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**Subject: State Aid SA.46349 (2017/N) – The Netherlands
Introduction of a system of tradable phosphate rights for dairy cattle**

Sir,

The Commission wishes to inform you that it has decided to raise no objections to the above mentioned measure, for the reasons set out below.

1. PROCEDURE

- (1) Following pre-notification contacts, the Dutch authorities notified the abovementioned measure on 27 October 2017. Further clarifications were requested by the Commission on 9, 21 and 23 November and 4 December 2017 and the Dutch authorities replied to such requests on 14, 22 and 23 November and 4 December 2017.
- (2) By letter of 27 October 2017, the Netherlands agreed to waive its rights deriving from Article 342 of the Treaty on the Functioning of the European Union ("TFEU") in conjunction with Article 3 of Regulation No 1¹ and to have this Decision adopted and notified in English.

¹ Council Regulation No 1 determining the languages to be used by the European Economic Community (OJ 17, 6.10.1958, p. 385).

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2. DESCRIPTION OF THE MEASURE

2.1. National legal basis

- (3) On 2 July 2015, the Dutch government informed the national Parliament² of their intention to set up a tradable phosphate right system for farmers so as to limit the level of phosphate from manure produced by dairy cows.
- (4) On 6 December 2016 and on 23 May 2017 respectively, the Dutch Second and First Chamber adopted the amendment to the Dutch Fertilisers Act (Meststoffenwet) in connection with the introduction of a system of phosphate rights³, which introduces the tradable phosphate right system, by amending the Fertilizers Act⁴ and the Economic Offences Act⁵. This is to be further complemented⁶ by a Regulation concerning amendment of the Fertilisers Act Implementing Regulations for the purposes of further regulation of the phosphate bank and a Decision to amend the Fertilisers Act Implementing Regulations following specification of the percentage by which farms will have their phosphate rights reduced as of 1 January 2018 and the addition of two problem cases.
- (5) In their notification, the Dutch authorities informed the Commission that the measure will only enter into force following a European Commission decision that the introduction of phosphate production rights is compatible with the internal market⁷.

2.2. Legal framework and policy background

- (6) Council Directive 91/676/EEC of 12 December 1991⁸ concerning the protection of waters against pollution caused by nitrates from agricultural sources, hereafter Nitrates Directive, sets out⁹, inter alia, that the amount of livestock manure applied to the land each year, including by the animals themselves, shall not exceed a specified amount per hectare.
- (7) Under a Derogation of 16 May 2014 (2014/291/EU), which expires on 31 December 2017, the Netherlands is allowed to apply more nitrogen from manure to the land than would normally be allowed under the Nitrates Directive. However, it has to limit overall manure production at least to the volume of phosphate it produced nationwide in 2002, i.e. 172.9 million kilograms.

² Parliamentary Papers 2014/15, 33 979, No. 98.

³ Bulletin of Acts and Decrees 2017, no. 229.

⁴ Bulletin of Acts and Decrees 1986, no. 598, as amended.

⁵ Bulletin of Acts and Decrees 1950, no. 574, as amended.

⁶ Not yet published.

⁷ In addition, in a letter to the Dutch Parliament of 12 July 2017, the Dutch government explicitly stated: “Partly as a consequence of the amendment by Member Lodders (Parliamentary Paper 34 532, No. 50), the entry into force of the system is still dependent on discussions with the European Commission about the prospect of a new derogation for the period 2018–2021 as well as about state aid.”.

⁸ OJ L 375, 31.12.1991, p.1.

⁹ See in particular the third subparagraph of paragraph 2 of Annex III of the Nitrates Directive.

- (8) The above-mentioned national phosphate production includes phosphate production from dairy cattle manure, which in 2002 amounted to 84.9 million kilograms.
- (9) As of 1 January 2018, for the period 2018–2021, the Netherlands is including the above-mentioned national phosphate production ceiling of 172.9 million kilograms in its sixth Nitrates Action Programme, and also a national sectoral ceiling for dairy cattle of 84.9 million kilograms, which was not a requirement under the Derogation of 16 May 2014. These phosphate production ceilings contribute to the realisation of the objectives set out in the Nitrates Directive.

2.3. Functioning of the system of tradable phosphate rights for dairy cattle

2.3.1. The system

- (10) The system is based on one specific obligation: after the entry into force, dairy farms are only allowed to produce phosphate from dairy cattle corresponding to the phosphate production rights they hold. Phosphate production rights limit the production of phosphate in a calendar year. Hence, only after a certain calendar year, it is possible to check if a farm complies with the rules¹⁰. Phosphate rights are denominated in kilograms of phosphate.
- (11) The Fertilizers Act provides for specific rules to determine the phosphate production of dairy cattle. The production is determined using the flat-rate excretory level per dairy cow based on average milk production per dairy cow¹¹. As the phosphate production of dairy cattle is highly dependent on the milk production, the rules determining the phosphate production explicitly take milk production on a dairy farm into account.
- (12) When the phosphate rights system will enter into force, on 1 January 2018, farming operations (i.e. existing farms) with dairy cattle will be awarded phosphate rights free of charge.
- (13) Farmers will then be forbidden to produce more phosphate than the phosphate rights awarded to their farm. Moreover, the system will provide for proper control and enforcement. Farms will be required to demonstrate that they have sufficient phosphate rights to justify the amount of phosphate produced by their dairy cattle at the end of each calendar year. Both the number of animals held by each farm and the relevant phosphate rights holder will be registered in a national register through an electronic system. On that basis, it can be determined whether the dairy stock held in a particular calendar year corresponds with the amount of phosphate rights held by the relevant farm at the end of the year. Physical inspections will be conducted in order to ensure that submitted figures on the number of animals held are true and accurate.

¹⁰ According to the Dutch authorities, even on 30 December of a given calendar year, a farm can still obtain phosphate rights to justify phosphate production during that year.

¹¹ The flat-rate excretory level of dairy cows has been actualized to 2015 and is based on advice by the Committee of Experts Fertilisers Act, which is an independent scientific advisory board on the Fertilisers Act.

