

Case No.: 64738  
Event No: 483971  
Dec. No: 501/08/COL

The logo of the EFTA Surveillance Authority, consisting of the text "EFTA SURVEILLANCE AUTHORITY" in white capital letters on a dark blue rectangular background.

**EFTA SURVEILLANCE AUTHORITY DECISION**  
of 16 July 2008

regarding a notified scheme for the grant of a temporary exemption in relation to an environmental agreement between fourteen business organisations and the Norwegian State relating to reduction of Nitrogen Oxide (“NO<sub>x</sub>”) emissions

(Norway)

THE EFTA SURVEILLANCE AUTHORITY<sup>1</sup>

Having regard to the Agreement on the European Economic Area<sup>2</sup>, in particular to Articles 61 to 63 and Protocol 26 thereof,

Having regard to the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice<sup>3</sup>, in particular to Article 24 thereof,

Having regard to Article 1(3) of Part I and Article 4(3) of Part II of Protocol 3 to the Surveillance and Court Agreement<sup>4</sup>,

Having regard to the Authority’s Guidelines on the application and interpretation of Articles 61 and 62 of the EEA Agreement<sup>5</sup>, and in particular the Chapter on State Aid for Environmental Protection and on measures relating to Direct Business Taxation thereof,

Whereas:

## **I. FACTS**

### **1 Procedure**

By letter of 14 May 2008, (Event No: 477252), the Norwegian authorities notified pursuant to Article 1(3) of Part I of Protocol 3, a scheme for the grant of a temporary tax

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<sup>1</sup> Hereinafter referred to as the Authority.

<sup>2</sup> Hereinafter referred to as the EEA Agreement.

<sup>3</sup> Hereinafter referred to as the Surveillance and Court Agreement.

<sup>4</sup> Hereinafter referred to as Protocol 3.

<sup>5</sup> Guidelines on the application and interpretation of Articles 61 and 62 of the EEA Agreement and Article 1 of Protocol 3 to the Surveillance and Court Agreement, adopted and issued by the Authority on 19 January 1994, published in the Official Journal of the European Union (hereinafter referred to as OJ) L 231 of 03.09.1994 p. 1 and EEA Supplement No 32 of 03.09.1994 p. 1. The Guidelines were last amended on 16 July 2008. Hereinafter referred to as the State Aid Guidelines. The updated version of the State Aid Guidelines is published on the Authority’s website:

<http://www.eftasurv.int/fieldsofwork/fieldstateaid/guidelines/>

exemption to undertakings in order to promote measures aimed at reducing nitrogen oxide (“NOx”) emissions.

## 2 Description of the proposed measures

As of 1 January 2007, pursuant to the Act of 19 May 1933 No. 11 concerning special taxes, the Norwegian State introduced a tax of NOK 15 per kilogram of emission of NOx on energy production delivery.<sup>6</sup> The measure notified by the Norwegian authorities concerns the possibility for undertakings to benefit from a full exemption from the NOx tax where they have entered into environmental agreements with the Norwegian State under which they commit themselves collectively to reduce NOx emissions in accordance with a predetermined environmental target.

### 2.1 Description of the Norwegian Environmental Tax on emissions of NOx

The ratification by Norway of the Protocol to Abate Acidification, Eutrophication and Ground-Level Ozone of 30 November 1999 to the Convention on Long-Range Transboundary Air Pollution of 13 November 1979, (the “Gothenburg Protocol”) committed the Norwegian State to reduce its national emissions of NOx to an annual maximum by 2010 of 156,000 tonnes.<sup>7</sup> In order to fulfil its commitment to reduced national emissions under the Gothenburg Protocol, Norway introduced a NOx tax.

Section 1, first paragraph, of the resolution of the Norwegian Parliament (“Storting”) on NOx emissions, lays down the legal basis for the NOx tax and provides as follows:

“1. Pursuant to the Act of 19 May 1943 No. 11 concerning special taxes, a special tax shall be payable to the Treasury from 1 January 2007 in the amount of NOK 15 per kilogram of emission of nitrogen oxides (NOx) on energy production delivery from the following sources:

- a) Propulsion machinery with a total installed capacity of over 750 kW,
- b) motors, boilers and turbines with a total installed capacity of more than 10 MW, and
- c) flares on offshore installations and facilities on land.

*In the case of NOx emissions from taxable incineration of refuse, tax is payable pursuant to the Storting resolution on tax on the end processing of refuse.*

*The Ministry may issue regulations on the subject of the liability for taxation and on restrictions and supplements to this provision.”*

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<sup>6</sup> According to the Storting’s resolution on tax on emissions of NOx for 2008, the tax rate for 2008 is NOK 15,39.

<sup>7</sup> The Gothenburg Protocol was originally adopted on 30 November 1999 in Gothenburg and signed by 31 countries including Norway, as a major initiative in the development of international pollution controls. It aims at controlling several pollutants and their effects through a single agreement. The Protocol sets new targets for emission cuts by 2010 for sulphur dioxide, NOx and volatile organic compounds.

