

## III

(Other acts)

## EUROPEAN ECONOMIC AREA

## EFTA SURVEILLANCE AUTHORITY DECISION

No 496/13/COL

of 11 December 2013

**concerning the financing of Harpa Concert Hall and Conference Centre (Iceland)**

THE EFTA SURVEILLANCE AUTHORITY ('THE AUTHORITY'),

HAVING REGARD to the Agreement on the European Economic Area ('the EEA Agreement'), in particular to Article 61(3)(c) and Protocol 26,

HAVING REGARD to the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice ('the Surveillance and Court Agreement'), in particular to Article 24,

HAVING REGARD to Protocol 3 to the Surveillance and Court Agreement ('Protocol 3'), in particular Article 7(3) of Part II,

HAVING called on interested parties to submit their comments pursuant to those provisions <sup>(1)</sup> and having regard to their comments,

Whereas:

## I. FACTS

## 1. PROCEDURE

- (1) On 19 September 2011, the Authority received a complaint (Event No 608967), concerning the alleged subsidising by the Icelandic State ('the State') and the City of Reykjavík ('the City') of conference services and restaurant/catering services in Harpa Concert Hall and Conference Centre ('Harpa') <sup>(2)</sup>.
- (2) Having received all the relevant information from the Icelandic authorities and having discussed the case in a meeting on 5 June 2012 <sup>(3)</sup>, the Authority decided by Decision No 128/13/COL of 20 March 2013 to initiate the formal investigation procedure into potential State aid involved in the financing of Harpa Concert Hall and Conference Centre ('Decision No 128/13/COL' or 'the opening decision').
- (3) By letter dated 28 May 2013 (Event No 673762), the Icelandic authorities submitted comments on the Authority's decision. The case was also the subject of discussions between the Authority and the Icelandic authorities at the package meeting in Reykjavík on 4 June 2013.

<sup>(1)</sup> EFTA Surveillance Authority Decision No 128/13/COL of 20.3.2013 to initiate the formal investigation procedure into potential State aid involved in the financing of the Harpa Concert Hall and Conference Centre, published in the *Official Journal of the European Union*, OJ C 229, 8.8.2013, p. 18, and the EEA Supplement No 44, 8.8.2013, p. 5.

<sup>(2)</sup> For the purposes of this decision 'Harpa' will refer to the building itself and its facilities.

<sup>(3)</sup> For a more detailed description of the correspondence, see paragraphs 2-5 of the Authority's Decision No 128/13/COL.

- (4) On 8 August 2013, Decision No 128/13/COL was published in the Official Journal of the European Union and in the EEA Supplement. Interested parties were given one month to submit comments on the Authority's opening decision. The Authority did not receive any comments from interested parties.

## 2. DESCRIPTION OF THE MEASURE

### 2.1. General

- (5) In Decision No 128/13/COL the Authority assessed the financing of Harpa Concert Hall and Conference Centre. Harpa is a multipurpose building, located in the centre of Reykjavík, which is currently owned by the Icelandic State (54 %) and Reykjavík City (46 %), which together contribute to its financing.

### 2.2. Background

- (6) In 1999 the Mayor of Reykjavík along with representatives of the Icelandic government announced that a concert and conference centre would be constructed in the centre of Reykjavík. In late 2002 the Icelandic State and the City signed an agreement regarding the project and the following year the company Austurhöfn-TR ehf. was founded with the purpose of overseeing the project <sup>(4)</sup>.
- (7) The original business model for Harpa was that a private party would be responsible for the construction and the operation of the building and in turn receive annual contributions from the State and the City. In April 2004 the State Trading Centre announced a pre-qualification process for the project and in 2005 an evaluation committee came to the conclusion that an offer from the limited liability company Portus ehf. was the most favourable out of the four offers received. Subsequently the Icelandic State and the City entered into a contract ('Project Agreement') with Portus for the construction and operation of a concert and conference centre <sup>(5)</sup>. However, in 2008, after the financial collapse, the selected private partner experienced severe financial difficulties and had to withdraw from the project and therefore the construction of Harpa was put on hold.
- (8) When the private partner withdrew from the project, approximately half of Harpa had already been built, and the Icelandic authorities thus had to make a decision regarding the future of Harpa. According to the Icelandic authorities there were mainly three options available at the time <sup>(6)</sup>:
- (a) It was possible to continue the project with public funding. The cost of this was at the time estimated to be around ISK 13 billion.
- (b) The second possibility was to temporarily postpone the building of Harpa. This was estimated to cost around ISK 19 billion.
- (c) The third possibility was to stop the project indefinitely or even tear down what had already been built. The cost of stopping the project was estimated to be around ISK 10 billion.
- (9) It was also clear that a 'half built' building at the size of Harpa in the heart of the city would cause problems in the long term and value would be destroyed. Hence, it was not considered feasible to close the project down, as huge resources had been spent in order to start the project and its re-opening at a later stage would be a very costly and complex exercise. Therefore, in February 2009, the Mayor of Reykjavík and the Minister of Education reached an agreement which entailed that the State and the City would continue with the construction of the project without the private partner <sup>(7)</sup>.
- (10) Austurhöfn-TR ehf. consequently took over the project and the plans were reviewed in order to find more economic solutions to the building process and the design of the house. In a press release from the State and the City it was stated that the takeover was a temporary solution, and that the ownership and financing of Harpa would be reviewed when the economy had recovered. The Project Agreement was amended in 2010, to reflect the new management of the project and the withdrawal of the private partner <sup>(8)</sup>, and the construction was resumed. Landsbankinn effectively wrote off a large portion of the investment costs and all share capital was wiped out in the process. In 2011 the construction of Harpa finished and the building was formally opened on 20 August 2011.

<sup>(4)</sup> Further information on Austurhöfn-TR ehf. can be found on their website: <http://www.austurhofn.is/>

<sup>(5)</sup> Project agreement between Austurhofn-TR ehf. and Eignarhaldsfelagid Portus ehf, signed on 9 March 2006.

<sup>(6)</sup> See letter from the Icelandic authorities dated 28 May 2013 (Event No 673762).

<sup>(7)</sup> Statement from the Ministry of Culture and Education available online at: <http://www.menntamalaraduneyti.is/frettir/Frettatilkyningar/nr/4833>

<sup>(8)</sup> Amended and restated project agreement between Austurhofn-TR ehf. and Eignarhaldsfelagid Portus ehf, signed on 19.1.2010.

- (11) Until recently there were several limited liability companies involved in Harpa's operations, namely: Portus ehf., which was responsible for Harpa real estate and operations, and Situs ehf., which was responsible for other buildings planned in the same area. Portus had two subsidiaries: Totus ehf., which owned the real estate itself, and Ago ehf., which was responsible for all operations in Harpa and leased the property from Totus. Situs also had two subsidiaries; Hospes ehf., which would have owned and operated a hotel which is to be constructed in the area, and Custos ehf., which was to own and operate any other buildings in the area.
- (12) However, in order to minimize operational costs and increase efficiency, the board of Austurhöfn-TR ehf. decided in December 2012 to simplify the operational structure of Harpa by merging most of the limited liability companies involved in its operations into one company. The State and the City therefore founded the company Harpa Concert and Conference Centre ehf. (i. Harpa tónlistar- og ráðstefnuhús ehf.) which is to oversee all of Harpa's operations. Simplifying the infrastructure of Harpa is a part of a long term plan to make Harpa's operations sustainable.