- (14) The phosphate rights system will be legally enforced on the basis of the Economic Offences Act, which provides for criminal sanctions in case of breach of the relevant regulations¹².
- (15) In addition to these criminal penalties, an administrative provision is also introduced. According to the Dutch authorities, in case a farm that has been penalized already for not having sufficient rights to justify the phosphate production for a certain calendar year continues to violate the rules, the Minister of Economic Affairs can impose a daily ceiling on the number of dairy cows for this individual farm¹³. This ceiling will determine the size of the permitted dairy stock at any given time in accordance with the phosphate rights held by the relevant farm. As a result, it will be possible to determine physically whether a dairy farm is exceeding the permitted number of dairy animals at any given time or moment of the day. The Minister can then forcibly intervene on the basis of an administrative enforcement order to reduce the number of animals held by a farm over the course of the year and recover the related costs from the offender¹⁴. This provision will be used if it becomes apparent that a farm will not acquire the necessary phosphate production rights in order to be able to justify its phosphate production.
- (16) Farms holding more dairy cattle on 1 January 2018 than justified by the phosphate rights granted to them will have two options. They can either acquire additional phosphate rights on the market, or they can reduce phosphate production on their farm by removing dairy cattle from their farm.

2.3.2. Number of phosphate production rights allocated and generic deduction

- (17) The rights to be awarded are calculated on the basis of phosphate production of the dairy cattle (as a proxy for holding capacity, see recital (95) below) on an individual farm on 2 July 2015, the reference date. Any increase in the number of dairy cattle on a farm after 2 July 2015 will not be translated into phosphate rights.
- (18) Only farms that are still operational on 1 January 2018 will receive tradable rights. Hence, in case of total closure between 2015 and the end of 2017, no rights will be granted.
- (19) There are over 17,800 dairy farms that will require phosphate rights. The Dutch authorities will carry out the calculation of the expected needs in a two step approach.
- (20) Firstly, according to the Dutch authorities, for reasons of administrative feasibility, allocation of tradable permits on 1 January 2018 will be based on

¹² The size of potential sanctions will depend on whether the dairy farm has deliberately violated the regulations. This fact would constitute a crime punishable by a prison sentence of up to six years, community service or a fine of up to €82,000. In the absence of intent, the violation will be deemed an offence punishable by a prison sentence of up to one year, community service or a fine of up to €20,500.

¹³ Section 22a of the Fertilisers Act.

¹⁴ Section 5:25, Paragraph 1, of the General Administrative Law Act.

transparent and objective legal criteria which take into account the number of dairy cattle owned on 2 July 2015 (i.e. when the Dutch authorities publicly announced in parliament the intention to introduce a tradable rights scheme).

- (21) According to the Dutch authorities, the decision to use the number of dairy cattle owned at a reference date, as a proxy to determine the holding capacity, is based on the fact that it would prove virtually impossible to assess the actual holding capacity of every individual farm. Furthermore, to do otherwise would have given farmers an incentive not to reduce their cattle, or even increase their number, awaiting the start of the trading system, which would go against the same environmental objectives of the scheme.
- (22) Secondly, there may be farms that reduced both the number of dairy cattle and also the holding capacity necessary to effectively use the amount of rights that would be allocated based on the reference date. Aiming at preventing over-endowment of such farms, the Dutch authorities will individually assess farms that have significantly reduced their dairy cattle as compared to the number of cows owned on 2 July 2015 (50% of reduction or more, representing [over 500]* farms). This will be done in order to determine whether the allocation of rights on the basis of 2 July 2015 corresponds to their expected needs. A percentage of these farms will be also inspected on site. It will be assessed whether the production capacity necessary to justify the allocation is still present and, if not, the allocation will be limited to the amount that corresponds to the production that can be realized. The cut off of 50% is chosen, a.o., based on the fact that if a farm reduces its dairy stock by less than 50%, it is unlikely that fundamental changes would have been made to the other means of production associated with dairy farms. According to the Dutch authorities, with the individual assessment of the [over 500] farms, already one third of the total reduction of cows that took place between 2 July 2015 and 1 October 2017 by over 17,800 dairy farmers will be covered.
- (23) In order to ensure that the national phosphate production is below the 2002 level (see the environmental objective of the system of limiting the phosphate production below the 2002 level in section 2.4.1 below), the Dutch authorities have decided that the system will immediately, on 1 January 2018, implement a compulsory generic deduction of 8.3%¹⁵ on the number of rights allocated to non-land based farms.
- (24) Land-based farms will not have to contribute to the generic deduction (see below). This means that thanks to the deduction a relatively larger part of the production will take place on farms that are land-based than without the deduction.

2.3.3. *Transfer of phosphate production rights*

- (25) Phosphate production rights allocated to existing farms on 1 January 2018 can be traded. The Dutch government, by means of an electronic register, will determine

* Confidential information

¹⁵ The generic reduction of 8,3% was calculated by the Committee of Experts on the Fertilisers Act and announced on 12 July 2017.

which farm holds production rights. A trade needs to be notified to the register in order to be effective. A transaction will only occur if a farm actually holds the rights it wishes to transfer and only when both the holder and the recipient agree on a transfer.

- (26) Once phosphate production rights are traded, 10% of the traded rights of each transfer will be withheld¹⁶. These withheld rights will be kept in a so-called “phosphate bank”.
- (27) Transfers of rights to family members, usually necessary to pass the farm to the next generation, or in cases of inheritance will be exempted from this 10% creaming off.

2.3.4. *Land-based versus non-land based farms*

- (28) Farms that were non-land based on 2 July 2015 will be confronted with a generic reduction of 8.3%. A farm is land-based if it is able to accommodate all phosphate from manure it produces on its own land. In order to establish whether a farm is land-based, it is necessary to calculate the amount of phosphate being produced by its dairy cattle¹⁷ and the amount of phosphate that such a farm is allowed to apply on its own land¹⁸.
- (29) If a farm is allowed to apply all of the phosphate it produces on its own land, it is considered to be land-based. A farm can only claim land as its own if it can prove it is legally entitled to use the land. A farm therefore needs to prove it owns or rents the land in order to be considered land-based. Only one farm can claim a particular piece of land. An electronic system, also used for awarding direct payments as a result of the Common Agricultural Policy (CAP), ensures that a certain plot cannot be claimed by more than one farm. Only land located in the territory of the Netherlands will be acceptable to justify manure production¹⁹. A farm therefore will not be considered land-based if it aims to apply its manure in another country.
- (30) A farm that produces more phosphate than it can accommodate on its own land will be considered as non-land based. According to the Dutch authorities, 58% of dairy farms in the Netherlands are non-land based, but they produce 76% of the phosphate.
- (31) A farm that produces an excess of only 5%, will not be confronted with a reduction of 8.3%. The generic deduction will be dependent on the excess. If the

¹⁶ There is no creaming off of 10% in the case of take-over of the legal entity that holds the phosphate production rights, however, according to data submitted by the Dutch authorities, the vast majority of farms (98.97%) is operated by natural persons, not being separate legal entities, and legal entities hold only a very small part of the Dutch dairy herd (1.49%).