The tax on emissions of NOx therefore covers energy producing units within a variety of sectors including the following: domestic shipping (including fisheries), aviation, railway operations, land-based activities and offshore activities on the Norwegian Continental Shelf.

## 2.2 The objective of the aid measure

The tax exemption was introduced in order to achieve a more efficient reduction in national emissions of NOx in accordance with Norway's commitments under the Gothenburg Protocol than the application of the full tax rate was foreseen to be.

### 2.2.1 National legal basis for the aid measure

Section 2, sub-section (d), of the Storting's resolution on taxes on emissions contains the exemption from the tax.

Section 2, first paragraph provides as follows:

*"...2. Exemption from, refunds of or subsidies for are granted with respect to emissions of NOx from the following sources:*

- a) (..)
- b) (..)
- c) (..)
- d) *emission sources encompassed by environmental agreements with the State concerning the implementation of measures to reduce NOx in accordance with a predetermined environmental target.*

*The Ministry may issue regulations limiting and imposing conditions on exemptions."*

The proposed scheme comprises two agreements: the "NOx Agreement" and the "Participant Agreement".

The NOx Agreement is a collective environmental agreement between fourteen business organisations representing undertakings emitting NOx (the "Business Organisations") and the Ministry of Environment on behalf of the Norwegian Government.<sup>8</sup> The main objective of the agreement is to reduce annual emissions of NOx from sources covered by the Storting's resolution on taxes on emissions down to 98,000 tonnes compared to an estimated emission of 128,000 tonnes at the outset. Accordingly, the fourteen organisations that are party to the NOx Agreement have committed themselves

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<sup>8</sup> The Business Organisations are as follows: the Construction Products Association, the Norwegian Fishing Vessel Owners' Association, the Norwegian Seafood Federation, the Association of Cargo Freighters, the Federation of Norwegian Aviation Industries, the Norwegian Hospitality Association, the Norwegian Fishermen's Association, the Norwegian Shipowners' Association, the Norwegian District Heating Association, the Federation of Norwegian Industries, the Confederation of Norwegian Enterprise, the Norwegian Oil Industry Association, the Federation of Norwegian Coastal Shipping, and the Norwegian High-speed Craft Owners' Association.

collectively to ensure the implementation of measures that will reduce the annual emissions of NO<sub>x</sub> by 30,000 tonnes by the end of 2011.

The Business Organisations do not themselves produce emissions of NO<sub>x</sub> that are subject to the NO<sub>x</sub> tax. It is the undertakings which emit NO<sub>x</sub> who will join the scheme. Individual undertakings wishing to join the scheme must sign a Participant Agreement. They may either join the Participant Agreement which has already been signed or enter directly into a new environmental agreement with the Norwegian Ministry of Environment.

The Participant Agreement creates rights and obligations between the individual undertakings and the Norwegian State. The Business Organisations have established a fund to administer the NO<sub>x</sub> Fund (the "*NO<sub>x</sub> Fund*"). The NO<sub>x</sub> Fund has a Board and a Technical Committee. Participation in the environmental agreement is confirmed through the issuance of a Participation Certificate by the NO<sub>x</sub> Fund. Undertakings receiving a Participation Certificate will be committed to the fulfilment of the obligations and benefit from the conditions provided in the NO<sub>x</sub> Agreement as well as decisions made by the NO<sub>x</sub> Fund in accordance with the Participant Agreement.

According to the plans prevailing at the time of the notification, instead of paying NOK 15 per kilogram of NO<sub>x</sub> in the form of a tax, undertakings that are party to the NO<sub>x</sub> Agreement will pay the following amounts: offshore petroleum industry NOK 11; and NOK 4 for other sectors (shipping, supply-vessels, fishing, industry and aviation etc.).<sup>9</sup> The fees of NOK 11 and NOK 4 have been determined by NO<sub>x</sub> Fund and not the State. The payments made by participating undertakings shall be paid into the NO<sub>x</sub> Fund, which shall in turn, allocate financial support to individual undertakings in order that emission reducing measures may be implemented. The operation of the scheme is described in detail below.

#### *2.2.2 The environmental agreement between the Norwegian State and the fourteen Business Organisations (NO<sub>x</sub> Agreement)*

The objective of the NO<sub>x</sub> Agreement is to fulfil specific reduction obligations for the years 2008, 2009 and 2010. The NO<sub>x</sub> Agreement will lead to emission measures that go beyond the source specific international requirements which bind Norway.

Article 2.1 stipulates that the overall objective of the NO<sub>x</sub> Agreement is the reduction in the annual emissions of NO<sub>x</sub> from the sources covered by the Storting's resolution on tax on emissions of NO<sub>x</sub> such that these emissions do not exceed 98,000 tonnes by 2011.

Pursuant to Article 2.9, the NO<sub>x</sub> Agreement is to be regarded as an environmental agreement that provides a basis for temporary exemptions from NO<sub>x</sub> taxes for undertakings that join the scheme through the Participant Agreement. Undertakings that affiliate themselves with the NO<sub>x</sub> Agreement, receive the rights and obligations that are set forth in the NO<sub>x</sub> Agreement and Participant Agreement.

