Dear Sir or Madam,

Subject: Letter of formal notice to Iceland concerning the award and renewal of hydropower and geothermal authorisations

1 Introduction

1. By a letter of 29 March 2011, the EFTA Surveillance Authority ("the Authority") informed the Icelandic Government that it had opened an own initiative case regarding the conditions for the grant and renewal of authorisations for the utilisation of hydropower and geothermal energy. It also invited Iceland to provide clarification on various points concerning the applicable legal framework.

2. The Icelandic Government replied to that letter on 3 June 2011 and the case was consequently discussed at the package meeting in Reykjavik on 7 June 2011.

3. On 16 February 2012, the Internal Market Affairs Directorate ("the Directorate") sent a pre-Article 31 letter to Iceland presenting its preliminary conclusions on the matter. The Directorate concluded that the Icelandic legislation currently applicable to the award and renewal of hydropower and geothermal licences is in breach of EEA law. More precisely, that the existing legislation is contrary to the Services Directive 2006/123/EC and Article 31 of the EEA Agreement ("the Agreement").

4. At the package meeting in June 2012, the Icelandic Government’s representatives provided the Authority with a timetable regarding the process of adoption of a new legislation. On 18 June 2012, Iceland replied to the Authority’s letter confirming what was agreed during the package meeting.

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1 Event No 591385.
2 Your ref. IDNI1060006/7.6.2, Event No 600032.
3 Event No 621656.
4 The Act referred to at point 1 of Annex X to the EEA Agreement, Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market, as adapted to the EEA Agreement by Protocol 1 thereto.
5 Your ref. IDNI1060006/7.6.2, Event No 638119.
5. According to the timetable put forward by the Icelandic Government, a special report prepared by a working group set up by the Prime Minister was supposed to be published by the end of June 2012. On the basis of this report, a bill of law was supposed to be drafted and finalised by October 2012. However, the abovementioned report was only finalized in September 2012, and a draft bill was not put forward to the Parliament.

6. In November 2012, the Directorate informally contacted the Icelandic Government to enquire about the latest developments on this issue and was informed that a draft legislative amendment was to be presented to the Parliament during the 2013 spring session. That bill did, however, not materialise.

7. In June 2013, the issue was discussed at the package meeting. The Icelandic’s representatives indicated that nothing had changed since the last package meeting. Since then the Authority has not received any new information from the Icelandic Government.

8. In light of the discussions and exchanges of correspondence with the Icelandic Government, and as set out below in detail, the Authority has reached the following conclusion:

On the basis of the Services Directive 2006/123/EC and Article 31 EEA, the Icelandic legislation currently applicable to the award and renewal of hydropower and geothermal licences is in breach of EEA law in that the Icelandic legal and regulatory framework:

- Does not set out the procedures and formalities applicable for the award of licences; those procedures must provide full guarantees of impartiality and transparency, including, in particular, adequate publicity about the launch, conduct and completion of the procedure and must be conducted on the basis of objective, transparent and non-discriminatory criteria set out in advance;

- Does not guarantee that licences are granted for an appropriate limited period of time, in such a way that the length does not restrict or limit free competition beyond what is necessary in order to enable the provider to recoup the cost of investment and to make a fair return on the capital invested;

- Provides for a discriminatory renewal procedure, which confers an unjustified advantage on the licensee, by entitling him to negotiations on an extension of the authorisation when half of the agreed period of use has passed, instead of subjecting the renewed award of the licence to an impartial and transparent procedure.

2. Relevant national law

9. Article 3a of Act No 57/1998 on the survey and utilisation of ground resources ("the Ground Resources Act") provides that:

"The State, municipalities, and their wholly owned undertakings are not permitted to transfer, directly or indirectly, on a permanent basis, ownership rights to geothermal energy and groundwater, cf. paragraph 1 of Article 10 and Article 14."
The State, municipalities and companies owned by them, as provided in paragraph 2, are permitted to grant temporary rights of use of the rights under paragraph 1 for a period of up to 65 years at a time. Holders of temporary rights of use shall be entitled to negotiations on an extension of the rights when half of the agreed period of use has passed.

Decisions on to whom to grant rights of use shall be made on a non-discriminatory basis. Also, such decisions should promote use of resources and investments in facilities.