¹⁷ The amount of phosphate being produced with dairy cattle is calculated using the flat-rate excretory level of dairy stock.

¹⁸ The amount of phosphate a farm is allowed to apply on or into the soil is also regulated and dependent on different variables (like soil type, soil quality and soil fertility).

¹⁹ Cfr. Section 1, point 1, sub m, of the Fertilisers act. Section 1, point 1, sub m, of the Fertilizers act defines "farmland belonging to the farm" as area of farmland *situated in the Netherlands*, which is used by the farm in the course of normal operations.

excess of phosphate produced is higher than 8.3%, a generic deduction of 8.3% will be applied. If however the excess of phosphate being produced is less than 8.3%, the reduction will reflect the excess. In other words, if a farm produces 5% more phosphate than it can accommodate on its own land, it will face a generic deduction of 5%. The reason of the Dutch authorities for this is that a farm with little excess of phosphate production should not end up in a worse position than a farm which is only just land-based.

2.3.5. *The phosphate bank*

- (32) The phosphate bank will serve to further encourage the development of more land-based dairy farming. Once phosphate rights have been introduced, dairy farms will need phosphate rights in order to start the exploitation of a farm or to expand a farm. Dairy farms, including new entrants, can acquire phosphate rights on the market, as phosphate rights can be traded. Dairy farms, including new entrants, may also apply for non-tradable rights from the phosphate bank if they are land-based.
- (33) The 10% of phosphate production rights withheld upon each transfer of tradable rights will be held by the public phosphate bank, which will then issue non-tradable rights in the form of temporary "exemptions (permits)" to land-based farms for free.
- (34) The non-tradable rights (exemptions) allow a specific land-based farm to produce a certain amount of phosphate with dairy cattle without needing to justify this production with regular, tradable, phosphate production rights.
- (35) The phosphate bank uses the year prior to the year of application in order to determine whether a farm is land-based.
- (36) The phosphate bank will allocate the non-tradable rights using a lottery-system²⁰. Young farmers (see section 2.4.3 below) with a land-based farm will be favoured as their chances of award with non-tradable rights will be doubled. Non-land based farmers (whether young or not) cannot receive rights from the phosphate bank.
- (37) By issuing rights to land-based farms via the phosphate bank that are non-tradable, the Dutch authorities wish to limit the incentive to what is necessary. If the phosphate bank were to allocate tradable rights, the farm that is awarded these rights could make an additional profit, by selling the phosphate rights to another farm. This is deemed unnecessary and undesirable, as the phosphate rights allocated by the phosphate bank are granted to farms which are able to spread all manure on own land, for them to actually keep cattle and spread the manure on their own land, and not to be able to make a profit by selling. The rights allocated by the phosphate bank cannot be used to justify production previously covered with regular tradable phosphate rights. A specific provision is included²¹ to

²⁰ Section 111e, paragraph 2 of the Regulation concerning amendment of the Fertilisers Act Implementing Regulations for the purposes of further regulation of the phosphate bank.

²¹ In their notification, the Dutch authorities explain that Section 111i, paragraph 2, of the Regulation concerning amendment of the Fertilisers Act Implementing Regulations for the purposes of further regulation of the phosphate bank therefore dictates that if a farm would sell regular tradable phosphate

prevent a land-based farm from switching regular tradable rights with rights obtained from the phosphate bank. This is necessary, because if land-based farms could simply obtain rights from the phosphate bank and sell tradable rights previously allocated, the system would be less likely to result in additional land-based farms.

- (38) The non-tradable rights (exemptions) are only temporarily allocated for a period of five years, after which the rights return to the phosphate bank and will be issued again. Equally, if a farm were to no longer need the non-tradable rights, the rights would be returned to the phosphate bank and will be issued again.
- (39) According to the Dutch authorities, the temporary allocation will allow the phosphate bank to stimulate more farmers to produce land-based, since the rights can be issued to more farmers. Due to the fact that the amount of rights in the phosphate bank is limited and the transition to land-based farming is an essential objective of the measure, it is important to ensure that a large group of land-based or land-based young farmers can be stimulated by the non-tradable rights from the phosphate bank.
- (40) Furthermore, as regards the allocation to young farmers, the Dutch authorities explain that limiting the allocation to five years is in line with EU Common Agricultural Policy²² which limits the aid to young farmers to a maximum period of five years.
- (41) As the phosphate rights issued by the phosphate bank will be non-tradable, an ever-increasing part of tradable phosphate rights will gradually be converted into non-tradable phosphate rights to be allocated by the phosphate bank.

2.4. Objectives of the measure

- (42) With the introduction of a system of tradable phosphate rights, the Dutch authorities wish to limit the phosphate production from manure in the Netherlands. This forms part of a larger effort by the Netherlands to reduce phosphate in dairy cattle manure also via the reduction of phosphorus in dairy cow compound feed.
- (43) At the same time, the system is conceived to encourage land-based farming, which will potentially lead to a reduction of the number of animals per hectare and an increase in grazing, with a positive consequence on biodiversity, ammonia emissions and animal welfare.
- (44) Altogether, the system is aimed at achieving the overall environmental goal of improving water quality in the Netherlands.

rights while it also holds non-tradable rights, both types of rights are reduced with the same amount, which prevents land-based farms to switch from tradable to non-tradable rights and safeguards the effectiveness of the phosphate bank.

²² Article 50 (5) of Regulation (EU) No 1307/2013 of the European Parliament and of the Council of 17 December 2013 establishing rules for direct payments to farmers under support schemes within the framework of the common agricultural policy and repealing Council Regulation (EC) No 637/2008 and Council Regulation (EC) No 73/2009.

- (45) Next to these main environmental objectives, through the operation of the phosphate bank, the measure also supports young farmers as a secondary objective.