### 2.3. Purpose and objective of the Harpa project

- (13) According to the Icelandic authorities, Harpa is to be a forum for diverse and ambitious music and cultural life in Iceland, with the purpose of promoting the best that Icelandic artists have to offer at each time, with a special emphasis on diverse musical events. Harpa is further meant to be the source of innovation in the Icelandic culture and music scene and an emphasis will be put on international connections so that Harpa will be a worthy venue for the visits of foreign artists to Iceland.
- (14) Furthermore, Harpa is meant to be a forum for all kinds of conferences, meetings and gatherings, domestic and foreign, and to strengthen the position of Iceland as a venue for international conferences by offering services and conference halls that are compatible with conference facilities in other countries. Harpa is also meant to promote tourism in Iceland and strengthen the city centre of Reykjavik, by being the centre for all Icelanders in the area and a destination for visitors, both Icelandic and foreign, that want to get to know the building and enjoy the services offered, the architecture of the house and art displayed in the building.
- (15) The Icelandic Symphony Orchestra, the Icelandic Opera and the Reykjavik Big Band have entered into long term contracts for the use of certain facilities within Harpa. Harpa also accommodates conferences as well as various art events such as pop and rock concerts from both Icelandic and foreign artists. Other activities in Harpa such as catering, restaurants, a music shop and a furniture shop are operated by private companies who rent facilities in Harpa. These facilities are leased to the private operators on market terms and were subject to public tenders where the most favourable offers were accepted.
- (16) Prior to the construction of Harpa, there were no concert halls in Iceland with proper acoustics that could seat more than 300 people and facilitate both the Icelandic Symphony Orchestra and the Icelandic Opera. The Icelandic authorities therefore considered that it was necessary to build a culture hall that would ensure that the citizens of Iceland could enjoy music and art. With regard to the conference facilities there were, according to the Icelandic authorities, no conference centres or facilities in Iceland capable of hosting large conferences.

### 2.4. The facilities within Harpa

- (17) Harpa covers 28 000 square meters and is situated at the old harbour in Reykjavik at Austurbakki 2. The house is designed by the Danish Henning Larsen Architects in cooperation with the Icelandic architecture firm Batteríð arkitektar. Artist Ólafur Elíasson designed the glass structure around the house in cooperation with the architects. Artec Consultants Inc is responsible for the acoustics, sound isolation, and design of the theatre and sound equipment.
- (18) The design of the house aims at ensuring diversity and good facilities for all types of concerts and conferences, and provides Icelanders with facilities that were not available in the country before. Harpa has already won awards for the concert facilities, and was selected as one of the greatest concert halls of the new millennium by Gramophone magazine and Best Performance venue 2011 by Travel & Leisure magazine. Furthermore, Harpa is the winner of the 2013 European Union Prize for Contemporary Architecture — the Mies van der Rohe Award <sup>(9)</sup>.

<sup>(9)</sup> Press release available online at: [http://europa.eu/rapid/press-release\\_IP-13-376\\_en.htm](http://europa.eu/rapid/press-release_IP-13-376_en.htm)

- (19) In the following is an overview of the halls within Harpa <sup>(10)</sup>:
- (i) *Eldborg* seats 1 800 people and is Harpa's largest hall at a total of 1 008 m<sup>2</sup>. The ceiling height in *Eldborg* is 23 m and the stage measures 22 m × 17 m. *Eldborg* is equipped with configurable reverberation time, choir wagons and recording facilities as well as facilities for performers. The hall is specially designed for concerts.
  - (ii) *Norðurljós* is a recital hall that is designed for concerts. There are balconies all around the perimeter of the hall, and the stage is movable. The hall is equipped with custom-designed lighting equipment that can be configured in a number of coloured themes, creating the most suitable atmosphere for the event taking place. Two soundproofed portals connect *Norðurljós* and *Silfurberg*, so that the two halls can easily be used together for larger events. The hall is 540 m<sup>2</sup> and can accommodate 520 seated guests (theatre style).
  - (iii) *Silfurberg* is the only hall in Harpa that is specially designed for conferences. The hall is 735 m<sup>2</sup>, and seats up to 840 guests (theatre style). The stage is movable and expandable. The hall can be divided into two parts, each accommodating 325 seated guests, with a soundproofed retractable partition. Two soundproofed portals connect *Silfurberg* and *Norðurljós* that can be opened allowing the halls to be connected for larger events, if needed. The hall is suitable for all types of conferences, receptions or concerts. It features the best available technological equipment for conferences. The hall is also suitable for many types of music performances.
  - (iv) *Kaldalón* is the smallest hall in Harpa at 198 m<sup>2</sup>. The hall can seat 195 people. It is designed for concerts. The stage is movable, and the floor can also be used as a stage for musicians. The reverberation time in the hall can be changed, thus making it adaptable for various types of events.
  - (v) *Björtuloft* is a 400 m<sup>2</sup> hall on the 6th and 7th floor of Harpa that seats 130 people. The hall is suitable for meetings and banquets, standing receptions and other events. The hall can accommodate about 130 people on the upper floor (7th floor) and about 60-70 people on the floor below, bringing the total to about 200 people sitting at round tables on both floors. In the case of standing receptions, the space can accommodate about 300-350 people over the two floors. The 7th floor is equipped with a screen, projector and sound system and the lighting is adjustable.
- (20) There are 7 smaller conference rooms in Harpa that seat from 8 to 250 people and there are also several public spaces in Harpa that are occasionally rented out for exhibitions and receptions in order to increase the income of the company. The meeting rooms can be divided into smaller rooms. All meeting rooms are technically equipped and include a projector, internet meeting equipment and sound system.

## 2.5. The financing of Harpa's operations

- (21) As previously noted, Harpa is fully owned by the Icelandic State and the City through *Austurhöfn-TR ehf.* The obligation of the State and the City are regulated by Article 13 of the Project agreement from 2006 <sup>(11)</sup>. The annual payments of the State and the City are covered by their respective budgets. According to the State budget for 2011 the annual state contribution was expected to amount to ISK 424,4 million. For the year 2012 the expected amount to be contributed by the State was ISK 553,6 million. All public contributions to Harpa are borne in accordance with the participation in the project, i.e. the State pays 54 % and the City 46 %. The contributions are also indexed with the consumer price index.
- (22) In addition to the contribution provided for in the State and the City's budgets the government of Iceland and the City of Reykjavik have undertaken an obligation to grant a short term loan for the operation of Harpa until long term financing necessary to fully cover the cost of the project is completed. As from 2013 the total amount of the loan was ISK 794 million with an interest rate of 5 % and a 200 bp premium. The loan was to be repaid before 15 February 2013. On 6 March 2013 the City, the State and *Harpa Concert and Conference Centre ehf.* signed an agreement stating that the bridge loan would be changed into share capital of Harpa, as no capital had previously been submitted to the company. In the same agreement the State and the City committed to additional temporary annual payments to Harpa at the amount of ISK 160 million a year in the years 2013-16 to cover firstly real estate taxes allocated to Harpa, as they turned out much higher than expected <sup>(12)</sup>. Secondly, there were also other unforeseen costs related to Harpa.