The Minister responsible for negotiation in this field shall negotiate the consideration (rent) for the use of rights subject to the control of the State pursuant to paragraph 3. The arrangements and consideration for the use of rights on public land shall be subject to the applicable legislation. 6

10. Article 16 of the Water Act No 15/1923 ("the Water Act") provides that:

"The State, municipalities, and their wholly owned undertakings are not permitted to transfer, directly or indirectly, on a permanent basis, the right to possess and use water that has hydroelectric power above 10MW."

The State, municipalities and companies owned by them, as provided in paragraph 2, are permitted to grant temporary rights of use of the rights under paragraph 1 for a period of up to 65 years at a time. Holders of temporary rights of use shall be entitled to negotiations on an extension of the rights when half of the agreed period of use has passed.

Decisions on to whom to grant rights of use shall be made on a non-discriminatory basis. Also, such decisions should promote use of resources and investments in facilities.

The Minister responsible for negotiation as regards consideration for the use of resources owned and controlled by the Icelandic State shall negotiate the consideration (rent) for the use of rights subject to the control of the State

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6 "Ríki, sveitarfélagum og fjörirtæktum, sem alarið eru i eigu þeirra, er þeimilt að framselja beint eða óbeint og með varanlegum hætti eignarrétt að jarðhita og grumvatni umfram heimilis- og þúsþarfir, sbr. 1. mgr. 10. gr. og 14. gr.

(...) Ríki, sveitarfélagum og félagum í þeirra eigu, sbr. 2. mgr., er þeimilt að veita tímabundinó afnotarett að réttindum skv. 1. mgr. til allt að 65 ára í senn. Handhaft tímabundinis afnotaréttar skal eiga rétt á viðræðum um framlendingu réttarins þegar helmingur umsamins afnotatíma er líðinn.
Við ákvörðum um það hverjum skal veittur afnotaréttur skal geta jafnraðis. Þá skal geta þess að ákvörðum stuðlu að haugkvæmri nýtíngu auðlinda og þfarfestinga í mannverkum.
{Sá raðherra er fer með samningagerð a því svíði skal semjá um endurgjald (leiðu) fyrir afnotarett réttinda undir yfirráðum ríkisins skv. 3. mgr. Um ráðstofnun og endurgjald fyrir nýtíngu réttinda í þjóðöldum fer samkvæmt ákvæðum laga þar að lútanli.}
pursuant to paragraph 3. The arrangements and consideration for the use of rights on public land shall be subject to the applicable legislation.”

3. Relevant EEA law

11. Article 2(1) of Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market⁷ (the “Services Directive”) provides that:

“This Directive shall apply to services supplied by providers established in a Member State.”

12. According to Article 37 of the EEA Agreement:

“Services shall be considered to be 'services' within the meaning of this Agreement where they are normally provided for remuneration, in so far as they are not governed by the provisions relating to freedom of movement for goods, capital and persons.

'Services' shall in particular include:
(a) activities of an industrial character;
(b) activities of a commercial character;
(c) activities of craftsmen;
(d) activities of the professions.”

13. Article 4(6) of the Services Directive provides that:

“'authorisation scheme' means any procedure under which a provider or recipient is in effect required to take steps in order to obtain from a competent authority a formal decision, or an implied decision, concerning access to a service activity or the exercise thereof;”

14. As stated in Recital 39 of the Services Directive:

The concept of 'authorisation scheme’ should cover, inter alia, the administrative procedures for granting authorisations, licences, approvals or concessions (...).

15. Article 12 of the Services Directive provides that:

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⁷ “Ríki, sveitarfelögum og fyrirækjun sem afhæfi eru í eigu þeirra er öheimilt að framselja beint eda óbeint og með varanlegum hætti rétt til umráða og hagnýtingar á því vثمí sem hefur að geysa virkitanlegt af umfram 10 MW.