2.4.1. Objective of limiting phosphate production

- (46) Firstly, the Dutch authorities put the measure in place in order to limit the phosphate production from dairy cattle manure and to have an overall national phosphate production from manure below the 2002 level (i.e. 172.9 million kilograms). The overall national phosphate production includes phosphate production from dairy cattle manure, for which the 2002 level amounted to 84.9 million kilograms.
- (47) Although a reduction of 7.3% on the number of tradable rights for dairy cattle allocated to non-land based farms would be enough to bring the phosphate level to the 2002 level, the system will immediately, on 1 January 2018, implement a generic deduction of 8.3%. According to the Dutch authorities, this reduction on the number of rights has the effect of bringing the phosphate production from dairy cattle manure, as from the start of the system, not only to the 84.9 million kilograms level but even below.
- (48) In their notification, the Dutch authorities confirmed that the reduction of 8.3% will ensure a 1% margin, which can be used for problem cases²³ [...] and [...] to further reduce the phosphate production from dairy cattle below the 2002 level.
- (49) The Dutch authorities expect that the introduction of the tradable rights system will bring the phosphate level to at least 400.000 kilograms below the level of 2002, i.e. to 84.5 million kilograms or lower. This is an estimate that does not take into account the accompanying efforts in 2017 as regards the reduction of phosphorous in dairy cattle compound feed (see recital (42) above).
- (50) In fact, both the allocation of phosphate production rights and the generic deduction are based on the flat-rate excretory level, which is determined in a prudent manner using higher phosphorus levels in dairy compound feed, not taking into account that this level has been lowered in 2017 with a considerable margin.
- (51) According to data provided by the Dutch authorities in their notification, the reduction of phosphorous in dairy cattle compound feed has already achieved a reduction of 2.9 million kilograms of phosphate in dairy cattle manure. According to the Dutch authorities, the same effect is expected for 2018.
- (52) Consequently, according to data provided by the Dutch authorities, the dairy sector will from the start of the system on 1 January 2018 produce even less phosphate than the 84.5 million kilograms of phosphate mentioned above. The Dutch authorities expect that due to the lower phosphorus levels in dairy

²³ Problem cases cover situations where the livestock present on 2 July 2015 was considerably lower due to unfortunate circumstances, e.g. due to construction work, animal health problems or illness, involvement in public infrastructure works, or entirely new farms in the process of building up their dairy animal stock. The solution for problem cases is to allocate rights based on the dairy stock that would have normally been present on 2 July 2015.

compound feed it is likely that phosphate production of dairy cattle will be [81-84.5 million kilograms].

2.4.2. *Objective of stimulating land-based farming*

- (53) Secondly, the measure aims at stimulating land-based farming. This is done, firstly, via the generic deduction (see recital (23) above) upon allocation, which applies only to non-land based farms. Secondly, land-based farms are stimulated via the functioning of the phosphate bank which will only issue rights to land-based farms.
- (54) Land-based farms only produce as much phosphate from manure as they can apply on their own land and hence these are the farms that operate without creating a phosphate surplus.
- (55) Land-based farming is beneficial to water quality in additional ways. Data provided by the Dutch authorities show that farms with fewer cows per hectare keep relatively more grassland. The introduction of phosphate rights will stimulate land-based farms, which is expected to reduce the average number of cows that will be kept per hectare and stimulate grassland in the process. Appropriately managed grassland has on average a lower risk of nitrates leaching to water and also offers benefits regarding retaining organic matter and the reduction of soil erosion.

2.4.3. *Objective of supporting young farmers*

- (56) In addition to the environmental objectives, the measure also aims as a secondary objective²⁴ at to a certain extent supporting young farmers, once the phosphate bank will start functioning. The phosphate bank will allocate non-tradable rights to land-based farms using a lottery-system, whereby young farmers will have an advantage as their chances for award with non-tradable rights will be double.
- (57) A young farmer is defined as a natural person not older than 40 years of age who manages for the first time a farming business at own expense and risk for no longer than three years.
- (58) In this regard, the Dutch authorities noted that young farmers are a priority in the EU Common Agricultural Policy and aid for the thematic subject "young farmers" is covered by several instruments, and also under the State aid instruments in the agricultural sector (State aid Guidelines and Agricultural Block Exemption Regulation) young farmers may receive a differentiated treatment and are entitled to higher support, i.e. an increased aid rate²⁵.

²⁴ The extent of the support, i.e. the number of non-tradable rights allocated to young farmers, will depend, inter alia, on the number of trades and number of rights creamed off.

²⁵ Regulation (EU) No 1305/2013 of 17 December 2013 on support for rural development by the European Agricultural Fund for Rural Development (EAFRD) and repealing Council Regulation (EC) No 1698/2005, Recital 8, Article 7(3), Article 17(3), Article 19(1)(a)(i) and 19(6) and "Annex II Amounts and support rates" of Regulation (EU) No 1305/2013 of 17 December 2013; Regulation (EU) 1307/2013 of the European Parliament and of the Council of 17 December 2013 establishing rules for direct payments to farmers under support schemes within the framework of the common agricultural policy and repealing Council Regulation (EC) No 637/2008 and Council Regulation (EC) No 73/2009,

- (59) According to data provided by the Dutch authorities (Source: Eurostat), the farming population in the EU is ageing and only 6% of all farm holdings in the EU are run by farmers under 35, whereas in the Netherlands, the percentage of farms run by farmers under 35 dropped from 4.09% in 2005 to 1.68% in 2013. In addition, the percentage of farms run by farmers aged between 35 and 44 is 9.86% in the Netherlands compared to 15% average in the EU. The Netherlands is therefore a country where the problem with regard to the aging population of farmers is particularly acute. The measure aims at contributing to also addressing this problem, by incentivising young farmers.

2.5. Duration

- (60) The measure will enter into force on 1 January 2018 and has no end date. The Dutch authorities have committed to renotifying the measure 20 years following the date of adoption of this decision.
- (61) The Dutch authorities have in their notification committed to notifying the Commission in the event of any envisaged amendment, before entry into force.