<sup>(10)</sup> As described in the letter from the Icelandic authorities dated 28 May 2013 (Event No 673762). Further information on the halls and meeting rooms within Harpa is available online at: <http://harpa.is/harpa/salir-og-skipulag>

<sup>(11)</sup> As amended and restated in 2010.

<sup>(12)</sup> There is currently a dispute before the Reykjavik District Court concerning Harpa's real estate taxes and whether they are based on correct assessments.

- (23) The State and the City allocate funds on a monthly basis in order to pay off loan obligations in connection with Harpa. Since the project is meant to be self sustainable, the profits must cover all operational costs. The funds from the owners are therefore, according to the Icelandic authorities, only meant to cover outstanding loans <sup>(13)</sup>.
- (24) On 16 April 2013 a new agreement ('the 2013 Project Agreement') was signed, replacing the Amended Project Agreement <sup>(14)</sup>. According to the new Agreement the contribution of the City and State will continue to be an unconditional payment paid in monthly instalments at the same amount, ISK 595 000 000 each year, for a period of 35 years, starting from March 2011. When the annual amount has been adjusted according to the rise in the consumer price index as of March 2013, the amount payable each year is ISK 1 023 339 932 <sup>(15)</sup>.
- (25) According to the projected annual account of Austurhöfn-TR ehf. for the year 2012, the company was expected to sustain a significant operating loss corresponding to a total negative EBITDA of ISK 406,5 million. The conference part of Harpa was run at a negative EBITDA of ISK 120 million in 2012 and the same goes for 'other art events' (negative EBITDA of ISK 131 million). The projected annual accounts and earning analysis for the year 2013 also foresee a considerable operating loss, a total negative EBITDA of around ISK 348 million, with both the conference activities and 'other art events' operating at a loss <sup>(16)</sup>.

## 2.6. Cost allocation and the separation of accounts

- (26) According to the original Project agreement, there was to be a financial separation between the different companies involved in the operation of Harpa and between the different operations and activities:

'13.11.1. The Private Partner will at all times ensure that there is financial separation between the Real Estate Company, the Operation Company, Hringur and the Private Partner. Each entity shall be managed and operated separately with regards to finances.

13.11.2. The Private Partner will at all times ensure that there is sufficient financial separation, i.e. separation in book-keeping, between the Paid for Work and other operations and activities within the CC. The Private Partner shall at all times during the Term be able to demonstrate, upon request from the Client, that such financial separation exists.'

- (27) The operations of Harpa are divided into several categories: 1) The Icelandic Symphony Orchestra, 2) The Icelandic Opera, 3) Other art events, 4) Conference department, 5) Operations, 6) Ticket sales, 7) Operating of facilities, 8) Management cost. All these cost categories now fall under Harpa — tónlistar- og ráðstefnuhús ehf. and the revenue and costs attributed to each of these categories are included in the budget under the relevant category. Common operational costs such as salary, housing (heating and electricity) and administrative costs are divided among the categories according to a cost allocation model <sup>(17)</sup>.
- (28) For a more detailed description of the measure, reference is made to the Authority's Decision No 128/13/COL <sup>(18)</sup>.

## 3. GROUNDS FOR INITIATING THE FORMAL INVESTIGATION PROCEDURE

- (29) In Decision No 128/13/COL, the Authority assessed preliminarily whether the financing of Harpa constituted State aid and, if so, whether the aid was compatible with the State aid provisions of the EEA Agreement.
- (30) According to the Icelandic authorities, the financing of Harpa does not involve State aid since it has been properly ensured that there are separate accounts for the different activities within the concert hall and conference centre. To support this claim the Icelandic authorities submitted reports by two accounting firms concerning the separation of accounts of the companies involved in the operation of Harpa. The Icelandic authorities also submitted a

<sup>(13)</sup> See memorandum issued by the Director of Harpa, dated 24 September 2012 (Event No 648320).

<sup>(14)</sup> Agreement between the Icelandic State, the City of Reykjavik and Harpa tónlistar og ráðstefnuhús ehf. on the operation and the activities of Harpa Concert Hall and Conference Centre, of 16.4.2013.

<sup>(15)</sup> *Ibid.*

<sup>(16)</sup> See report by KPMG, dated 7.2.2013 (Event No 662444).

<sup>(17)</sup> *Ibid.*

<sup>(18)</sup> In particular, part 3 of the Decision.

pricing analysis where they compared the prices of comparable conference facilities in Reykjavik, based on size and capacity. Furthermore, the Icelandic authorities maintained that the conference business positively contributed towards other activities in Harpa and without the conference business, the costs other activities would have to carry would be considerably higher.

(31) However, in the preliminary view of the Authority, the financing of Harpa was considered to involve State aid within the meaning of Article 61(1) of the EEA Agreement. The following aspects were identified in Decision No 128/13/COL:

(i) The Authority concluded that since the Icelandic State and the City of Reykjavík together cover the annual deficit of the operation of Harpa by contributing a certain amount from their budgets, state resources within the meaning of Article 61 of the EEA Agreement are involved.

(ii) The Authority expressed its opinion that both the construction and operation of an infrastructure constitutes an economic activity if that infrastructure is, or will be, used to provide goods or services on the market <sup>(19)</sup>. Some of the activities taking place in Harpa, notably conferences, theatre performances, popular music concerts etc., can attract a significant number of customers while they are in competition with private conference centres, theatres or other music venues. Therefore, the Authority took the preliminary view that the companies involved in the operation of Harpa, in so far as they engage in commercial activities, qualify as undertakings.

(iii) Furthermore, the Authority considered that the public financing of the construction of Harpa would constitute an economic advantage and thus aid, since the project would admittedly not have been realised in the absence of such funding. Additionally, it considered that an advantage is conferred on the companies involved in the operation of Harpa in the form of foregone profits when the State and the City do not require a return on their investment in the concert hall and conference centre, in so far as those companies engage in commercial activities, such as the hosting of conferences or other art events. The preliminary assessment of the Authority was thus considered to show that a selective economic advantage could not be excluded at any level (construction, operation and use).

(iv) Finally, the Authority concluded that the measures were liable to distort competition. As the market for organising international events such as conferences and events is open to competition between venue providers and event organisers, which generally engage in activities which are subject to trade between EEA States, the effect on trade could be assumed. In this case, the effect on trade between certain neighbouring EEA States is even more likely due to the nature of the conference industry <sup>(20)</sup>. Therefore, the Authority came to the preliminary view that the measure threatened to distort competition and affect trade within the EEA.

(32) Moreover, the Authority doubted that the State aid could be considered compatible with the EEA Agreement. According to Article 61(3)(c) of the EEA Agreement, aid to promote culture and heritage conservation may be considered compatible with the functioning of the EEA Agreement, where such aid does not affect trading conditions and competition in the EEA to the extent that is contrary to the common interest. The Icelandic authorities had stated that the primary objective of the measure in question was to promote culture through the construction of a concert hall that could house both the Icelandic Symphony Orchestra and the Icelandic Opera. The Authority accepted that, given its cultural purpose, the construction and operation of a Symphony and Opera facility, could qualify as aid to promote culture.