(…)
Ríki, sveitarfelögum og félögum í þeirra eigu, sbr. 2. mgr., er heimilt að veita tímbundin afnotaret á réttindum skv. 1. mgr. til allt að 65 ára í senn. Hæfthun tímbundins afnotaretar skal eiga rétt á vörðum um framleingingu réttarins þegar helmingur umsamiðs afnotatíma er liðinn. Við ákvöðum um það hverjum skali veittur afnotaretur skal gæta jafnþreðis. Þá skal gæta þess að ánkvöðun stuðl að hagkvæmi nýtingu auðlindanna og fjárfestinga í mannvíkjun. Sá ráðherra er fær þegar samningagerð um endurgjald fyrir nýtingu auðlinda í eigu og á forradó islenska ríkisins skal semja um endurgjald í leigu fyrir afnotaret réttinda undir yfirráðum ríkisins skv. 3. mgr. Úm ráðstöfun og endurgjald fyrir nýtingu réttinda í þjóðlendum fur samkvæmt ákvöðum laga þar að lúandi.”

⁸ Act referred to at point 1 of Annex X to the EEA Agreement.
"1. Where the number of authorisations available for a given activity is limited because of the scarcity of available natural resources or technical capacity, Member States shall apply a selection procedure to potential candidates which provides full guarantees of impartiality and transparency, including, in particular, adequate publicity about the launch, conduct and completion of the procedure.

2. In the cases referred to in paragraph 1, authorisation shall be granted for an appropriate limited period and may not be open to automatic renewal nor confer any other advantage on the provider whose authorisation has just expired or on any person having any particular links with that provider.

3. Subject to paragraph 1 and to Articles 9 and 10, Member States may take into account, in establishing the rules for the selection procedure, considerations of public health, social policy objectives, the health and safety of employees or self-employed persons, the protection of the environment, the preservation of cultural heritage and other overriding reasons relating to the public interest, in conformity with Community law."

16. Indeed, as indicated in Recital 62 of the Services Directive:

"Where the number of authorisations available for an activity is limited because of scarcity of natural resources or technical capacity, a procedure for selection from among several potential candidates should be adopted with the aim of developing through open competition the quality and conditions for supply of services available to users. Such a procedure should provide guarantees of transparency and impartiality and the authorisation thus granted should not have an excessive duration, be subject to automatic renewal or confer any advantage on the provider whose authorisation has just expired. In particular, the duration of the authorisation granted should be fixed in such a way that it does not restrict or limit free competition beyond what is necessary in order to enable the provider to recoup the cost of investment and to make a fair return on the capital invested. This provision should not prevent Member States from limiting the number of authorisations for reasons other than scarcity of natural resources or technical capacity. These authorisations should remain in any case subject to the other provisions of this Directive relating to authorisation schemes."

17. Article 13(1) of the Services Directive provides that:

"Authorisation procedures and formalities shall be clear, made public in advance and be such as to provide the applicants with a guarantee that their application will be dealt with objectively and impartially."

18. Article 31(1) of the EEA Agreement provides that:

"Within the framework of the provisions of this Agreement, there shall be no restrictions on the freedom of establishment of nationals of an EC Member State or an EFTA State in the territory of any other of these States."

repealing Directive 96/92/EC\(^9\) (the “Electricity Directive”), which concerns “Authorisation procedure for new capacity” provides that:

“1. For the construction of new generating capacity, Member States shall adopt an authorisation procedure, which shall be conducted in accordance with objective, transparent and non discriminatory criteria.

2. Member States shall lay down the criteria for the grant of authorisations for the construction of generating capacity in their territory. These criteria may relate to:
   (a) the safety and security of the electricity system, installations and associated equipment;
   (b) protection of public health and safety;
   (c) protection of the environment;
   (d) land use and siting;
   (e) use of public ground;
   (f) energy efficiency;
   (g) the nature of the primary sources;
   (h) characteristics particular to the applicant, such as technical, economic and financial capabilities;
   (i) compliance with measures adopted pursuant to Article 3.

3. Member States shall ensure that authorisation procedures for small and/or distributed generation take into account their limited size and potential impact.

4. The authorisation procedures and criteria shall be made public. Applicants shall be informed of the reasons for any refusal to grant an authorisation. The reasons must be objective, non discriminatory, well founded and duly substantiated. Appeal procedures shall be made available to the applicant.”

4. The Authority’s assessment

20. Article 3a of the Ground Resources Act sets up an authorisation procedure for the right to harness geothermal energy and groundwater owned by the State, municipalities and the companies owned by them. Article 16 of the Water Act sets up the same authorisation procedure regarding the right to occupy and harness water resources owned by the State, municipalities or companies owned by them, that contain exploitable energy in excess of 10 MW.