3. OPINION OF THE DUTCH AUTHORITIES

- (62) The Dutch authorities are of the opinion that the proposed measure does not constitute State aid within the meaning of Article 107(1) of the TFUE.
- (63) According to the Dutch authorities the introduction of the system of tradable phosphate rights for dairy cattle does not imply State aid because:
- a) there is a lack of selectivity; and
 - b) there are no State resources involved and the measure is not imputable to the State.
- (64) However, in case the European Commission were to decide that the introduction of phosphate production rights constitutes State Aid, the Dutch authorities considered the measure compatible with the internal market, either on the Community Guidelines on State Aid for Environmental Protection and Energy 2014-2020 (hereafter EEAGs) or directly under the TFEU.
- (65) The Dutch authorities consider that the introduction of phosphate rights in the Dutch dairy farming sector makes an increased contribution to the Union environmental policy while not adversely affecting trading conditions to an extent contrary to the common interest. Furthermore, the Dutch authorities consider that the design of the measure ensures that the positive impact of the measure towards an objective of common interest exceeds its potential negative effects on trade and competition.

Article 50; European Union Guidelines for State aid in the agricultural and forestry sectors and in rural areas 2014 to 2020 (2014/C 204/01), Section 1.1.1.1. point (153)(a), Section 1.1.2., Section 1.1.1.1. point (148)(a), Section 1.1.10.2 point 300; Commission Regulation (EU) No 702/2014 of 25 June 2014 declaring certain categories of aid in the agricultural and forestry sectors and in rural areas compatible with the internal market in application of Articles 107 and 108 of the Treaty on the Functioning of the European Union, Article 14(13)(a), Article 18, Article 14(9)(d), Article 22(2).

4. ASSESSMENT OF THE MEASURE

4.1. Presence of State aid pursuant to Article 107 (1) TFEU

- (66) According to Article 107(1) TFEU, "*any aid granted by a Member State 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 Member States, be incompatible with the internal market*".
- (67) In order to qualify as State aid under Article 107(1) TFEU, therefore, the following cumulative conditions must be met: (i) the measure must be imputable to the State and financed through State resources; (ii) it must confer an advantage on its recipient; (iii) that advantage must be selective; and (iv) the measure must distort or threaten to distort competition and affect trade between Member States.
- (68) As regards State resources and the imputability of the measure to the State, the Commission notes the following. Firstly, the system of tradable phosphate rights is introduced by an act of the Dutch Parliament. The measure is therefore imputable to the State. Secondly, in line with the case-law of the EU courts, by setting up a scheme which provides for the possibility of trading the phosphate production rights on the market, the Netherlands has conferred on these rights the character of intangible assets. The Netherlands have foregone State resources by putting such assets at the disposal of the undertakings concerned free of charge, whereas they could have been sold or put up for auction²⁶.
- (69) As stated above, the notified scheme will create intangible assets which have a market value and can be traded. By granting intangible asset for free to certain farms, the Dutch authorities will therefore grant an advantage to the farms that will be allocated such assets²⁷.
- (70) As regards selectivity, the Commission acknowledges that the system of tradable phosphate rights applies to all dairy farmers in the Netherlands. However, only farms with dairy cattle on 2 July 2015 that are still operational on 1 January 2018 are allocated tradable rights for free. To the extent that farmers entered into the market after 2 July 2015 or want to enter the market in the future, they will have to purchase those rights (unless they are land-based, in which case they may receive non-tradeable rights for free if and when the phosphate bank will become operational, see section 2.3.5 above).
- (71) In addition, the system favours land-based farms, as they will not be affected by the initial generic deduction of 8,3%. Land-based farms can also receive non-tradeable phosphate rights for free for five years through the phosphate bank

²⁶ See Judgment of 8 September 2001, C-279/08 P, EU: C: 2011: 551, paragraph 107.

²⁷ See Judgment of 8 September 2001, C-279/08 P, EU: C: 2011: 551, paragraphs 88 and 91. This is also in line with paragraph 53 of the Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (OJ (2016/C 262/01), 19.07.2016), according to which "*...granting special or exclusive rights without adequate remuneration in line with market rates, can constitute foregoing State revenues (as well as the granting of an advantage)*".

mechanism (with increased chances to obtain these rights for young land-based farms, see recital (36) above).

- (72) The measure is hence selective.
- (73) Moreover, the measure has the potential to affect trade between Member States and to distort competition because the beneficiaries are farmers active in the milk sector, where trade between Member States takes place.
- (74) Consequently, the Commission considers that the measure constitutes State aid within the meaning of Article 107(1) TFEU.

4.2. Legality of the aid measure

- (75) By notifying the measure before its implementation, the Dutch authorities have fulfilled their obligation according to Article 108(3) TFEU.

4.3. Assessment of the aid measure

4.3.1. Applicable legal basis for assessment

- (76) In derogation from the general prohibition of State aid laid down in Article 107(1) TFEU, aid may be declared compatible by the Commission if it can benefit from one of the derogations enumerated in Article 107(2) and (3) TFEU. For the present case, Article 107(3)(c) TFEU may provide the appropriate basis for compatibility.
- (77) The Commission has wide discretion in matters falling under Article 107(3) TFEU. Exercising this discretion, it has issued guidelines and notices setting forth criteria for declaring certain types of aid compatible with the internal market based on Article 107(3) TFEU. It is constant jurisprudence that the Commission is bound by the guidelines and notices that it issues in the area of supervision of State aid in as much as they do not depart from the rules in the Treaty and are accepted by the Member States. It is therefore necessary to first assess whether the notified aid falls into the scope of application of one or more guidelines or notices issued by the Commission. If this is the case, the Commission is bound for the exercise of its discretion under Article 107(3) TFEU by the respective text. If this is not the case, the Commission needs to verify whether the aid can be declared compatible directly based on Article 107(3)(b) and/or 107(3)(c) TFEU.
- (78) In the present case, the measure falls, in view of its objectives, within the scope of the EEAGs.
- (79) The scope of application of the EEAGs is defined in paragraph 13 as follows: "*These Guidelines apply to State aid granted for environmental protection or energy objectives in all sectors governed by the Treaty in so far as measures are covered by Section 1.2. They therefore also apply to those sectors that are subject to specific Union rules on State aid (transport, coal, agriculture, forestry, and fisheries and aquaculture) unless such specific rules provide otherwise.*".
- (80) Furthermore, paragraph 18 letter m) of the EEAGs lists aid in the form of tradable permits as an environmental measure for which State aid under certain conditions may be compatible with the internal market under Article 107(3) of the Treaty.