(33) The Authority also accepted that an infrastructure such as Harpa could also be used to house various commercial activities such as restaurants, coffee shops, stores, conferences and popular concerts. However, in order not to distort competition, safeguards had to be put in place to ensure that there is no cross subsidisation between the commercial activities and the subsidised cultural activities. The Authority came to the preliminary conclusion that it had doubts as to whether the Icelandic authorities had put the necessary safeguards in place to ensure that such cross subsidisation did not occur. Consequently, following its preliminary assessment, the Authority had doubts whether the construction and operation of Harpa could be deemed compatible under Article 61(3)(c) of the EEA Agreement.

<sup>(19)</sup> See the Commission Decision in Case SA. 33618 (Sweden) *Financing of the Uppsala arena* (OJ C 152, 30.5.2012, p. 18), paragraph 19.

<sup>(20)</sup> See Case T-90/09 *Mojo Concerts BV and Amsterdam Music Dome Exploïtatïe BV v The European Commission*, Order of the General Court of 26.1.2012, para 45, published in OJ C 89, 24.3.2012, p. 36.

## 4. COMMENTS BY THE ICELANDIC AUTHORITIES

- (34) The comments of the Icelandic authorities reflected their view that the financing of the operation of Harpa does not involve State aid since they had properly ensured that the companies keep separate accounts for the different activities within Harpa <sup>(21)</sup>.
- (35) The Icelandic authorities do not dispute that the financial contributions to Harpa are granted through state resources and are imputable to the State. However, they maintain that Harpa cannot be considered to be an undertaking within the meaning of Article 61(1) of the EEA Agreement. According to the Icelandic authorities, Harpa is an infrastructure and a culture venue that aims at preserving and promoting culture and Icelandic heritage, and therefore it cannot be seen as providing goods and services on a competitive market. Furthermore, the Icelandic authorities are of the opinion that the condition regarding an economic advantage is not met in this case, as it has been ensured that the commercial part of Harpa is not financed through state resources which are only allocated to cultural activities. Finally, with regard to the effect on competition and trade between the Contracting Parties, the Icelandic authorities note that the geographical position of Iceland must be kept in mind and that it is not likely that audiences from other states that are parties to the EEA Agreement will travel to Iceland specifically to attend concerts or similar events.
- (36) The Icelandic authorities emphasize that the overall operations of Harpa are not of a commercial nature. According to them, Harpa would not have been created by a private undertaking and cannot be compared to a private group of undertakings. Therefore, according to the Icelandic authorities, the facts demonstrate clearly that the market economy investor test (MEIP) has its limits in this case.
- (37) After consulting with the directors of Harpa the Icelandic authorities have proposed that the structure used to ensure prevention of cross-subsidy will not be in the form of separate companies or mandatory tendering of the conference operations. The Icelandic authorities are confident that other measures are better suited and will create less difficulty in the operations of the facility. Thus, irrespective of whether the state resources used to finance and operate Harpa are considered to be State aid compatible with State aid rules — or not to constitute State aid at all — the Icelandic authorities agree that measures have to be implemented to ensure that any support does not unlawfully distort competition in the conference market.
- (38) The Icelandic authorities agree with the Authority that it has to be secured that the conference operations are financially independent from other operations of Harpa and that safeguards need to be implemented to prevent cross-subsidisation between the two parts. Therefore, to ensure proper division between the commercial activities and other activities, and in order to prevent any subsidy to the former, two main measures have been taken:
- (i) *Firstly*, the directors of Harpa have implemented a new business and accounting software <sup>(22)</sup>. It enables Harpa tónlistar- og ráðstefnuhús ehf. to ensure proper division of different activities and link its accounting system more closely with its project management. Much more transparency and analytical functions are included in the new system. The separation of accounts in Harpa takes note of guidance given by Directive 2006/111/EC on the transparency of financial relations between Member States and public undertakings (the ‘Transparency Directive’) <sup>(23)</sup>. Special accounts (divisions) are kept for all cultural activities and tenants, as well as the conference operations, thereby ensuring that internal accounts corresponding to different activities are kept.
- (ii) *Secondly*, the Icelandic authorities have ensured that a certain part of Harpa’s fixed and common costs are allocated to each individual division of the operations, based on actual usage and commercial activity. Additionally, the conference department has been charged market rent for office space and other facilities. The Icelandic authorities established the market rate for the rent and the remuneration for the usage of common services by comparing what private parties would charge in comparable situations.

<sup>(21)</sup> See footnote 6.

<sup>(22)</sup> The new software, Microsoft Dynamics Nav, was introduced in January 2013. See memorandum from the CFO of Harpa, dated 21.5.2013 (Event No 673770).

<sup>(23)</sup> Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings (OJ L 318, 17.11.2006, p. 17), incorporated at point 1a of Annex XV to the EEA Agreement.

- (39) The Icelandic authorities have submitted a draft proposal for a complete separation of accounts for the conference department of Harpa that takes account of the new cost and income allocation methodology <sup>(24)</sup>. The following table demonstrates the suggested separation of accounts within Harpa <sup>(25)</sup>:

The separation of accounts for the conference department of Harpa			
	<b>Operating revenue</b>	<b>2013</b>	<b>2016</b>
1	Conference facility rental income	109 282	141 815
2	Technical equipment rental income	37 965	47 870
3	Technician service income	38 054	48 105
4	Other income	2 186	2 836
	— Total income excluding catering related income:	187 486	240 626
	<b>Catering related income</b>		
5	Conference department share in catering revenue	34 396	38 697
6	Fixed rent	7 209	7 209
	<b>Total conference revenue</b>	<b>229 091</b>	<b>286 533</b>
	<b>Operating expenses</b>		
7	Fixed rental — conference office	686	686
8	Fixed rental — catering	7 209	7 209
9	Salaries and related expenses — conference employees	42 908	42 908
10	Financial administrative charge (bookkeeping)	1 000	1 000
11	Salaries and related expenses — marketing employees	6 738	6 738
12	Marketing cost	22 000	22 000
	<b>Event related cost</b>		
13	Rental charge (75 % of facility rental income)	81 961	106 361
14	Equipment rental cost (75 % of equipment lease income)	28 474	35 903
15	Technician service cost (75 % of technical service income)	28 541	36 079
	<b>Total operating expenses</b>	<b>219 571</b>	<b>258 884</b>
	<b>EBITDA</b>	<b>9 574</b>	<b>27 649</b>

- (40) With regard to the rental charge, the Icelandic authorities submitted to the Authority a comparison of the rent charged by other conference facilities in Iceland which shows that the conference department's rent is above the

<sup>(24)</sup> It is the Authority's understanding that the new cost and income allocation methodology and the separate accounts model will be reflected in the 2013 annual account for Harpa.