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<sup>9</sup> Pursuant to Article 3 of the Participant Agreement the NO<sub>x</sub> Fund is free to set the contribution rates up to the maximum applicable tax rate if the fund deems it necessary to achieve the goals of the scheme.

According to Article 2.5 of the NOx Agreement, the Business Organisations shall establish the NOx Fund, which has the purpose of supporting the Business Organisations in fulfilling their obligations under the NOx Agreement.

Through the NOx Fund, the Business Organisations shall carry out tasks pursuant to the NOx Agreement, the Participant Agreement and the Statutes of the NOx Fund. The principal functions of the NOx Fund are: (i) to require on behalf of the Business Organisations contributions per kilogram of emissions of NOx from undertakings that affiliate themselves with the NOx Agreement; and (ii) to provide financial support to individual undertakings on behalf of the Business Organisations for cost-efficient NOx reducing measures. The NOx Fund shall be operated in accordance with the non-profit principle. The State has no right to control or issue instructions to the NOx Fund.

Article 2.6 provides that the Business Organisations shall work actively during the term of the NOx Agreement to increase the capacity in the market for emission reducing measures.

Article 2.7 provides that the State and the Business Organisations are committed to working together to survey, develop and provide information on possible emission reducing measures for the implementation of the NOx Agreement.

#### *2.2.2.1 Obligations of the Business Organisations to reduce the NOx emissions*

Pursuant to Article 3 of the NOx Agreement, the Business Organisations shall through the establishment and operation of the NOx Fund ensure that they fulfil the overall objective of the agreement set forth in Article 2.1.

Article 3.2 also stipulates that the Business Organisations must achieve annual reductions in emissions based upon projections as follows:

- measures implemented in 2008 that reduce annual NOx emissions by 2,000 tonnes (at latest by the first quarter of 2009)
- measures implemented in 2009 that reduce annual NOx emissions by 4,000 tonnes (at latest by the first quarter of 2010)
- measures implemented in 2010 that reduce the annual NOx emissions by 24,000 tonnes (by at least 17,000 by the end of the first quarter of 2011 and fully by the end of 2011).

Article 3.3 provides that any fulfilment surplus to the reduction obligation for 2008 and 2009 shall be deducted from the emission reduction obligation for the subsequent year. In addition, any under-fulfilment of the emission reduction obligation for 2008 and 2009 shall be added to the emission reduction obligation for the subsequent year. Altogether this means that the Business Organisations undertake to implement measures such that the overall reduction from 2008 to 2011 shall amount to 30 000 tonnes of NOx emissions.

Article 3.5 stipulates that the Business Organisations shall ensure through the NOx Fund that implemented measures that are undertaken by the affiliated undertakings are



operated in a manner that maintains the emission reduction effects at least until 31 December 2012.

Article 7 imposes detailed reporting obligations on the Business Organisations to report to the Norwegian Pollution Control Authority on a range of measures including NOx emissions produced per sector, emission reducing measures implemented and details of plans for future emission reducing measures. On the basis of an 'Annual Status Report,' the Norwegian Ministry of the Environment shall determine whether the reduction obligation of Article 3.2 has been fulfilled.

Article 9.1 provides that every undertaking producing NOx emissions and which may undertake emission reductions may affiliate itself with the NOx Agreement by sending a Participant Declaration to the NOx Fund.

Article 9.2 provides that participation in the NOx Agreement and Participation Agreement gives the right to exemption from the NOx tax.

#### *2.2.2.2 Obligation to pay tax in the event of a lack of fulfilment of the reduction obligation*

Article 9.4 provides that if the Norwegian Pollution Control Authority finds that the Business Organisations have fulfilled less than 90% of their annual reduction obligation before the deadline, a tax obligation will arise for the relevant calendar year. The tax is due to be paid on 18<sup>th</sup> July of the following year.

For 2010, the tax obligation arises if the Annual Status Report shows that the Business Organisations have fulfilled less than 100% of their annual reduction obligation by the deadline. The NOx tax shall be paid according to a declared quantity of emissions of NOx for the preceding year from taxable sources for the period during which they have been exempted from the tax. The tax rate according to the Storting's tax resolution shall be reduced by the percentage share of the annual emission reduction rate that has been fulfilled. The Norwegian Pollution Control Authority shall calculate which rate shall be utilised by the undertakings liable to pay the reduced tax.

This payment obligation implies that if the Business Organisations, for example, fulfil 60% of the annual reduction obligation, then the individual taxable source shall pay 40 % of the ordinary tax. As an upper limit, the payment to the NOx Fund and the NOx tax to be paid shall not exceed what the undertaking would have paid in ordinary NOx tax absent the exemption.

#### *2.2.3 The Participant Agreement*

Part 1 provides that by signing the Participant Agreement, the undertaking joins the NOx Agreement. Participation is confirmed through the issuance of a Participant Certificate by the NOx Fund. The undertaking is then committed to fulfilling the obligations and is granted the benefits set forth in the NOx Agreement and the Participant Agreement.