- (81) According to the EEAGs, paragraph 25, the Commission when assessing aid measures falling within the scope of EEAGs will apply the common assessment principles set out in Section 3.1 and, where applicable, the more specific conditions set out in Section 3, Chapter 3.
- (82) According to Section 3.1 paragraph 27 of the EEAG the Commission will consider a State aid measure compatible with the internal market only if it satisfies each of the following criteria:
- a) contribution to a well-defined objective of common interest;
 - b) need for State intervention;
 - c) appropriateness of the aid measure;
 - d) incentive effect
 - e) proportionality of the aid;
 - f) avoidance of undue negative effects on competition and trade between Member States; and
 - g) transparency of aid.
- (83) Specific compatibility conditions are provided in Section 3.10 of the EEAGs for aid in the form of tradable permit scheme.
- (84) For the measure at hand, the contribution to a well-defined objective of common interest, the need for State intervention, the appropriateness of the aid measure, the incentive effect, and the proportionality of the aid will be assessed as part of the compatibility assessment under Section 3.10, and in particular paragraphs 235 and 236.

4.3.2. Compatibility conditions for tradable permit schemes contained in paragraph 235 of the EEAGs

(a) the tradable permit schemes must be set up in such a way as to achieve environmental objectives beyond those intended to be achieved on the basis of Union standards that are mandatory for the undertakings concerned

- (85) With regard to the environmental objectives, with the phosphate rights trading system, the Dutch authorities wish to pursue the objective of limiting phosphate production, the objective of stimulating land-based farming, and the objective of increasing grazing, as described in section 2.4 above.
- (86) The Dutch authorities have set up the system in such a way as to achieve environmental objectives beyond those intended to be achieved on the basis of Union standards mandatory for the undertakings concerned.
- (87) Firstly, as regards the objective of limiting phosphate production, the Commission acknowledges that by limiting the phosphate production and by means of the generic deduction upon allocation of phosphate rights, the system aims to go beyond (i.e. will be lower than) the 2002 level already on 1 January 2018 (see recital (23) above). As such, the system aims at achieving a phosphate production

level lower than the ceiling of phosphate production established in the context of the implementation of the Nitrates Directive in the Netherlands, i.e. the 2002 production level.

- (88) Therefore, in the view of the Commission, the measure can be considered to be set up in such a way as to achieve environmental objectives beyond those intended to be achieved on the basis of Union standards that are mandatory for the undertakings concerned.
- (89) Secondly, the system can be considered to achieve another environmental objective beyond those intended to be achieved on the basis of Union standards by stimulating land-based farms, which has environmental benefits, as described in section 2.4.2 above.
- (90) The Commission notes that, under current Union law, dairy farmers are under no obligation to accommodate all phosphate from manure they produce on their own land. The Nitrates Directive limits the amount of manure that can be spread on land but does not require that the manure produced by a given farmer must be fully absorbed in his/her own land.
- (91) In addition, as stimulating land-based dairy farms is expected to result in more grassland, this would have the potential effect of lowering the risk of nitrates leaching to water.
- (92) Based on the above, in the view of the Commission, the measure can be considered to be set up in such a way as to achieve environmental objectives beyond those intended to be achieved on the basis of Union standards that are mandatory for the undertakings concerned.
- (93) Thirdly, the system is set up in such a way as to increase grazing, which is environmentally beneficial, see recital (43) above. The Commission notes that with respect to grazing, no specific Union standard exists.
- (94) Hence, in the view of the Commission, the measure can be considered to be set up in such a way as to achieve environmental objectives beyond those intended to be achieved on the basis of Union standards that are mandatory for the undertakings concerned, and respects condition (a).

(b) the allocation must be carried out in a transparent way, based on objective criteria and on data sources of the highest quality available, and the total amount of tradable permits or allowances granted to each undertaking for a price below their market value must not be higher than its expected needs as estimated for a situation without the trading scheme

- (95) The expected needs of an individual farm are based on the (historical) production holding capacity of the farm, consisting of amongst others stables, land, cow milking equipment and dairy cattle.
- (96) The Commission acknowledges that the Dutch authorities will carry out the calculation of the expected needs in a two step approach. Firstly, according to the Dutch authorities, for reasons of administrative feasibility, allocation of tradable permits will be based on transparent and objective legal criteria which take into account the number of dairy cattle owned on 2 July 2015. Secondly, aiming at

preventing over-endowment of such farms, the Dutch authorities will individually assess farms that have significantly reduced their dairy cattle as compared to the number of cows owned on 2 July 2015.

- (97) In the view of the Commission, the allocation is carried out in a transparent way, based on objective criteria and on data sources of the highest quality available to the Dutch authorities.
- (98) In the view of the Commission, the proposed approach and the administrative burden reasons put forward by the Dutch authorities seem reasonable to justify the allocation of the tradable rights as designed by the Dutch authorities to meet the expected needs of each farmer.
- (99) Based on the above, the Commission considers that the proposed system respects condition (b).

(c) the allocation methodology must not favour certain undertakings or certain sectors, unless this is justified by the environmental logic of the scheme itself or where such rules are necessary for consistency with other environmental policies

- (100) The system first of all favours farms with dairy cattle on 2 July 2015 (the reference date) that are still operational on 1 January 2018, which are allocated tradable rights for free, whereas farmers that entered the market after that date will have to purchase those rights or, if they are land-based, may receive non-tradeable rights for free via the phosphate bank.
- (101) The Commission notes that the system aims at achieving environmental objectives. The Commission acknowledges that a reference date had to be set in order to avoid that farmers would not have reduced, or even increased their number of cattle and hence phosphate production, awaiting the start of the trading system on 1 January 2018, which would go against the environmental objectives of the system (see recital (21) above). As such, it is the opinion of the Commission that the favouring of farms with dairy cattle on the reference date that are still operational on 1 January 2018 can be justified by the environmental logic of the system.
- (102) The system favours also land-based farms. Land-based farms will not be affected by the initial generic deduction of 8,3%. Land-based farms can also receive temporary, non-tradable phosphate rights for free through the phosphate bank mechanism (with increased chances to obtain these rights for young land-based farms, see recital (36) above).
- (103) The Commission acknowledges that stimulating land-based farming is one of the main objectives of the system. The Commission acknowledges that the land-based farms contribute to the environmental objectives that the system aims to achieve. The Commission acknowledges that, by issuing rights to land-based farms via the phosphate bank that are non-tradable, the Dutch authorities wish to limit the incentive to what is necessary to stimulate land-based farming. The Commission acknowledges that issuing rights temporarily for five years will allow the phosphate bank to issue rights to more farmers and stimulate land-based farming more. As such, it is the opinion of the Commission that the favouring of land-based farms, and the extent to which this is done via non-tradable temporary rights, can be justified by the environmental logic of the system.