<sup>(25)</sup> All figures are in thousand ISK.

comparable market rate to retail customers. According to the Icelandic authorities the rental price to a wholesaler operator such as the conference department, would normally be considerably lower than what a retail customer would pay. Therefore, the Icelandic authorities propose that a 25 % margin (discount) be applied <sup>(26)</sup>. According to the Icelandic authorities, such a low level of margin should ensure that the conference department is properly charged in comparison with other market operators.

- (41) According to the Icelandic authorities, it is understandable that an investment such as Harpa, like any other large investment project, would not return a profit for the first couple of years of its operation. However, the new cost and income allocation model shows that the commercial part will become gradually more profitable, providing the owners of Harpa with a return on their investment in the next couple of years. The new model also demonstrates that the conference department has, until now, most likely borne an un-proportionally high part of the common cost.
- (42) Finally, if the Authority were to consider the measure to constitute State aid, the Icelandic authorities have expressed the view that such aid could be considered compatible with Article 61(3) of the EEA Agreement, having regard to the objectives of the measure, including the objective to preserve and promote culture and the Icelandic heritage. In this regard, the Icelandic authorities have also invited the Authority to assess whether such aid should be considered to constitute the financing of a service of general economic interest ('SGEI').

## II. ASSESSMENT

### 1. THE PRESENCE OF STATE AID WITHIN THE MEANING OF ARTICLE 61(1) EEA

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

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

- (44) This implies that a measure constitutes State aid within the meaning of Article 61(1) of the EEA Agreement if the following conditions are cumulatively fulfilled: the measure (i) is granted by the State or through State resources; (ii) confers an economic advantage to the beneficiary; (iii) is selective; (iv) has an impact on trade between Contracting Parties and is liable to distort competition <sup>(27)</sup>.
- (45) In the following chapters the state funding of the financing of Harpa will be assessed with respect to these criteria.

#### 1.1. State resources

- (46) According to Article 61(1) of the EEA Agreement, a measure must be granted by the state or through state resources in order to constitute State aid.
- (47) At the outset, the Authority notes that both local and regional authorities are considered to be equivalent to the State <sup>(28)</sup>. Consequently, the State for the purpose of Article 61(1) covers all bodies of the state administration, from the central government to the City level or the lowest administrative level as well as public undertakings and bodies. Furthermore, municipal resources are considered to be state resources within the meaning of Article 61 of the EEA Agreement <sup>(29)</sup>.
- (48) Since the Icelandic State and the City of Reykjavík cover jointly the annual deficit of the company operating Harpa by annually contributing a certain amount from their budgets, state resources are involved. Furthermore, the conversion of loans into share capital also entails a transfer of state resources since the State and the City would forego their entitlement to receive a full repayment of the outstanding loans. Therefore, the first criterion of Article 61(1) of the EEA Agreement is fulfilled.

<sup>(26)</sup> According to the Icelandic authorities, it is customary for the margin in comparable industries to be between 20-30 %.

<sup>(27)</sup> According to settled case-law, classification as aid requires that all the conditions set out in the provision should be fulfilled, see Case C-142/87 *Belgium v Commission* ('Tubemeuse') [1990] ECR I-959.

<sup>(28)</sup> See Article 2 of the Transparency Directive 2006/111/EC.

<sup>(29)</sup> See the Authority's Decision No 55/05/COL section II.3, p. 19 with further references, published in OJ L 324, 23.11.2006, p. 11, and EEA Supplement No 56, 23.11.2006, p. 1.

## 1.2. Undertaking

- (49) In order to constitute State aid within the meaning of Article 61(1) of the EEA Agreement, the measure must confer an advantage upon an undertaking. Undertakings are entities engaged in an economic activity, regardless of their legal status and the way in which they are financed <sup>(30)</sup>. Economic activities are activities consisting of offering goods or services on a market <sup>(31)</sup>. Conversely, entities that are not commercially active, in the sense that they are not offering goods and services on a given market, do not constitute undertakings.
- (50) As was noted in Decision No 128/13/COL, the Authority is of the opinion that both the construction and operation of an infrastructure constitute an economic activity in itself (and are thus subject to State aid rules) if that infrastructure is, or will be used, to provide goods or services on the market <sup>(32)</sup>. In this case, Harpa is intended for e.g. hosting conferences as well as music, culture and 'other art events' on a commercial basis, i.e. for the provision of services on the market. This view has been confirmed by the Court of Justice of the European Union ('the Court of Justice') in the *Leipzig/Halle* case <sup>(33)</sup>. Consequently, in infrastructure cases, aid may be granted at several levels: construction, operation and use of the facilities <sup>(34)</sup>.
- (51) As previously noted, Harpa hosts concerts by the Icelandic Symphony Orchestra, the Icelandic Opera, and various other art events as well as conferences. In the view of the Icelandic authorities only the conference aspect of Harpa's operation constitutes an economic activity. All other activities should therefore be classified as non-economic.
- (52) However, some of the activities taking place in Harpa, notably conferences, theatre performances, popular music concerts etc., can attract significant numbers of customers while they are in competition with private conference centres, theatres or other music venues. Therefore, the Authority takes the view that Harpa Concert Hall and Conference Centre and the company involved in its operation, in so far as they engage in commercial activities, qualify as an undertaking <sup>(35)</sup>.

## 1.3. Advantage

- (53) In order to constitute State aid within the meaning of Article 61 of the EEA Agreement the measure must confer an economic advantage on the aid recipient.
- (54) Regarding the financing of the construction of Harpa, State aid can be excluded if it is in conformity with the market economy investor principle ('MEIP') <sup>(36)</sup>. However, the Icelandic authorities have objected to the application of the MEIP test in this case since, according to them, the overall operations of Harpa are not of a commercial nature. According to the Icelandic authorities, Harpa would not have been created by a private undertaking and therefore cannot be compared to a private group of undertakings. Thus, it is the view of the Icelandic authorities that the market economy investor test (MEIP) has its limits in this case.
- (55) As regards the construction of Harpa the State and the City had, according to the Icelandic authorities, initially hoped that a private investor would finance the realization of the project. However, due to the financial crisis, it became impossible to carry out the project without public funding. The direct grants by the State and the City are thus claimed to be necessary, as without them there would not have been enough funds to finance the project. The Authority therefore considers that the public financing of the construction of Harpa would constitute an economic advantage and thus aid, since the project would admittedly not have been realised in the absence of public funding. The participation by the State and the City was therefore essential to the Harpa project as a whole.
- (56) It follows from the Authority's decisional practice that when an entity carries out both commercial and non-commercial activities, a cost-accounting system that ensures that the commercial activities are not financed

<sup>(30)</sup> Case C-41/90 *Höfner and Elser v Macroton* [1991] ECR I-1979, paragraphs 21-23 and Case E-5/07 *Private Barnehagers Landsforbund v EFTA Surveillance Authority* [2008] Ct. Rep. 61, paragraph 78.

<sup>(31)</sup> Case C-222/04 *Ministero dell'Economica e delle Finanze v Cassa di Risparmio di Firenze SpA* [2006] ECR I-289, paragraph 108.

<sup>(32)</sup> See footnote 19.

<sup>(33)</sup> Case C-288/11 P *Mitteldeutsche Flughafen and Flughafen Leipzig-Halle v The European Commission*, 19/12/2012, paragraphs 40-43, not yet published.