Part 2, Article 2 provides that by joining the scheme, the individual undertakings are committed to fulfilling the following obligations vis-à-vis the Business Organisations and the NOx Fund:

- a) An obligation to pay the NOx Fund an amount (NOK 4 or 11) per kilogram of NOx emissions;
- b) Formulation of a plan/application relating to NOx reducing measures for their own undertaking;
- c) Implementation of NOx reducing measures by their own undertaking;
- d) Reporting of own NOx emissions to the NOx Fund; and
- e) Loyalty to the NOx Fund, its statutes and its decisions that affect their operations.

Article 3 provides that participant undertakings are obliged to pay the rate per kilogram of emissions to the NOx Fund, which shall be determined by the Board of the NOx Fund.

Pursuant to Article 4, within two years of joining the scheme, participant undertakings are obliged to formulate their own detailed measure plan for NOx reductions for themselves. The measure plan shall be regarded as the application for support from the NOx Fund to enable implementation of the measures proposed.

Article 5 sets forth the administrative procedure according to which the NOx Fund determines which measures are to be granted support. Priority should be given to measure plans submitted by undertakings with cost effective measures yielding the largest NOx reduction.

The Participant Agreement also contains the reporting obligations of participant undertakings.

Article 8 provides that in specific circumstances, the NOx Fund may impose coercive fines before the establishment of a violation of the conditions of the Participant Agreement. This is in order to ensure adequate pressure with regard to fulfilment of reduction measures for the life of the scheme. The coercive fine shall run from the date of commencement of the possible violation. The provisions relating to pre-determined coercive fines stipulated in section 73 of the Pollution Control Act shall apply accordingly. The NOx Fund also has the power to revoke Participant Certificates in cases of significant violations of obligations under the Participant Agreement. Pursuant to Article 9, the effect of revocation is that the undertaking in question loses the benefit of the tax exemption under the NOx Agreement and has to pay the full NOx tax from the day of revocation. In such circumstances, the undertaking in question keeps the support received from the NOx Fund that has been spent on NOx reducing measures up until revocation but must repay any support that has not been spent on such measures.

Article 11 lays down the obligation to pay tax in the event of a lack of fulfilment of the reduction obligation which mirrors the provision contained in Article 9.4 of the NOx Agreement.

### 2.3 Recipients

All undertakings that are subject to the NOx tax may enter into the NOx Agreement with the Norwegian State by signing the Participant Agreement in order to be granted full relief from the tax. According to a press release on the website of the Confederation of Norwegian Enterprises, dated 1 July 2008, 450 undertakings had already signed the Participant Agreement.<sup>10</sup>

### 2.4 Budget and duration

The NOx Agreement provides that undertakings may benefit from a tax exemption for a maximum period of three years, from 1 January 2008 until 31 December 2010. The period in which the Business Organisations shall fulfil the emission reduction commitment is however, extended until 31 December 2011, without obtaining an exemption for that year.

The Norwegian authorities have indicated that if all companies and sources liable to the NOx Tax decide to enter into the NOx Agreement, the exemption of NOx Tax will lead to annual aid in the form of foregone tax revenue of NOK 1.6 billion (approximately EUR 200 million).

## II. ASSESSMENT

### 1 The presence of state aid

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.”*

In order to constitute state aid within the meaning of Article 61(1) EEA, a measure must meet four cumulative criteria. The measure must: (i) confer on recipients an economic advantage which is not received in the normal course of business; (ii) the advantage must be granted by the State or through state resources; (iii) the measure must be selective by favouring certain undertakings or the production of certain goods; and (iv) it must distort competition and affect trade between the Contracting Parties.

#### 1.1 Economic advantage

The Authority has assessed the way the tax exemption granted in consideration for entering into the environmental agreement could be seen to constitute an economic advantage. As regards the requirement that a measure must confer an economic advantage, such an advantage may be provided through a reduction in undertakings' tax burdens in various ways, including a reduction in the tax base or total or partial reduction

<sup>10</sup> <http://www.nho.no/article.php?articleID=19948&categoryID=473>



in the amount of tax or a deferment of tax liability. In the present case undertakings that are usually subject to a general NOx tax but benefit from an exemption under the proposed measures therefore receive an economic advantage.

## 1.2 Presence of state resources

As part of its analysis, the Authority has examined whether the grant of the tax exemption to the participating undertakings involve the use of state resources. The Authority takes the view that through the grant of an exemption to participating undertakings, the Norwegian State renounces tax revenue which it would normally have received from those undertakings. The absence of these funds represents a burden on state resources from charges that are normally borne from the budgets of participating undertakings.<sup>11</sup> A loss of tax revenue is equivalent to the consumption of State resources in the form of fiscal expenditure.<sup>12</sup>

## 1.3 Favouring certain undertakings or the production of certain goods

The measure must favour certain undertakings or the production of certain goods.

The Norwegian authorities submit that the tax exemption does not constitute a selective measure but rather a general measure. This is on the basis that the possibility to enter into agreements is open to all sectors and all sources covered by the NOx tax and is not restricted to any specific sector or industry.