- (104) In addition to the above, it must be noted that the phosphate bank will favour to a certain extent young land-based farmers as opposed to the other land-based farmers.
- (105) In this regard, the Commission acknowledges that favouring young farmers is part of a wider EU agricultural policy objective and that the data provided by the Dutch authorities demonstrate that the Netherlands is a country where the problem with regard to the aging population of farmers is particularly acute compared to the EU average situation. In addition, the non-tradable rights for young land-based farmers are temporary rights for five years, which thereafter return to the phosphate bank. The Commission acknowledges that the rationale for limiting the allocation to five years is in line with the EU Common Agricultural Policy²⁸.
- (106) In the light of the above, the Commission finds the fact that the allocation methodology favours certain undertakings is justified by the environmental logic of the scheme itself and the measure respects condition (c).
- (d) new entrants are not in principle to receive permits or allowances on more favourable conditions than existing undertakings operating on the same markets. Granting higher allocations to existing installations compared to new entrants should not result in creating undue barriers to entry*
- (107) As rights are allocated based on a historic reference date, existing (land-based and non-land based) farms will be awarded rights for free, whereas new entrants after that date will first need to obtain phosphate production rights on the market or from the phosphate bank if they satisfy the criteria to be awarded non-tradable rights from the bank. Both existing farms that wish to expand their dairy herd and new entrants will have to obtain phosphate rights to be able to operate.
- (108) In the view of the Dutch authorities, this is not considered an undue barrier as it is expected that trading of phosphate production rights will take place and, therefore, rights will be available both from the market and from the phosphate bank. Furthermore, the Dutch authorities introduce the phosphate production rights because, from an environmental perspective, there is no more room for additional production in the Netherlands. As a consequence, entry is normally only possible if it coincides with someone exiting (or reducing its presence on) the market.
- (109) The Commission acknowledges that this limitation aims at achieving the environmental objectives of the system and accepts that this limitation follows from the logic and objectives of the phosphate rights system and cannot be considered as an undue barrier.
- (110) New entrants who are land-based and who will, based on the lottery, receive permits from the phosphate bank for free, will get rights (exemptions) which are

²⁸ Article 50 (5) of Regulation (EU) No 1307/2013 of the European Parliament and of the Council of 17 December 2013 establishing rules for direct payments to farmers under support schemes within the framework of the common agricultural policy and repealing Council Regulation (EC) No 637/2008 and Council Regulation (EC) No 73/2009.

non-tradable and temporary, as opposed to existing (land-based and non-land based) farmers who get rights that can be traded and are not temporary.

- (111) According to the Dutch authorities, the reason for this is the environmental objective of the system.
- (112) The Commission acknowledges that the phosphate rights (exemptions) issued by the phosphate bank are granted to farms which are able to spread all manure on own land, for them to actually keep cattle and spread the manure on their own land, and not to be able to make a profit by selling the rights. The Commission acknowledges that issuing rights temporarily for five years will allow the phosphate bank to issue rights to more farmers and stimulate land-based farming more. Hence, the Commission acknowledges that these limitations aim at achieving the environmental objectives of the system and accepts that these limitations follow from the logic and objectives of the phosphate rights system and cannot be considered as an undue barrier.
- (113) Young land-based farmers have increased chances to obtain temporary non-tradable rights from the phosphate bank compared to land-based farmers that do not qualify as young farmers, see recital (36) above.
- (114) The Commission considers that favouring young farmers is part of a wider EU agricultural policy objective and that the data provided by the Dutch authorities demonstrate that the Netherlands is a country where the problem with regard to the aging population of farmers is particularly acute compared to the EU average situation. The Commission accepts that the increased chances for young land-based farmers aim at achieving one of the objectives of the system and that this follows from the logic and objectives of the system. Hence, this cannot be considered as an undue barrier to entry.
- (115) Based on the above, the Commission is of the opinion that the barriers can be considered as not undue in the light of the objectives of the system.
- (116) The Commission concludes that the measure respects condition (d).

4.3.3. The necessity and proportionality criteria for tradable permit schemes as provided contained in paragraph 236 of the EEAGs

(a) The choice of 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 if they are in a similar factual situation

- (117) The Commission considers that the allocation of the phosphate rights will be based on objective and transparent criteria.
- (118) The Commission notes that not all dairy farms under the system are in a similar factual situation, such as farms with dairy cows on 2 July 2015 that have made investments and farms that entered after that date, and land-based and non-land based farms, which can be considered justified by the environmental objective. The Commission considers that the rights are in principle allocated in the same way for all competitors in the same sector if they are in a similar factual situation.

- (119) Based on the above, the Commission considers this condition fulfilled.
- (b) Full auctioning must lead to a substantial increase in production costs for each sector or category of individual beneficiaries*
- (120) According to the Dutch authorities, auctioning of phosphate production rights would lead to an allocation based on willingness to pay. Such an allocation could contribute to enhancing efficiency in dairy production by allocating the phosphate production rights to the lowest cost producers. However, willingness to pay may be limited by ability to pay, which may differ between farms for various reasons, such as farm scale, recent investments made, equity/debt ratio. Auctioning is likely to not only lead to a redistribution of milk production over dairy farms, but also to induce farmers, who historically produced milk, to be pushed to exit the dairy sector. The Dutch authorities provide arguments supporting that auctioning of phosphate production rights could lead to a significant cost increase.
- (121) According to the Dutch authorities, tradable phosphate production rights are an essential input for future dairy production in the Netherlands. This creates a scarcity element in that it is likely that farmers may have a tendency to acquire more phosphate production rights than is corresponding to their current level of production, but also will take into account their future farm development strategy. The need for phosphate production rights as an essential input and the known limited availability may raise concerns with individual farmers that they may run the risk of not being able to acquire a sufficient amount of phosphate production rights, which may induce them to pay a risk premium as part of their willingness to pay for phosphate production rights.
- (122) The Dutch authorities provided for a quantitative assessment of cost impacts of phosphate rights auctioning. The analysis shows that auctioning of the phosphate rights would involve a substantial investment of about €1 million per average dairy farm and an associated annual cost equivalent to about 8% of the milk price.
- (123) The Commission acknowledges the rationale put forward by the Dutch authorities and has assessed the quantitative assessment provided, which demonstrates that full auctioning would lead to a substantial increase in production costs for the individual beneficiaries concerned.
- (124) On this basis, the Commission considers that this condition is respected.
- (c) The substantial increase in production costs cannot be passed on to customers without leading to significant sales reductions. The analysis may be conducted on the basis of estimates of the product price elasticity of the sector concerned, among other factors. To evaluate whether the cost increase from the tradable permit scheme cannot be passed on to customers, estimates of lost sales as well as their impact on the profitability of the company may be used*
- (125) According to the Dutch authorities, in the case of phosphate rights two elements are important:
- 1) Primary dairy production is characterized by high fixed costs and investments having a high asset-specificity (e.g. investment in milking parlour). In particular in the short run, dairy farmers do not have many alternatives but to