<sup>(34)</sup> See the Commission Decision in Case SA. 33728 (Denmark) *Financing of a new multiarena in Copenhagen* (OJ C 152, 30.5.2012, p. 6), paragraph 24.

<sup>(35)</sup> See the Commission Decision in Case N 293/2008 (Hungary) *Cultural aid for multifunctional community cultural centres, museums, public libraries* (OJ C 66, 20.3.2009, p. 22), paragraph 19.

<sup>(36)</sup> See the Commission Decision in Case SA. 33728 (Denmark) *Financing of a new multiarena in Copenhagen* (OJ C 152, 30.5.2012, p. 6), paragraph 25.

through State resources allocated to the non-profit making activities must be in place <sup>(37)</sup>. This principle is also laid down in the Transparency Directive. The Transparency Directive does not apply directly to the case at hand, since the total net annual turnover of Harpa, for the last two years, is below the turnover threshold laid out in Article 5(1)(d) of the Directive <sup>(38)</sup>. However, the Authority is of the opinion that the principles of operating economic activities on commercial terms with separate accounts, and a clear establishment of the cost accounting principles according to which separate accounts are maintained, still apply.

- (57) As described in Section I.2 above, the operations of Harpa are divided into several categories, e.g. hosting the Icelandic Symphony Orchestra and the Icelandic Opera as well as other art events and conferences. The Icelandic authorities have however not until after the Authority adopted Decision No 128/13/COL, properly ensured that there is a clear and consistent separation of the accounts for the different activities of Harpa. Simply dividing the losses associated with the operation of the building and common administrative costs between the different activities of Harpa based on estimated usage and other criteria, as was the practice for the first years of the operation of Harpa, cannot be seen as a clear separation of accounts under EEA law. This situation therefore could have led to cross-subsidisation between the cultural activities and the economic activities within Harpa.
- (58) As described in Section I.4, the Icelandic authorities have introduced certain measures in order to separate the accounts of the commercial and the non-commercial activities within Harpa <sup>(39)</sup>. The measures include a new cost- and income allocation methodology and the keeping of separate accounts for Harpa's conference department. Although these new arrangements minimise the advantage of the companies involved in the operation of Harpa to the minimum necessary to ensure operation of the infrastructure, an advantage to the conference department cannot be entirely excluded.
- (59) Additionally, an advantage is conferred on the companies involved in the operation of Harpa in the form of foregone profits when the State and the City do not require a return on their investment in the concert hall and conference centre, in so far as those companies engage in commercial activities, such as the hosting of conferences. Any business owner or investor will normally require a return on its investment in a commercial undertaking. Such a requirement effectively represents an expense for the undertaking. If a state owned undertaking is not required to generate a normal rate of return for its owner this effectively means that the undertaking benefits from an advantage whenever the owner foregoes that profit <sup>(40)</sup>.

#### 1.4. Advantage assessed in the light of Altmark

- (60) The Icelandic authorities take the view that the financing of the construction and operation of Harpa should be characterised as the funding of a service of general economic interest and that the four cumulative criteria of the 'Altmark test' are fulfilled so that the measure does not constitute State aid within the meaning of Article 61(1) of the EEA Agreement.
- (61) The Court of Justice's judgment in the *Altmark* case provides clarification regarding the conditions under which public service compensation does not constitute State aid, owing to the absence of any advantage <sup>(41)</sup>. However, for such compensation to escape qualification as State aid in a particular case, four cumulative conditions, commonly referred to as the *Altmark* criteria, must be satisfied <sup>(42)</sup>.
- (62) The four conditions are as follows: (i) the beneficiary of a state-funding mechanism for an SGEL must be formally entrusted with the provision and discharge of an SGEL, the obligations of which must be clearly defined; (ii) the parameters for calculating the compensation must be established beforehand in an objective and transparent manner, to avoid it conferring an economic advantage which may favour the recipient undertaking over competing undertakings; (iii) the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of the SGEL, taking into account the relevant receipts and a reasonable profit for discharging those obligations; and (iv) where the beneficiary is not chosen pursuant to a public procurement procedure, the level of compensation granted must be determined on the basis of an analysis of the costs which a typically well-run undertaking would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit.

<sup>(37)</sup> See the Authority's Decision No 343/09/COL on the property transactions engaged in by the Municipality of Tím concerning property numbers 1/152, 1/301, 1/630, 4/165, 2/70, 2/32 (OJ L 123, 12.5.2011, p. 72; EEA Supplement No 27, 12.5.2011, p. 1) and the Authority's Decision No 91/13/COL, of 27.2.2013, on the financing of municipal waste collectors, paragraph 34, available online at: <http://www.eftasurv.int/media/decisions/91-13-COL.pdf>

<sup>(38)</sup> See footnote 23.

<sup>(39)</sup> It is the Authority's understanding that these measures will be reflected in the 2013 annual account for Harpa.

<sup>(40)</sup> Case C-234/84 *Belgium v Commission* [1986] ECR I-2263, paragraph 14.

<sup>(41)</sup> Case C-280/00 *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH*, [2003] ECR I-7747.

<sup>(42)</sup> See paragraphs 87 to 93 of the judgment, cited above.

- (63) EEA States have, in general, a wide discretion concerning the identification of a service as an SGEL, while following the relevant case-law which sets out the general principles to be respected. It transpires from Article 59(2) of the EEA Agreement that undertakings entrusted with the operation of SGELs are undertakings entrusted with 'a particular task' <sup>(43)</sup>.
- (64) According to the Authority's guidelines on the application of the State aid rules to compensation granted for the provision of services of general economic interest <sup>(44)</sup>, the public service task must be assigned by way of an act that, depending on the legislation in the EFTA States, may take the form of a legislative or regulatory instrument or a contract. It may also be laid down in several acts. Based on the approach taken by the Commission and the Authority in such cases, the act or series of acts must at least specify:
- (a) the content and duration of the public service obligations;
  - (b) the undertaking and, where applicable, the territory concerned;
  - (c) the nature of any exclusive or special rights assigned to the undertaking by the authority in question;
  - (d) the parameters for calculating, controlling and reviewing the compensation; and
  - (e) the arrangements for avoiding and recovering any overcompensation.
- (65) The public service obligations of Harpa are, according to the Icelandic authorities, clearly defined in its ownership policy. According to the ownership policy, the purpose of Harpa is to: (i) be a forum for music- and cultural life in Iceland, (ii) to strengthen the position of Iceland as venue for conferences, (iii) to fortify the position of the travel industry in Iceland and (iv) to promote life in the city centre of Reykjavik. Furthermore, the ownership policy stipulates that the operations of Harpa shall be self-sustainable and that there should be no further contributions to Harpa other than those agreed upon in the Project Agreement. However, the ownership policy neither addresses the duration of the public service obligations nor does it outline particular parameters for calculating, controlling and reviewing the compensation or describe arrangements for avoiding and recovering overcompensation. Therefore, in the view of the Authority, the first *Altmark* criterion is not fulfilled.
- (66) Furthermore, according to the Project Agreement, the contribution from the State and the City was to be a fixed annual amount (ISK 595 000 000) which was to be amended on each payment date to reflect changes in the consumer price index. However, due to Harpa's financial situation there have been considerable temporary financial contributions from Harpa's owners as well as loan conversion arrangements <sup>(45)</sup>. Therefore, contrary to the view of the Icelandic authorities, the compensation for the alleged public service obligation appears not to have been established in advance in an objective and transparent manner. Moreover, the non-transparent nature of the aid (the coverage of the annual deficit of Harpa, the potential cross subsidisation and the practice of not requiring a reasonable return on investment) can only lead the Authority to conclude that the Icelandic authorities did not properly ensure that the compensation did not exceed what was necessary.
- (67) Finally, the Authority notes that the operator of Harpa has not been selected in a public procurement procedure and that the Icelandic authorities have not provided the Authority with information enabling a verification of whether the costs incurred by Harpa correspond to the costs of a typical undertaking, well run and adequately equipped as required by the 4<sup>th</sup> *Altmark* criterion.
- (68) Hence, on the basis of the above, the Authority concludes that the financing of Harpa, does not fulfil all of the *Altmark* criteria and can therefore not be characterised as the funding of a service of general economic interest.