Whilst the Authority accepts that the possibility to enter into an agreement is open to a potentially very wide category of undertakings across various sectors, in the view of the Authority, the measure is selective in nature due to the discretionary power of the Norwegian authorities as regards the actual implementation of the exemption.

According to the case law of the European Courts, even interventions which, *prima facie*, apply to undertakings in general may be selective, and accordingly be regarded as measures designed to favour certain undertakings or the production of certain goods. That is the case in particular, where the administration called upon to apply a general rule has a discretionary power so far as concerns the application of the measure.<sup>13</sup> The State Aid guidelines on business taxation also make clear that the discretionary practices of some tax authorities may also give rise to measures that are caught by Article 61.<sup>14</sup>

According to Section 2(d) of the Storting's resolution on taxes on emissions, exemption is granted to emission sources encompassed by environmental agreements with the State concerning the implementation of measures to reduce NOx in accordance with a

<sup>11</sup> Case C- 156/98 *Germany v Commission* [2000] ECR I-6857, at paragraph 26.

<sup>12</sup> See *inter alia* Section 3(3) of the State Aid Guidelines on the application of state aid rules to measures relating to direct business taxation.

<sup>13</sup> Case C-241/94 *France v Commission* [1996] ECR I-4551, paragraphs 23 and 24, Cases T-92/00 and T-103/00 *Ramondin v Commission* [2002] ECR II-1385.

<sup>14</sup> Section 3.3(1) of the State Aid Guidelines on the application of state aid rules to measures relating to direct business taxation.

predetermined environmental target. The wording of the Act does not however, indicate whether the State is obliged to enter into such agreements if certain conditions are fulfilled or the State enjoys discretion in that regard. In any event, the Act does not indicate what conditions would have to be fulfilled in order to obtain an agreement with the State.

The last sentence after Section 2(d) of the Storting's resolution on taxes on emissions provides that "*The Ministry may issue regulations limiting and imposing conditions on exemptions.*" The Ministry has not issued any regulation with regard to Section 2(d).

The Act therefore, appears to give the State discretion with regard to whether it wishes to enter into such agreements. The intention that the law should be interpreted in this way was also confirmed in the Budget discussion documents produced by the Storting Finance Committee<sup>15</sup> which led the Storting's resolution on tax on emissions. In particular, page 89 of the Finance Committee's document makes clear that the possibility for exemptions should not mean that the State is under any obligation to conclude such agreements with any individual business organisation or undertaking at all but that the State has discretion regarding with which Business Organisations or undertakings it may conclude agreements. In addition, the Norwegian State has explained that the Ministry has wide discretion in its exercise of its power to enter into environmental agreements with Business Organisations and individual undertakings.

The Ministry may therefore exercise its discretion to grant certain undertakings exemptions and not others. The proposed measures therefore favour undertakings to the exclusion of others and are therefore, selective in nature.

#### **1.4 Distortion of competition and effect on trade between Contracting Parties**

The aid measure must distort competition and affect trade between the Contracting Parties.

As the law introducing the NOx tax includes propulsion machinery with a total installed capacity of over 750 kW, and motors, boilers and turbines with a total installed capacity of more than 10 MW, it is likely that several undertakings applying for exemptions will have activities involving propulsion vessels such as large ships or production of goods that compete internationally like the offshore petroleum sector. Such undertakings will therefore be involved in trade between EEA States. The grant of support via tax exemptions to undertakings in *inter alia*, these sectors will strengthen the position of recipients compared to other undertakings which are located in Norway or in other EEA countries and competing in such (and related) businesses. On this basis, the Authority considers that the grant of financial support (via the NOx tax exemption) to undertakings operating in the above-mentioned sectors amongst others, may distort competition and affect trade.

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<sup>15</sup> Budsjett-innst. S. nr. 1 (2006-2007) Budsjettinnstilling til Stortinget fra finanskomiteen at page 89.

## 2 Procedural requirements

Pursuant to Article 1(3) of Part I of Protocol 3, “*the 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 the procedure has resulted in a final decision*”.

By submitting notification of the scheme for the grant of a temporary exemption to undertakings entering into an environmental agreement with the Norwegian State relating to reduction of NOx emissions with a letter dated 14 May 2008 (Event No.: 477252), the Norwegian authorities have complied with the notification requirement. By not putting the measure into effect before approved by the Authority, Norway has complied with the standstill obligation.

The Authority can therefore conclude that the Norwegian authorities have respected their obligations pursuant to Article 1(3) of Part I of Protocol 3.

## 3 Compatibility of the aid

### 3.1 The aid in the form of an exemption from environmental taxes must contribute to the improvement of the level of environmental protection

Article 61(3)(c) of the EEA Agreement stipulates that aid to facilitate the development of certain economic activities may, where such aid does not adversely affect trading conditions to an extent contrary to the common interest of the Contracting Parties to the EEA Agreement, be found compatible with that Agreement.

The Authority has assessed the compatibility of the notified exemption of the NOx tax for undertakings that have entered into environmental agreements with the Norwegian State with Article 61(3)(c) of the EEA Agreement read in conjunction with the Chapter of the Authority’s Guidelines on State Aid for environmental protection (hereinafter the “*Environmental Aid Guidelines*”).