employ their resources in dairy. As a result of this their supply will be price inelastic (supply is not very responsive to changes in the price of milk).

- 2) At the demand side, price responsiveness is likely to be significantly greater in the short term, which is caused by several factors, including the following.
- (126) According to the Dutch authorities, customers have more alternatives: they can source dairy products from a large and well-integrated single EU market. This holds more for dairy products than for the raw milk (a voluminous and perishable product), but the Netherlands being a small country imports from neighbouring countries e.g. Belgium, Germany and Denmark can easily take place (and already occur). Several of the customers are international food companies or retailers with operations in neighboring countries. The increased market orientation with respect to the dairy sector, as this has been pursued by several reforms of the Common Agricultural Policy (including the switch from classical price support to a safety net provision and direct payments that are largely decoupled from production, and the abolition of the milk quota) has further integrated the EU market with world dairy product markets. This has not only contributed to a broadening of sourcing possibilities, but also has affected the price determination, making this less sensitive to local supply shocks. As a result of this, demand is likely to be much more responsive to price (price elastic) than supply, while farmers have increasingly become price-takers. The implication of these market characteristics is that the main burden of the phosphate cost is likely to be on farmers, rather than being passed on to downstream stages of the supply chain.
- (127) In their notification, the Dutch authorities submitted a quantitative assessment of cost impacts of phosphate rights auctioning showing that more than 90% of the burden of phosphate costs will be borne by Dutch dairy farmers, and only a minor part of the costs could be passed on to downstream stages of the supply chain to users/consumers.
- (128) The Commission acknowledges the rationale put forward by the Dutch authorities and has assessed the quantitative assessment, which demonstrates that the substantial increase in production costs cannot be passed on to customers without leading to significant sales reductions.
- (129) On this basis, the Commission considers that the condition is fulfilled.
- (d) Individual undertakings in the sector should not have the possibility to reduce emission levels in order to make the price of the certificates bearable. Irreducible consumption may be demonstrated by providing the emission levels derived from best performing technique in the European Economic Area ('EEA') and using them as a benchmark. Any undertaking reaching the best performing technique can benefit at most from an allowance corresponding to the increase in production cost from the tradable permit scheme using the best performing technique, and which cannot be passed on to customers. Any undertaking having a worse environmental performance benefits from a lower allowance, proportionate to its environmental performance*
- (130) The Commission acknowledges that as dairy stock necessarily produces phosphate, it is not possible to reduce emission levels in order to make the price of certificates bearable.

(131) On this basis, the Commission considers that the condition is fulfilled.

4.3.4. *Avoidance of undue negative effects on competition and trade between Member States*

(132) For the aid to be compatible with the internal market, the negative effects of the aid measure, in terms of distortions of competition and impact on trade between Member States, must be limited and outweighed by the positive effects in terms of contribution to the objective of common interest.

(133) The measure has the potential to affect trade between Member States and to distort competition because the beneficiaries are farmers active in the milk sector, where trade between Member States takes place.

(134) Furthermore, the measure may also have effects on competition between existing, competing operators producing milk and an adverse effect on trade between Member States.

(135) At the same time, the proposed measure ensures positive environmental effects. The measure is expected to limit the phosphate production and go below the overall national 2002 level phosphate production, to stimulate land-based farming, improving water quality, and increase grazing, as described in section 2.4 above.

(136) The Commission acknowledges that these objectives are clearly established and according to the Dutch authorities could not result from other types of alternative measures, and concludes that the overall balance in terms of contribution to the objectives of common interest is positive.

4.3.5. *Transparency of aid*

(137) The Dutch authorities have confirmed that the full text of the legal basis establishing the system and its implementing provisions (or a link to it) will be available on-line. The information published will contain also the Commission's aid measure reference number, and the principal economic sector of the beneficiaries (at NACE group level). The information must be published after the decision to grant the aid has been taken, must be kept for at least ten years and must be available to the general public without restrictions.

4.3.6. *Reporting and monitoring*

(138) According to paragraphs 252 and 253 of the EEAGs, Member States must submit annual reports to the Commission and must ensure that detailed records regarding all measures involving the granting of aid are maintained. These records must be maintained for 10 years from the date on which the aid was granted and be provided to the Commission upon request.

(139) Reporting should include amongst other things the number of rights allocated, the details of the categories of farmers to which these are allocated, the number of rights traded, the number of rights creamed off, the number of non-tradable rights granted by the phosphate bank and to which categories they are granted.

(140) The Dutch authorities have undertaken to submit these detailed annual reports on the implementation of the measure, in line with the EEAGs, which will allow the Commission to also follow-up its efficiency.

4.3.7. Conclusion on compatibility

(141) The Commission concludes therefore that the notified measure is compatible with Article 107(3)(c) TFEU.

5. CONCLUSION

(142) The Commission has accordingly decided not to raise objections to the aid on the grounds that it is compatible with the internal market pursuant to Article 107(3)(c) of the Treaty on the Functioning of the European Union.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: <http://ec.europa.eu/competition/elojade/isef/index.cfm>.

Your request should be sent electronically to the following address:

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Yours faithfully
For the Commission

Margrethe VESTAGER
Member of the Commission