4.1 Services Directive

21. According to Article 2 of the Services Directive, the Directive applies to services supplied by providers established in an EEA State.

22. The economic activity at stake in the present case is the harnessing of energy resources located on public land, for production of electricity and heat. This is an activity “of an industrial character”, which, in accordance with Article 37 EEA, falls within the scope of “services” and thus within the scope of the Directive.

\(^9\) Act referred to at point 22 of Annex IV to the EEA Agreement.
23. According to Article 4(6) of the Services Directive, “authorisation schemes” are procedures under which a service provider is in effect required to take steps in order to obtain from a competent authority a formal decision concerning access to a service activity or the exercise thereof. The definition is wide and covers all administrative procedures for granting authorisations, licences, approvals or concessions.\(^{10}\)

24. The Icelandic authorisation schemes fall under this definition. Indeed, under the above-mentioned Icelandic provisions, undertakings that want to harness the energy contained in geothermal, groundwater or water resources located on public land to produce electricity or heat must obtain from the competent authority a formal decision in order to exercise that activity.\(^{11}\)

25. As the Icelandic provisions constitute authorisation schemes within the meaning of Article 4(6) of the Services Directive, they must comply with the requirements imposed upon such schemes by the Directive. More specifically, as the number of authorisations available is limited because of the scarcity of available natural resources, this authorisation scheme falls within the scope of Article 12 of the Services Directive. It must thus comply with the specific requirements set out in that Article, as well as with any other relevant provisions of the Directive relating to authorisation schemes.\(^{12}\)

26. This implies the following obligations on Iceland:

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

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

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

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

4.1.1 First requirement

27. The first requirement, provided for in Article 13(1) of the Services Directive, is that the procedures and formalities for the authorisation must be clear and made public in advance.

28. This goes beyond the general requirement that authorisation procedures must be transparent and carried out on the basis of objective criteria. The requirement of advance publicity of procedures and formalities entails that the specifics of the procedures that will need to be followed and the formalities that will need to be carried out before a given authorisation is issued, must be spelled out in the applicable

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\(^{10}\) Recital 39 of the Services Directive.

\(^{11}\) The production of electricity is an activity “of an industrial character”, which, according to Article 37 EEA, falls within the scope of “services”.

\(^{12}\) See, in particular, Recital 62 of the Services Directive.
national provisions. The requirement of clarity entails that the procedures be unambiguous and easily understandable.

29. In other words, on the basis of the applicable national provisions, interested parties must be in a position to understand which rules will apply to the authorisation process and which steps are going to be followed in order to issue the authorisation.

30. It is submitted that this is not the case for the authorisation schemes foreseen by Articles 3a of the Ground Resources Act and 16 of the Water Act which are in breach of Article 13(1) of the Services Directive.

31. In the Water Act and the Ground Resources Act, the only indications as to the procedures and formalities to be followed are that the decision must be taken on a non-discriminatory basis, that the decision should promote use of resources and investments in facilities and that the competent minister will negotiate the consideration for the authorisation.

32. In its letter of 3 June 201113, Iceland also points to the Administrative Procedures Act No 37/1993 and to “general administrative customs and practices”, which would set out the applicable procedures.

33. Concerning the Administrative Procedures Act No 37/1993, the Authority notes that it simply requires public authorities to comply with the general principle of equality, by stating that “in deciding cases a public authority shall make every effort to ensure that, legally, it is consistent and observes the rule of equal treatment"14, and the principle of proportionality, by stating that “a public authority shall reach an adverse decision only when the lawful purpose sought cannot be attained by less stringent means. Care should then be taken not to go further than necessary”. Iceland has not explained how this is sufficient to comply with the requirements of Article 13(1) of the Services Directive.

34. As regards the “general administrative customs and practices” outlined in the letter of 3 June 2011, Iceland indicates that when a public body awards a licence, it must do so “in a transparent and non-discriminatory way based on objective criteria”. According to Iceland, this entails that “public authorities must award the licences transparently and treat all potential tenderers equally. This requires an adequate advertising to enable the market to be opened up to competition and ensuring that all potential tenderers will be provided with the same information. The decision making must be transparent in order for the authority in question to be able to demonstrate the impartiality of the procedure”.16

35. Firstly, Iceland does not demonstrate that those general principles have been given the necessary publicity.

36. Secondly, they remain at a very general level and constitute little more than general principles. They do not allow interested parties to know which actual procedures will be followed and which formalities will need to be carried out before the authorisations are awarded.