According to paragraph 151 of the Environmental Aid Guidelines, aid in the form of an exemption from environmental taxes will be considered compatible with the functioning of the EEA Agreement within the meaning of Article 61(3)(c) of the EEA Agreement provided that (i) it contributes at least indirectly to an improvement of the level of environmental protection and that (ii) the tax reduction and exemption does not undermine the general objective pursued.

#### *Condition (i)*

As regards fulfilment of condition (i) that the exemption contributes at least indirectly to an improvement of the level of environmental protection, the objective of the tax exemption and of the NOx Agreement is that the parties to the Agreement commit themselves to reduce annual emissions of NOx. The 14 organisations have committed themselves collectively to ensure the implementation of measures which will reduce

annual emissions of NOx by 30 000 tonnes by the end of 2011. Even if the undertakings do not reach the collective target of emission reductions, it is expected that important reductions in NOx emissions will be achieved due to the more structured approach to implementation of emission abatement measures foreseen by the scheme. This should contribute to an improvement of the level of environmental protection. The Norwegian authorities have indicated that the NOx Agreement will provide further and more predictable reductions in emissions of NOx within the time frame of the Agreement than what is the expected effect of the NOx tax. The NOx Agreement and the NOx Fund are furthermore expected to result in increased demand for emission reduction technology thus leading to rapid expansion of delivery capacity for emission reduction measures and technologies. The Authority therefore considers that the first mentioned condition is met.

*Condition (ii)*

As far as the second condition that the tax reduction and exemption does not undermine the general objective pursued is concerned, the tax exemption cannot be seen as undermining the general objective pursued by the NOx tax. Rather the exemption pursues its general objective further. Indeed, the aim of the NOx tax is, by imposing a financial contribution proportionate to the pollution made, to encourage undertakings to take concrete measures to reduce NOx emissions. The possibility to be exempted from the NOx tax goes further as it encourages the undertakings to combine their financial resources in order to enable them to implement measures which on their own they could less easily afford, thus achieving a direct and long term reduction in NOx emissions. Should the collective target not be reached, the general objective of the NOx tax will in any event not be undermined as the tax will in any case be payable *pro rata*. The Authority therefore considers that the second condition mentioned above is also met.

Where the exemption concerns taxes that have not been harmonised within the Community, as is the case here, paragraph 154 of the Environmental Aid Guidelines provides that the reductions or exemptions will be considered to be compatible with the functioning of the EEA Agreement for a period of ten years provided that the conditions set out in paragraphs 155 to 159 relating to necessity and proportionality are fulfilled.

**3.2 The aid in the form of an exemption from environmental taxes must be necessary**

Previous case law of the European Courts has established that in order for a measure to be compatible with Article 87(3)(c) of the EC Treaty (corresponding to Article 61(3)(c) of the EEA Agreement), it must not only comply with one of the objectives set out in Article 87 (3) (a), (b), (c) or (d), but must also be necessary for the attainment of those objectives<sup>16</sup>.

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<sup>16</sup> Case 730/79 *Philip Morris v Commission* [1980] ECR 2671, paragraph 17, and Case T-187/99, *Agrana Zucker und Starke AC v Commission*, paragraph 74.

This principle is also referred to at paragraph 27 of the Environmental Aid Guidelines which provides as follows: “*State aid for environmental protection must result in the recipient of the aid changing its behaviour so that the level of environmental protection will be higher than if the aid had not been granted*”. (emphasis added)

In addition, paragraph 158 of the Environmental Aid Guidelines - which corresponds to an application of the general necessity principle to the field of environmental protection - stipulates that three conditions must be met in order for the aid measure to be considered necessary. These are as follows:

First, the choice of the beneficiaries must be based on objective and transparent criteria, and the aid must be granted in principle in the same way for all competitors in the same sector/relevant market if they are in a similar situation.

The State has discretion with regard to which agreements it wants to enter into. However, once such an agreement has been made, emitting undertakings would benefit from the tax exemption. There are no additional conditions set, any undertaking emitting NO<sub>x</sub> may benefit from the exemption if it enters into a collective agreement with the State.

All undertakings that have entered into environmental agreements with the State shall benefit from the tax exemption in the same manner.

The Authority considers that the first condition of paragraph 158 of the Environmental Aid Guidelines is met on the basis that the possibility to enter into agreements is open to all sectors covered by the NO<sub>x</sub> tax and it is not restricted to any specific sector or industry.

The second and third conditions of paragraph 158 of the Environmental Aid Guidelines provides that the environmental tax without reduction must lead to a substantial increase in production costs and that this increase cannot be passed on to customers without leading to important sales reductions.

In terms of the increase in production costs, the Norwegian authorities have stated that without reduction the NO<sub>x</sub> tax would lead to substantial increases in production costs for undertakings in the majority of sectors affected by the tax.

