of general economic interest*

66 As mentioned in paragraph 8 above, the HFF granted, at the time when ESA adopted the contested decision, loans in the form of *general loans*, *supplementary loans* and *loans for rental housing*. The contested decision accepts all three lending activities as services of general economic interest. The Applicant's arguments concerning doubts as to whether HFF loans could qualify as a service of general economic interest are limited to the general loans scheme. The Court does not find it necessary to address the other two schemes.

67 What is decisive in the assessment of whether certain services are services of general economic interest within the meaning of Article 59(2) EEA, are the essence of the services deemed to be of general economic interest and the special characteristics of this interest that distinguish it from the general economic interest of other economic activities. Furthermore, Contracting Parties may take account of objectives pertaining to their national policy when defining the services of general economic interest which they entrust to certain undertakings. The service of general economic interest must be clearly defined by the Contracting Party. (See Case E-4/97 *Norwegian Banking Association* v *EFTA Surveillance Authority* [1999] EFTA Court Report 1, at paragraph 47 and 48; hereinafter "*Husbanken II*.")

68 The tasks of the HFF are defined in the Housing Act and further laid down by Regulations and ministerial decisions. The HFF general loans system is intended to promote security and equal rights as regards housing in Iceland by providing loans on manageable terms to the general public throughout the territory of Iceland and thereby foster private home ownership. This goes beyond the normal

economic interest of operators in the financial sector. A service with this objective may qualify as a service of general economic interest justifying State aid, provided that the service fulfils the requirements laid down in Article 59(2) EEA. In that respect, the presumptions or conditions under which the HFF system operates (cf. Case E-4/97 *Husbanken II*, at paragraph 48) will be addressed below.

*Doubts as to the proportionality in derogating from State aid rules*

69 Under Article 59(2) EEA, ESA must assess whether the application of State aid rules to the operation of the HFF general loans scheme obstructs the performance, in law or in fact, of the particular tasks assigned to HFF under that scheme. This must include an assessment of whether the subsidised HFF general loans scheme is a suitable means of attaining its objective. There is no reason why a service which is not suitable to meet its aim should benefit from a derogation from the EEA rules. Furthermore, this also calls for an analysis of whether the HFF, or a different provider, could have provided loans at the same "manageable terms" as the HFF provided at the relevant time without, or with less, State aid.

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

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

72 Secondly, as to the question of whether there were doubts that neither the HFF, nor a different provider, could have provided loans at the same "manageable terms" at the relevant time without, or with less, State aid, the Court recalls that the interest rates charged by the HFF for its general loans are calculated on the basis of its funding costs, with an added margin set by the Minister of Social Affairs. This margin was set at 0.6 percentage points from 1 July 2004, up from 0.35 percentage points. The funding costs consist mainly in the interest paid on bonds issued by the HFF. In this context, the HFF benefits from the State

guarantee which follows from the State's unlimited liability for the HFF's debts as its owner.

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

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

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

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

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

be eligible for a general loan under the HFF scheme; there are only limits to how much the HFF may grant as a general loan.

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

79 These features mean that in principle the HFF general loans scheme provides subsidised financing, up to a certain limit, for any house or apartment regardless of size and value, and also for construction or purchase of residential units for investment purposes. The scheme is not formally limited to assisting the average citizen in financing his or her own dwelling. Even if it may be so that few people have in fact exploited these features of the system, they raise questions under Article 59(2) EEA. The Court recalls in this context that the HFF scheme is intended to promote security and equal rights as regards housing by providing loans on manageable terms. Whether the above-mentioned features of the aid system at stake go beyond this is not clear. That warrants an in-depth assessment, with the opportunity for interested parties to comment. Only a formal investigation procedure would have provided such an opportunity. For that reason, "doubts" within the meaning of Article 4(4) of Protocol 3 SCA did remain at the conclusion of the preliminary examination as to whether the conditions under which general loans were achievable from HFF were proportionate to the aim of the service deemed to be a service of general economic interest.

*Doubts as to effects of the HFF general loans scheme on the development of trade contrary to the interests of the Contracting Parties*

80 As regards whether any alternative model for State-supported housing financing could have a lesser negative impact on the development of trade, which pursuant to Article 59(2) EEA must not be affected to such an extent as would be contrary to the interests of the Contracting Parties, the Court recalls that it is not a requirement that the measure adopted be the least restrictive possible. Rather, the test is of a negative nature: it examines whether the measure adopted is not disproportionate (see Case E-4/97 *Husbanken II*, at paragraph 62). In that appraisal, the common EEA interest, requiring extensive freedom in the field of services and capital as well as establishment, is to be balanced with Iceland's interest in regulating its housing policy according to the political goals set (see Case E-4/97 *Husbanken II*, at paragraph 70).

81 As part of the assessment of whether the scheme did not affect the development of trade to such an extent as would be contrary to the interests of the Contracting Parties, the relevant market must be defined. ESA considered "long-term house

financing for residential accommodation" to be the relevant product market (see section II point 3.2.3 of the contested decision). It is not obvious to the Court that the assessment should be limited in scope in this way, excluding the possible effects of the aid granted to the HFF on other parts of the EEA internal market, in particular the financial markets. For that reason, the definition of the relevant market in this particular case is also an issue which interested parties ought to be able to comment upon in a formal investigation procedure. The further assessment of the consequences of the HFF general loan system on the development of trade will depend to a considerable extent on the definition of the relevant market which the formal investigation procedure will lead to.

*Doubts as to the effects of the HFF general loans scheme on the fundamental freedoms*

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

*Duration of the preliminary examination and the need for additional information*

83 As to the duration of the preliminary examination by ESA, in conjunction with requests for additional information, this may be evidence, but not proof, that the conditions are not fulfilled for basing a decision in favour of the State aid on the preliminary examination (see, for comparison, Cases C-204/97 *Portugal* v *Commission* [2001] ECR I-3175, at paragraph 33; *Prayon-Rupel*, cited above, at paragraphs 97 to 100; and Case T-171/02, *Regione autonoma della Sardegna* v *Commission*, judgment of 15 June 2005, not yet reported, at paragraph 41). Given that the contested decision must be annulled for the reasons set out above, there is no need to address the duration of the preliminary examination or the need for additional information.

*Further pleas in law*

84 As the contested decision must be annulled on the basis that ESA failed to initiate the formal investigation procedure, it is not necessary for the Court to examine the two further pleas in law put forward by the Applicant or whether the application would be admissible with respect to those pleas.

## VII Costs

85 Under Article 66(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs if they have been applied for in the successful party's

pleadings. Since the SBV and the European Banking Federation have requested that ESA be ordered to pay the costs and the latter has been unsuccessful, it must be ordered to pay the costs. The Court has not found it appropriate to order the European Banking Federation to bear its own costs pursuant to the second subparagraph of Article 66(4). The costs incurred by the Republic of Iceland, the Kingdom of Norway and the Commission of the European Communities are not recoverable.

On those grounds,

THE COURT

hereby:

1. **Annuls the EFTA Surveillance Authority's Decision No 213/04/COL of 11 August 2004 concerning the Icelandic Housing Financing Fund.**

2. **Orders the EFTA Surveillance Authority to pay the costs incurred by the Applicant and those incurred by the European Banking Federation as Intervener.**

Carl Baudenbacher Thorgeir Örlygsson Henrik Bull

Delivered in open court in Luxembourg on 7 April 2006.

Henning Harborg
Registrar

Carl Baudenbacher
President