### 1.5. Selectivity

- (69) In order to constitute State aid within the meaning of Article 61 of the EEA Agreement the measure must be selective.

<sup>(43)</sup> See, for example, Case C-127/73 *BRT v SABAM* [1974] ECR-313, paragraphs 19-20.

<sup>(44)</sup> See the Authority's Guidelines on the application of the State aid rules to compensation granted for the provision of services of general economic interest (OJ L 161, 13.6.2013, p. 12 and EEA Supplement No 34, 13.6.2013, p. 1), available online at: <http://www.eftasurv.int/media/state-aid-guidelines/Part-VI—Compensation-granted-for-the-provision-of-services-of-general-economic-interest.pdf>

<sup>(45)</sup> The converting of loans into share capital.

- (70) The Icelandic authorities provide funding to the companies involved in the operation of Harpa. The funding is used to cover the losses stemming from the different activities within Harpa, including economic activities such as the hosting of conferences. This system of compensation, under which cross-subsidisation may occur, is not available to other companies that are active on the conference market in Iceland or elsewhere.
- (71) In light of the above, it is the Authority's view that the companies involved in the operation of Harpa receive a selective economic advantage compared to their competitors on the market.

#### 1.6. Distortion of competition and effect on trade between Contracting Parties

- (72) Finally, the measure must be liable to distort competition and affect trade between the Contracting Parties to the EEA Agreement in order to be considered State aid within the meaning of Article 61(1) of the EEA Agreement.
- (73) According to settled case law, the mere fact that a measure strengthens the position of an undertaking compared with other undertakings competing in intra-EEA trade, is considered to be sufficient in order to conclude that the measure is likely to affect trade between Contracting Parties and distort competition between undertakings established in other EEA States <sup>(46)</sup>. The state resources allocated to the companies involved in the operation of Harpa, in order to cover their losses, constitute an advantage that strengthens Harpa's position compared to that of other undertakings competing in the same market.
- (74) Even if most of the activities carried out in Harpa are of local character, Harpa has the capacity to host large and mid-size international events as well, and thus an effect on competition and trade between Contracting Parties cannot be excluded <sup>(47)</sup>. Although, according to the Icelandic authorities, it is rather unlikely that more than a few, if any, of the events taken place in Harpa will be of such an interest to persons living in neighbouring countries that they would be willing to travel a long distance to Reykjavík in order to attend the events and thus it would be unlikely that events taken place in Harpa would compete with similar arenas in nearby countries.
- (75) However, as the market for organising international events is open to competition between venue providers and event organisers, which generally engage in activities which are subject to trade between EEA States, the effect on trade can be assumed. In this case, the effect on trade between certain neighbouring EEA States is even more likely due to the nature of the conference industry. Moreover, the General Court has recently, in its Order concerning the Ahoy complex in the Netherlands, held that there was no reason to limit the market to the territory of that Member State <sup>(48)</sup>.
- (76) Therefore, as in the opening decision, the Authority considers that aid to Harpa has the potential to affect competition and trade within the EEA.

#### 1.7. Conclusion with regard to the presence of State aid

- (77) With reference to the above considerations the Authority concludes that the measure under assessment, i.e. the financing of Harpa, includes elements of State aid within the meaning of Article 61(1) of the EEA Agreement. Under the conditions referred to above, it is thus necessary to consider whether the measure can be found to be compatible with the functioning of the EEA Agreement.

### 2. PROCEDURAL REQUIREMENTS

- (78) Pursuant to Article 1(3) of Part I of Protocol 3, '[t]he EFTA Surveillance Authority shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. [...] The State concerned shall not put its proposed measures into effect until th[e] procedure has resulted in a final decision'.
- (79) The Icelandic authorities did not notify the aid measures to the Authority. Moreover, the Icelandic authorities have, by constructing and operating Harpa, put those measures into effect before the Authority has adopted a final decision. The Authority therefore concludes that the Icelandic authorities have not respected their obligations pursuant to Article 1(3) of Part I of Protocol 3. The granting of any aid involved is therefore unlawful.

<sup>(46)</sup> Case E-6/98 *The Government of Norway v EFTA Surveillance Authority* [1999] Rep. EFTA Court page 76, paragraph 59; Case 730/79 *Philip Morris v Commission* [1980] ECR 2671, paragraph 11.

<sup>(47)</sup> See Commission Decision in Case SA. 33618 (Sweden) *Financing of the Uppsala arena* of 2.5.2013 [not yet published], paragraph 45.

<sup>(48)</sup> See footnote 20.