The Authority notes that the NO<sub>x</sub> tax applies to propulsion machinery with installed capacity exceeding 750 kW, to motors, boilers and turbines with installed capacity above 10 MW, and to flares on offshore and on land based installations. This means that the tax does not apply to small machinery and small energy generating installations. The activities which therefore give rise to the benefit of the tax exemption are typically transport by ship or by plane, heavy engineering, or energy generation at an industrial scale, in addition to oil and gas production. Such activities and the undertakings performing them are subject to strong international competition.



In such an international competitive environment Norwegian companies are hardly in a position to independently set the prices of their products. Due to their limited size and the presence of foreign undertakings on the various markets they would be what in economic terms is phrased price takers, i. e., they have in their business behaviour to take prices on their products as given on the international markets. This means that their possibilities are very limited to carry increased costs, like a NOx tax, over in their product prices. If a producer faces a fixed, exogenously set market price, that means that the demand for his product is infinitely elastic. A small increase in his price would seriously diminish any demand.<sup>17</sup>

In some industry sectors in particular, such as domestic shipping and transport, fuel consumption constitutes a high proportion of production costs. In these sectors, the imposition of the NOx tax without reduction would lead to substantial increases in overall costs of production.<sup>18</sup>

Further evidence that the substantial increase in costs cannot be passed on is the fact that the proposal to introduce the notified regime was instigated by the industry itself. Originally, the Government proposed (in the Fiscal Budget for 2007) to introduce the tax without any option for environmental agreements. Only after pressure from industry did the Parliament provide for the possibility to introduce such agreements. If the tax could easily be passed on to consumers, there would not be much reason for industry to take the stance it has taken.

In conclusion, based on the above, the Authority considers that the second and third conditions of paragraph 158 of Environmental Aid Guidelines are met.

### **3.3 The aid in the form of an exemption from environmental taxes must be proportional**

The Authority considers that paragraph 159(c) of the Environmental Aid Guidelines provides that correct framework for conducting the proportionality assessment of the proposed scheme. In order to fulfil the requirements of paragraph 159(c), the aid scheme must satisfy the conditions under (i), (ii), and (iii). In addition, the undertakings must

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<sup>17</sup> Determination of oil prices, shipping freight rates, energy prices, and various other product prices for undertakings benefitting from the tax exemption is largely outside the control of the undertakings benefitting from the tax exemption. This is particularly so for export industries. Undertakings competing on the domestic market with imports are to a substantial degree in the same position. There are therefore limited possibilities for increased costs as a result of the introduction of the NOx tax to be passed on to consumers in any substantial way. On price formation for Norwegian export and import competing activities see e.g., Holmøy and Massey Heide, "Is Norway immune to Dutch Disease? CGE Estimates of Sustainable Wage Growth and De-industrialisation, Discussion Papers No. 413, March 2005, Statistics Norway, Research Department.

<sup>18</sup> Sectors that use steam generated by the use of oil or biomass to dry or heat products as part of the production process are also likely to experience a substantial increase in production costs. The offshore oil and gas sector is however, exceptional in this regard, since due to the high profitability of the sector, a tax of NOK 15 would appear to have an insignificant impact on production costs.

commit themselves to achieve environmental protection objectives which have the same effect as if point (a) or (b) or the Community minimum tax level were applied. These conditions are considered in turn.

Condition (i)

Pursuant to condition (i), the substance of the agreements must be negotiated by each EFTA State and must specify in particular the targets and fix a time schedule for reaching the targets. It follows from the description in Section 2.3 above of the NOx Agreement, the targets, and time schedules applicable, that the condition set out in point (i) of paragraph 159(c) of the Environmental Aid Guidelines is met.

Condition (ii)

Under condition (ii), the EFTA states must ensure independent and timely monitoring of the commitments concluded in these agreements. Regarding monitoring of the commitments, the NOx Agreement imposes various reporting obligations in the form of quarterly, semi-annual and annual status report (see Section 2.3.1 above). It is the Norwegian Pollution Control Authority which will review all the reports submitted.

The Authority therefore considers that the condition set out in point (ii) of paragraph 159(c) of the Environmental Aid Guidelines is met.

Condition (iii)

According to condition (iii), the agreement must be revised periodically in the light of technological and other developments. In the light of the limited time frame of the scheme (*i.e.* three years), the NOx Agreement does not provide for a formal revision mechanism. It provides however that the parties shall, prior to 1 May 2010, evaluate the effect of the NOx agreement, and assess whether it shall be continued in the same form.

In view of the short duration of the notified scheme, the Authority considers that the mechanism in place in the NOx Agreement meets this requirement.

Condition (iii) also provides that the agreement must stipulate effective penalty arrangements applicable if the commitments are not met. Article 9.4 of the NOx Agreement provides that where the collective NOx emission targets are not met, the undertakings will lose the benefit of the full tax exemption (see above section 2.3.1).

The loss of the benefit will be immediate only where the emission reduction amounts to less than 90% of the target. If emission reductions are between 90 and 100% of the target the under-fulfilment will be carried over to the next year. At the end of the scheme, it will not be possible to carry over any under-fulfilment, and the tax will be due as soon as the collective target (including any under-achievement carried over from preceding years) is not reached.