13 Your ref. IDN11060006/7.6.2, Event No 600032.
16 Ref. IDN11060006/7.6.2, event no 600032, page 2.
37. The applicable national legal framework leaves considerable discretion to public authorities as to what procedures and formalities they will need to apply and is insufficient for the authorisation scheme to comply with the requirement that the procedure and formalities be clear and made public in advance.

38. As a result, the Authority concludes that the authorisation schemes foreseen by Articles 3a of the Ground Resources Act and 16 of the Water Act are in breach of Article 13(1) of the Services Directive.

4.1.2 Second requirement
39. The second requirement, provided for in Article 12(1) of the Services Directive, is that the selection procedure applied to potential candidates must provide full guarantees of impartiality and transparency, including, in particular, adequate publicity about the launch, conduct and completion of the procedure.

40. Again, according to the information provided by Iceland, national law only requires that the procedure be non-discriminatory and comply with the principles of equality and proportionality. Iceland does not demonstrate that “full guarantees” are provided for the transparency of the procedure and for adequate publicity for the launch, conduct and completion thereof.

41. As a result, the Authority has come to the conclusion that Articles 3a of the Ground Resources Act and 16 of the Water Act are also in breach of Article 12(1) of the Services Directive.

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

43. According to the Water Act and the Ground Resources Act, the authorisations are to be granted for a duration of up to 65 years. However, there is no requirement that the duration of the licence be set at a shorter length of time should less time be sufficient for a given authorisation holder to recoup the cost of his investment and make a fair return on the capital he has invested. Nothing in Icelandic legislation provides that the competent authority is authorised to grant a licence for a duration of less than 65 years, even if, for a given project, this would prove to be more time than justified.

44. As a result, the Authority concludes that the authorisation schemes foreseen by Articles 3a of the Ground Resources Act and 16 of the Water Act are in breach of Article 12(2) of the Services Directive.

4.1.4 Fourth requirement
45. The fourth requirement, also provided for in Article 12(2) of the Services Directive, is that the authorisation must not be open to automatic renewal nor confer any other advantage on the provider whose authorisation has just expired or on any person having any particular links with that provider.
46. According to Article 16(3) of the Water Act and Article 3a(3) of the Ground Resources Act, the authorisation holder is entitled to negotiations on an extension of the authorisation when half of the agreed period of use has passed.

47. This clearly confers advantage on the authorisation holder as concerns the renewal of his authorisation. Indeed, the existing concession holder is given the possibility to negotiate the renewal years before it expires, thus avoiding having to compete with third parties to obtain the authorisation through a transparent, impartial and non-discriminatory procedure.

48. For that reason, the Authority maintains that the authorisation schemes foreseen by Articles 3a of the Ground Resources Act and 16 of the Water Act are in breach of Article 12(2) of the Services Directive.

4.2 Article 31 EEA

49. Should the above-mentioned authorisation schemes be considered to fall outside the scope of the Services Directive, they would need to comply, in any event, with the provisions of the main part of the EEA Agreement.

50. In the alternative therefore, the Authority would conclude that the conditions under which the authorisations are awarded and renewed would not be in compliance with the prohibition against restrictions on the freedom of establishment provided for under Article 31 EEA.

4.2.1 Non discrimination and transparency

51. It is settled case-law that Article 31 EEA confers on nationals of one EEA State who wish to pursue activities as self-employed persons in another EEA State the benefit of the same treatment as the host State's own nationals and prohibits any discrimination based on nationality which hinders the taking up or pursuit of such activities. The rules regarding equal treatment “forbid not only overt discrimination by reason of nationality or, in the case of a company, its seat, but all covert forms of discrimination which, by the application of other criteria of differentiation, lead in fact to the same result.”

52. In the context of an authorisation scheme in which the authorities of an EEA State award the pursuit of an economic activity to one or more economic operators in particular, this principle of non-discrimination implies, in turn, an obligation of transparency.