## 3. COMPATIBILITY ASSESSMENT

- (80) Support measures caught by Article 61(1) of the EEA Agreement are generally incompatible with the functioning of the EEA Agreement, unless they qualify for a derogation under Article 61(2) or (3) or Article 59(2) of the EEA Agreement and are necessary, proportional and do not cause undue distortion of competition. The Icelandic authorities argue that any aid involved in the project would be compatible with Article 61(3) of the EEA Agreement.
- (81) The EEA Agreement does not include a provision corresponding to Article 107(3)(d) of the Treaty on the Functioning of the European Union. The Authority nevertheless acknowledges that State aid measures may be approved on cultural grounds on the basis of Article 61(3)(c) of the EEA Agreement <sup>(49)</sup>.
- (82) On the basis of Article 61(3)(c) of the EEA Agreement, aid to promote culture and heritage conservation may be considered compatible with the functioning of the EEA Agreement, where such aid does not affect trading conditions and competition in the EEA to the extent that is considered to be contrary to the common interest. The Authority must therefore assess whether granting aid to the various activities in Harpa can be justified as aid to promote culture on the grounds of Article 61(3)(c) of the EEA Agreement.
- (83) It should be noted that the principles laid down in Article 61(3)(c) of the EEA Agreement have been applied to cases somewhat similar to this case <sup>(50)</sup>. The Icelandic authorities have stated that the primary objective of the measure in question was to promote culture through the construction of a concert hall that could house both the Icelandic Symphony Orchestra and the Icelandic Opera. Similar multipurpose cultural centres already exist in most other European cities. Harpa is intended to be Iceland's national concert hall, providing the necessary cultural infrastructure that was missing in Iceland and it will act as the focal point for the development and advancement of those performance arts in Iceland. Harpa therefore contributes to the development of cultural knowledge and grants access to cultural, educational and recreational values for the public <sup>(51)</sup>.
- (84) In view of the above, the Authority considers that, given its cultural purpose, the construction and operation of a Symphony and Opera facility, would qualify as aid to promote culture within the meaning of Article 61(3)(c) of the EEA Agreement. However, the Authority has expressed doubts as to whether aid granted to subsidize conference activities, can be justified under Article 61(3)(c) and this matter must therefore be assessed separately.
- (85) Concerning necessity, proportionality and whether the measure is likely to distort competition, the Authority has the following observations: as previously noted, the main reason for constructing Harpa was the apparent need for a suitable concert hall to accommodate both the Icelandic Symphony Orchestra and the Icelandic Opera. Given the scale of the project it is understandable that an infrastructure such as Harpa would also be used to house various commercial activities such as restaurants, coffee shops, stores, conferences and popular concerts. However, in order not to distort competition, safeguards must be put in place to ensure that there is no cross subsidisation between the commercial activities and the heavily subsidised cultural activities.
- (86) In Decision No 128/13/COL the Authority outlined three methods, by which the Icelandic authorities could ensure that there was no cross subsidisation between the commercial activities and the cultural activities within Harpa <sup>(52)</sup>. *Firstly*, the Authority noted that this goal could be achieved by tendering out the facilities intended for the commercial activities, thereby ensuring that the economic operator pays market price for the facilities and does not benefit from cross subsidisation. *Secondly*, the Icelandic authorities could have established a separate legal entity for the commercial activities. The *third* option outlined in the Authority's opening decision was to sufficiently separate the economic activities from the non-commercial activities by establishing a sufficient system of cost allocation and separate accounts that ensures a reasonable return on investment.

<sup>(49)</sup> See for example paragraph 7 (with further references) of the Authority's Guidelines on State aid to cinematographic and other audiovisual work, available at the Authority's webpage at: <http://www.eftasurv.int/state-aid/legal-framework/state-aid-guidelines/>

<sup>(50)</sup> See Commission Decision in Case N 122/2010 (Hungary) *State aid to Danube Cultural Palace* (OJ C 147, 18.5.2011, p. 3) and Commission Decision in Case N 293/2008 (Hungary) *Cultural aid for multifunctional community cultural centres, museums, public libraries* (OJ C 66, 20.3.2009, p. 22).

<sup>(51)</sup> See Commission Decision in Case SA 33241 (Cyprus) *State support to the Cyprus Cultural Centre* (OJ C 377, 23.12.2011, p. 11), paragraphs 36-39.

<sup>(52)</sup> See paragraph 64 of the Decision.

- (87) The Icelandic authorities have emphasised that the operation of Harpa needs certain flexibility as both the cultural events and conference activities need to co-exist and there are various instances where these two main activities would collide unless the supervision and planning was done in a very coherent manner. Thus it would increase the administrative burden and incur additional restraints and costs on the already difficult operation of Harpa to introduce a new operator, either a private operator or separate publicly owned entity, within the building. Therefore, the Icelandic authorities, after consulting with the directors of Harpa, concluded that the *third* option, i.e. the separation of the economic activities and the non-commercial activities of Harpa and the establishment of a sufficient system of cost allocation and separate accounts, was the most viable in light of the circumstances described above.
- (88) As previously noted, the separate accounts and the new cost- and income allocation methodology, that have been introduced by the owners of Harpa, take account of guidance given by the 'Transparency Directive'. Special accounts (divisions) are kept for all cultural activities and tenants, as well as the conference operations, thereby ensuring that internal accounts corresponding to different activities are kept. Moreover, the Icelandic authorities have ensured that a certain part of Harpa's fixed and common costs are allocated to each individual division of the operations, based on actual usage and commercial activity. In addition, the conference department will be charged market rent for office space and other facilities<sup>(33)</sup>. The measures implemented by the Icelandic authorities effectively ensure that there will be no cross subsidisation between the commercial activities and the cultural activities within Harpa.
- (89) According to the preliminary accounts for 2013, the conference department is expected to deliver a marginal profit of ISK 9 574 000. By the year 2016 this profit is expected to have grown to over ISK 23 million. Therefore, the new cost and income allocation model shows that the commercial part will become gradually more profitable, providing the owners of Harpa with a return on their investment in the next couple of years.
- (90) With regard to the conference department's deficit in the first years of Harpa's operation, the Authority agrees that it is understandable that an investment such as Harpa, like any other large investment project, would not return a profit for the first years of its operation. The covering of an operational deficit for the first years of commercial operations can thus be seen as a necessary start up cost in line with the MEIP. Furthermore, the separated accounts and the new cost- and income methodology would appear to suggest that the huge deficit of the commercial parts of Harpa that was assessed in the Authority's opening decision, a negative EBITDA of ISK 120 million for the year 2012, did not necessarily reflect the actual financial situation of the conference department.
- (91) Moreover, the Icelandic authorities have shown that Harpa will both complement existing facilities with additional capacity and increase the types of events, both cultural and commercial, which can take place in Reykjavik, and considerably benefit cultural development and the general public in Iceland. Thus, the aid must be considered well-targeted and the public financing thereof justified.
- (92) In addition, considering the location of Harpa and that most of the activities that take place within it are of local character, the effect on competition and trade between Contracting Parties is limited, although, as described above, it cannot be excluded<sup>(34)</sup>.
- (93) From the above reasons, it has been demonstrated that the involvement of the State and the City in the financing of Harpa is both necessary, proportionate and does not cause undue distortion of competition. Furthermore, by fully separating the accounts of the commercial and non-commercial part of Harpa, the Icelandic authorities have managed to ensure that there are no negative spillover effects stemming from their contributions to the cultural aspects of Harpa's operation. The financing of Harpa is therefore compatible with the State aid rules of the EEA Agreement.

#### 4. CONCLUSION

- (94) Based on the above considerations, the Authority concludes that the financing of Harpa constitutes State aid that is compatible with the functioning of the EEA Agreement within the meaning of Article 61(3)(c) of the EEA Agreement.
- (95) The Icelandic authorities are reminded that all plans to modify the financing of Harpa, including any increase in the grants by the State or the City by more than 20 %, should be notified to the Authority.

<sup>(33)</sup> The market rent and the remuneration for the usage of common services were established by comparing what private parties would charge in comparable situations.

<sup>(34)</sup> See Commission Decision in Case SA. 33618 (Sweden) *Financing of the Uppsala arena* of 2.5.2013 [not yet published], paragraph 59.

HAS ADOPTED THIS DECISION:

*Article 1*

The financing of Harpa Concert Hall and Conference Centre is compatible with the EEA Agreement.

*Article 2*

This Decision is addressed to the Republic of Iceland.

*Article 3*

Only the English language version of this Decision is authentic.

Done at Brussels, 11 December 2013.

*For the EFTA Surveillance Authority*

Oda Helen SLETNES

*President*

Sverrir Haukur GUNNLAUGSSON

*College Member*

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