If less than 90% of the collective target for 2008, 2009 and 2010 is met, and irrespective of the size of the under achievement for 2011, the tax level will be reduced by the relative share of the reduction commitment achieved.

In addition to the possible loss of the tax benefit, the NOx Fund may impose coercive fines in special cases of failure to comply.

The Authority considers that the penalty mechanism provided and the threat of the loss of the benefit of the scheme for all participating undertakings, provides an effective penalty mechanism with a clear deterrent effect. This is on the basis that it can lead to the loss of the tax exemption and additional penalties. In addition, the NOx Fund has significant powers to: (i) impose coercive fines upon participating undertakings before a violation of obligations under the Participant Agreement takes place; (ii) revoke Participation Certificates; and (iii) require repayment of all support received if it has not been spent upon NOx reducing measures. Therefore, the condition in point (iii) of paragraph 159(c) of the Environmental Aid Guidelines is met.

*Condition relating to the environmental protection objectives*

In relation to the proportionality of aid, paragraph 159(c) of the Environmental Aid Guidelines provides that the undertakings party to the agreement commit themselves to achieve environmental protection objectives which have the same effect as if point (a) or (b) or the Community minimum tax level were applied..

According to paragraph 159(b) of the Environmental Aid Guidelines, the aid will be proportional if the undertakings pay at least 20% of the NOx tax, unless a lower rate can be justified in view of a limited distortion of competition.

The Authority has considered the scenario under which the participating undertakings pay 20% of the NOx tax. As discussed in 2.1 above, the Norwegian State introduced a tax on emissions of NOx in order to encourage undertakings to take steps to reduce their emissions and introduce abatement technologies.<sup>19</sup>

The Norwegian authorities have commissioned studies analysing the economic effects of introducing the NOx tax, in particular, promoting introduction of new abatement technologies. These studies estimated that the introduction of the tax would produce reduction measures of between 16,000-26,000 tonnes of NOx.<sup>20</sup> However, the authorities stressed that the effect on emissions associated with the NOx tax is difficult to estimate.

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<sup>19</sup> If the undertakings were to pay 20% of the tax, on the basis of the estimates provided by the Norwegian authorities (See section 2.4 above) this would amount to NOK 320 million (approximately EUR 40 million).

<sup>20</sup> A report produced by the Norwegian Pollution Control Authority estimated a reduction of 26,500 tonnes of NOx by 2010. A study produced by Det Norske Veritas projected reductions of 16,555 tonnes of NOx by 2010.

The Authority notes that these estimates are however, based upon the assumption that 100% of the tax is paid. There is reason to believe that a NO<sub>x</sub> tax of 20% of the full tax would result in considerably lower emission reductions. The NO<sub>x</sub> Agreement sets as a strict target, the achievement of a reduction of 30 000 tonnes of NO<sub>x</sub> emissions. The Authority therefore concludes that the effect of the commitment entered into by participating undertakings is foreseen to be much higher than the effect of payment of 20% of the tax.

On this basis, the Authority considers that the conditions under paragraph 159 of the Environmental Aid Guidelines are fulfilled.

### **3.4 Duration**

Paragraph 154 of the Environmental Aid Guidelines provides that the maximum duration of a scheme considered compatible with Article 61 (3) (c) is of ten years.

The Norwegian authorities have indicated that the notified scheme is to apply for a maximum duration of three years.

The Authority therefore considers that the condition regarding duration of the scheme is met.

### **3.5 Cumulation**

The Norwegian authorities have indicated that the parties to the NO<sub>x</sub> Agreement have undertaken not to cumulate the tax exemption with other forms of state aid. Emission sources encompassed by a support scheme funded by the State will be excluded from entering into the NO<sub>x</sub> Agreement.

## **4 Conclusion**

On the basis of the foregoing assessment, the Authority considers that the notified exemption from the NO<sub>x</sub> tax for undertakings party to the NO<sub>x</sub> Agreement with the State which the Norwegian authorities are planning to implement is compatible with the functioning of the EEA Agreement within the meaning of Article 61 of the EEA Agreement.

The Norwegian authorities are reminded about the obligation resulting from Article 21 of Part II of Protocol 3 in conjunction with Article 6 of Decision 195/04/COL to provide annual reports on the implementation of the scheme. In accordance with paragraph 194 of the Environmental Aid Guidelines, the annual reports shall contain the legislative and/or regulatory text(s) establishing the aid and details of the categories of undertakings benefiting from tax reductions or exemptions and the sectors of the economy most affected by those tax exemptions/reductions.

HAS ADOPTED THIS DECISION:

**Article 1**

The EFTA Surveillance Authority has decided not to raise objections to the notified tax exemption to undertakings party to the submitted NOx Agreement on the basis of Article 61(3)(c) of the EEA Agreement.

**Article 2**

This Decision is addressed to the Kingdom of Norway.

**Article 3**

Only the English version is authentic.

Done at Brussels, 16 July 2008

For the EFTA Surveillance Authority,

A handwritten signature in blue ink, appearing to read "Per Sanderud".

Per Sanderud  
President

A handwritten signature in blue ink, appearing to read "Kurt Jaeger".

Kurt Jaeger  
College member