53. Indeed, without adequate transparency, the principle of equal treatment would be disregarded. Undertakings established in other EEA States and potentially interested in the licensed activity would not be able to express their interest and, therefore, exercise their right under Article 31 EEA. The obligation of transparency is thus a concrete and

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specific expression of the principle of equal treatment, which enables undertakings to exercise effectively the rights conferred upon them by Article 31 EEA.19

54. As a consequence and as held by the Court of Justice in Sporting Exchange Ltd, the obligation of transparency therefore appears to be a mandatory prior condition of the right of an EEA State to award to one (or more) private operators the exclusive right to carry on an economic activity, irrespective of the method of selecting the operator (or operators)20.

55. That obligation of transparency, which is imposed on the authority granting the authorisation, consists in ensuring, for the benefit of any potential applicant, a degree of advertising sufficient to enable the market to be opened up to competition and the impartiality of procedures to be reviewed21.

56. Moreover, as any prior administrative authorisation scheme, it must be based on objective, non-discriminatory criteria known in advance, in such a way as to circumscribe the exercise of the authorities' discretion so that it is not used arbitrarily. Finally, the decision must be capable of being made subject to judicial proceedings22.

57. These principles must be explicitly guaranteed in the internal legal system of the EEA State. Indeed, the States must implement their obligations under EEA law with unquestionable binding force and with the specificity, precision and clarity necessary to satisfy the requirements flowing from the principle of legal certainty. Individuals must have the benefit of a clear and precise legal situation enabling them to ascertain the full extent of their rights and, where appropriate, to rely on them before the national courts23.

58. It follows from the above that EEA States cannot maintain in force national provisions which permit the award of special and exclusive rights without them being put out to competition, on the basis of objective, non-discriminatory criteria known in advance, in such a way as to circumscribe the exercise of the authorities' discretion so that it is not used arbitrarily. Indeed, such legislation would infringe Article 31 EEA and the ensuing principles of equal treatment, non-discrimination, transparency and legal certainty.

59. The Authority concludes that under Icelandic law, compliance with the principle of transparency for the award of authorisations for the right to harness the energy

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22 Case C-389/05 Commission v France [2008] ECR I-5397, paragraphs 93-94.

contained in geothermal, groundwater or water resources located on public land to produce electricity or heat, would not be guaranteed.

60. Indeed, as demonstrated above, Icelandic law only requires that the procedure be non-discriminatory and comply with the principles of equality and proportionality. Iceland has not demonstrated that the application of those principles is sufficient to guarantee that the award procedure will be carried out with a degree of advertising sufficient to enable the market to be opened up to competition.

4.2.2 The renewal procedure

61. As established by the case-law of the Court of Justice, the above-mentioned principles of non-discrimination and transparency must apply both to the initial grant of the authorisation and to any renewal procedure.24

62. As indicated above, according to Article 16(3) the Water Act and Article 3a(3) of the Ground Resources Act, the authorisation holder is entitled to negotiations on an extension of the authorisation when half of the agreed period of use has passed. This means that authorisations can be renewed without a transparent, impartial and non-discriminatory procedure.

63. For that reason as well, the Authority would come to the conclusion that the Icelandic provisions are in breach of EEA law.

4.2.3 The duration of the authorisation

64. Finally, the Authority observes that the absence of any guarantee that the duration of the authorisation will be set in a proportionate manner would also be in breach of EEA law.

65. Indeed, the principle of proportionality is recognized by the established case law of the Court of Justice as “being part of the general principles of Community law”25. It also binds national authorities when they act within the sphere of application of EEA law, even when they have a large area of discretion.26 This is the case when States restrict the freedom of establishment through authorisation schemes.

66. In that context, the principle of proportionality requires that any measure which restricts the fundamental principles of free movement should be both necessary and appropriate in the light of the objectives sought. When a Member State considers the measures to be taken, it must adopt those which cause the least possible disruption to the pursuit of an economic activity.27

67. The same principles apply for the EFTA States, as confirmed by the EFTA Court:

"The Court has consistently emphasized the importance of this principle of EEA law (see, for instance, Cases E-6/96 Wilhelmsen, at paragraph 87, and E-3/00 EFTA Surveillance Authority v Norway, at paragraph 27). Under the proportionality principle, the measure chosen by an EEA Contracting Party must be proportionate to the aim pursued. It must be established that measures taken

are suited to achieve the objective sought, and that the same objective may not be as effectively achieved by measures which are less restrictive of intra-EEA trade.”28

68. When applied to authorisations such as the one provided for in Article 16(3) of the Water Act and Article 3a(3) of the Ground Resources Act, this principle requires that the restriction to the freedom of establishment caused by the authorisation be limited to what is strictly necessary. Concerning the duration of authorisations such as those subject to the present proceedings, the principle of proportionality requires that it be set so that it does not limit open competition beyond what is strictly required to ensure that the investment is paid off and that there is a reasonable return on invested capital, whilst maintaining a risk inherent in economic activities for the authorisation holder.

69. For the same reasons as set out above, the principle of legal certainty requires that this principle be guaranteed in a clear and unambiguous fashion in the national legal order.

70. However, the Authority submits that under Icelandic law, compliance with the principle of proportionality when setting the length of the hydropower and geothermal licences is not guaranteed.

71. For that reason as well, the Icelandic provisions are in breach of EEA law.

4.2.4 Justification
72. A restriction under Article 31 EEA may be justified by reasons referred to in Article 33 EEA or by considerations of overriding public interest.

73. The EFTA Court held that the reasons which may be invoked by an EEA State in order to justify any derogations from EEA law principles “[...] must be accompanied by an appropriate analysis of the expediency and proportionality of the restrictive measure adopted by that State, and precise evidence enabling its arguments to be substantiated.”29

74. In its letter of 15 June 201230, Iceland stated that “(...) the Icelandic authorities in general welcome the preliminary conclusion of the Authority (...).” Therefore, Iceland does not provide any reasons which could justify the restriction imposed by the authorisation scheme on the freedom of establishment provided in Article 31 EEA.

75. The Authority therefore considers that Iceland has not provided any objective reasons of public interest to justify the restrictions on the freedom of establishment imposed by the current authorisation scheme.

4.3 Electricity Directive

29 Case E-12/10 EFTA Surveillance Authority v Iceland, judgment of 28 June 2011, not yet reported, paragraph 57.
30 Your reference IDN 11060006/7.6.2, event no 638119.
76. Finally, for the sake of completeness, the Authority also wishes to address the issue of Article 6 of the Directive 2003/54/EC ("the Electricity Directive")\(^3\), which concerns "Authorisation procedures for new capacity".

77. The procedures foreseen in Article 16(3) of the Water Act and Article 3a(3) of the Ground Resources Act do not fall within the scope of that provision. Indeed, Article 6 of the Electricity Directive concerns licences for the construction of new generation capacity. The procedures foreseen in Article 16(3) of the Water Act and Article 3a(3) of the Ground Resources Act concern access to energy resources located on public land, which is a different matter.

78. The fact that Article 6 of the Electricity Directive was not intended to cover authorisations such as those subject to these proceedings is confirmed by the list of criteria which may be used by EEA States when granting authorisations for the construction of new capacity, listed in the second paragraph of Article 6. Indeed, if that provision had been intended to cover access to energy resources, it would have included criteria such as resource management or price paid for the authorisation. It does not cover anything of the like.

79. But in any event, even if the procedures foreseen in Article 16(3) of the Water Act and Article 3a(3) of the Ground Resources Act were to be considered to fall within the scope of Article 6 of the Electricity Directive, the Icelandic provisions would still be in breach of EEA law.

80. Firstly, the applicability of Article 6 of the Electricity Directive would not affect the applicability of the Services Directive.

81. Indeed, in accordance with Article 3(1) of the Services Directive, the provisions of that Directive are only disappplied in the presence of a provision of another EEA Act governing specific aspects of access to or exercise of a service activity in specific sectors if this sectoral legislation is in conflict with the Services Directive.

82. In the present case, Article 6 of the Electricity Directive does not contradict the Services Directive. Quite to the contrary, it sets out, in more general form, the same requirements as those of the Services Directive applicable to authorisations. The only specificity of Article 6 of the Electricity Directive is that it lists the type of objective and non-discriminatory criteria which may be taken into account by EEA States when granting authorisations for new capacity.

83. As a result, even if the procedures foreseen in Article 16(3) of the Water Act and Article 3a(3) of the Ground Resources Act were to be considered to fall within the scope of Article 6 of the Electricity Directive, they would still need to comply with Articles 12 and 13 of the Services Directive. As set out above, this is not the case.

84. Secondly, even if the Services Directive were considered not to be applicable, Articles 3(1) and 6 of Electricity Directive require that:

"The authorisation procedure and the applicable objective criteria must be made public" \(^32\).

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85. The EEA States must guarantee non-discrimination between undertakings, and thus, for the same reasons as set out above, award the authorisation on the basis of a transparent procedure with adequate publicity, both for the initial award and for the renewal of the authorisation.\textsuperscript{33}

86. As has been demonstrated above, this is not the case for the procedures set out in Article 16(3) of the Water Act and Article 3a(3) of the Ground Resources Act.

87. Moreover, as ruled by the Court of Justice, "when adopting measures to implement [EEA] legislation, national authorities must exercise their discretion in compliance with the general rules of [EEA] law, which include the principles of proportionality, legal certainty and the protection of legitimate expectations."\textsuperscript{34}

88. As a result of this and of Article 6(4) of the Electricity Directive, EEA States must guarantee in the internal legal order, in a clear and unambiguous manner, that the duration of the authorisation does not exceed what is strictly necessary to ensure that the investment is paid off and there is a reasonable return on invested capital, whilst maintaining a risk inherent in economic activities for the authorisation holder.

89. As demonstrated above, the Authority would submit that this is not the case in Icelandic law.

90. Therefore, even if the procedures foreseen in Article 16(3) of the Water Act and Article 3a(3) of the Ground Resources Act were to be considered to fall within the scope of Article 6 of the Electricity Directive, the Icelandic provisions would still be in breach of EEA law.

5. Conclusion

Accordingly, as its information presently stands, the Authority must conclude that, by maintaining in force Article 3a(2)-(6) of the Act No 57/1998 on the survey and utilisation of ground resources and Article 16(2)-(6) of the Water Act No 15/1923, which set up an authorisation scheme for the right to harness, respectively, geothermal energy and groundwater owned by the State, municipalities or companies owned by them, and the right to occupy and harness water resources owned by the State, municipalities or companies owned by them, that contains exploitable energy in excess of 10 MW, without providing for publicised, transparent and non-discriminatory award and renewal procedures, and without a requirement for a proportionate length for the authorisations, Iceland has failed to fulfil its obligation arising from Articles 12 and 13 of the Act referred to at point 1 of Annex X to the EEA Agreement, Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market, as adapted to the EEA Agreement by Protocol 1 thereto.

If the Services Directive would not be applicable, the Authority has reached the alternative conclusion that, by maintaining in force Article 3a(2)-(6) of the Act No 57/1998 on the survey and utilisation of ground resources and Article 16(2)-(6) of the Water Act No

\textsuperscript{32} Article 6(4) of the Electricity Directive.
\textsuperscript{33} Article 6(1) and (4), read in light of Article 3(1) of the Directive.
\textsuperscript{34} Joined cases C-231/00, C-303/00 and C-451/00 Cooperativa Lattepiù [2004] I-2869, paragraph 57.
15/1923, which set up an authorisation scheme for the right to harness, respectively, geothermal energy and groundwater owned by the State, municipalities or companies owned by them, and the right to occupy and harness water resources owned by the State, municipalities or companies owned by them, that contains exploitable energy in excess of 10 MW, without providing for publicised, transparent and non-discriminatory award and renewal procedures, and without a requirement for a proportionate length for the authorisation, Iceland has failed comply with Article 31 EEA.

Alternatively the Authority considers that, by maintaining in force the abovementioned national provisions, Iceland has failed to fulfil its obligation arising from Articles 3 and 6 of the Act referred to at Point 22 of Annex IV to the EEA Agreement, Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC, as adapted to the Agreement by Protocol 1 thereto as well as by sectoral adaptations.

In these circumstances, and acting under Article 31 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice, the Authority invites the Icelandic Government to submit its observations on the content of this letter within two months following receipt thereof.

After the time limit has expired, the Authority will consider, in the light of any observations received from the Icelandic Government, whether to deliver a reasoned opinion in accordance with Article 31 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice.

For the EFTA Surveillance Authority

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College Member