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**ANNUAL REPORT ON COMPETITION POLICY DEVELOPMENTS IN ICELAND**

-- 2012 --

*This report is submitted by Iceland to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 19-20 June 2013.*

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## 1. Executive Summary

1. The Icelandic Competition Authority (ICA) has played an important role in expediting the resurrection of the Icelandic economy after the banking collapse in 2008. With that in mind the Authority has been active, both in advocacy work as well as in firm enforcement of the Competition Act.

2. The ICA has advocated for effective competition in a range of areas. This includes a report on financial restructuring of undertakings in the aftermath of the banking collapse, a report on competition in financial markets and a report on food markets. (See chapter 2.2)

3. The ICA has maintained firm enforcement of competition law. Of the 51 decisions published on the ICA's website in 2012 and the first half of 2013, 7 were concluded with administrative fines. These deal with a range of markets, such as telecommunications, credit card market and waste management. Of 29 merger investigations, the ICA intervened in 16. (See chapter 2.3)

4. In the last 18 months, the Supreme Court concluded 6 cases, where important decisions of the ICA and the Competition Appeals Committee were mostly upheld.

5. During the past few years, the ICA has allocated considerable resources into the financial market. A recent report identifies increased concentration in the market and points at specific actions that would increase competition and spur productivity to the benefit of consumers. Important investigations into the financial markets have been conducted in the last months. (See chapter 3.1)

6. In a single settlement, the ICA recently concluded 7 cases concerning the operations of the incumbent telecoms company in Iceland (Skipti / Síminn). After thorough discussions, Skipti/Síminn and ICA entered into a far reaching settlement, where all outstanding cases were settled. Skipti/Síminn agreed to pay a fine of 300.000.000 ISK (approx. 1.880.000 Euros) and more importantly agreed to a wide-ranging structural and behavioural changes in their operations. (See chapter 3.2)

7. The ICA has recently published new rules that set the framework for market investigations. This is a new type of investigation, based on a recent change in the Competition Act, which enables the ICA to take action against any situation or behaviour that restricts competition, even though that behaviour does not violate the prohibition rules in the Competition Act itself. The first market investigation is directed at the fuel market in Iceland.

8. At present value the budget allocated to ICA's traditional work has decreased by 20% since the beginning of the crisis in 2008. At the same time the number of pending cases have risen considerably.

## 2. Enforcement of competition law and policies

### 2.1 Abstract

9. The year 2012 was fruitful in terms of enforcement of competition law in Iceland. The Icelandic Competition Authority (ICA) has played an important role in expediting the resurrection of the Icelandic economy after the banking collapse in 2008. With that in mind the Authority has been active, both in advocacy work as well as in firm enforcement of the Competition Act.

10. At present, when the economy is slowly picking up, the ICA has placed emphasis on enforcement activities in areas where Iceland is lagging behind neighbouring countries in terms of productivity. These are typically domestic service sectors which are generally not exposed to competitive pressure from foreign firms. These are also markets that stand for a large share of the total employment, and therefore

affect general productivity. Thus competition policy has an important role in order to spur economic growth.

11. To this end the ICA endeavours to facilitate healthy operations of businesses through active advocacy work, as well as firm enforcement.

## **2.2 *Advocacy in a range of areas.***

12. The ICA has advocated for effective competition in a range of areas in 2012 and the beginning of 2013. This has been done through the internet, the social media, meetings, conferences, reasoned opinions and reports. Among these are the following reports:

### *Financial restructuring – aftermath of the banking collapse*

13. After the banking collapse in 2008, the ICA has monitored closely the effects of the financial crisis on competition. As a part of this monitoring, the ICA has repeatedly examined the financial position and financial restructuring of 120 large companies in selected competitive markets. Moreover, the ICA has reviewed the financial position and development of business sectors since the collapse, assessed whether account has been taken of competition policy in the restructuring of companies and given a status-report on a plan to open up markets that the ICA put forward early on in this period.

14. The findings of this monitoring have repeatedly been published. In 2011 the ICA issued a report (No. 2/2011), “*Competition after the collapse*”, and the issue was revisited in 2012 in a new report (No. 3/2012), “*Financial restructuring – Profit generators or zombies?*”. In the report the ICA came to the conclusion that Icelandic firms are highly leveraged in international comparison, even those that have completed their financial restructuring. The ICA’s concern is that highly leveraged undertakings can neither provide competitive restraint nor operate efficiently in the market. The issue will be revisited in a report due to be published in the autumn of 2013.

### *Financial markets at crossroads*

15. In a recent report (No. 1/2013), called “*Financial Services at Crossroads*”, the ICA identifies increased concentration in the financial market, as the three largest commercial banks have gained substantial market share at the cost of smaller financial institutions. The report addresses obstacles to competition and points at actions that ministries, institutions and the banks themselves, should engage in, in order to enhance competition in the market (see chapter 3.2).

### *Food - retail*

16. In January 2012, the ICA issued a report on the groceries market (No. 1/2012), where attention was drawn to the fact that grocery prices had risen almost 60% during the six-year period from the beginning of 2006 to the end of 2011. The investigation indicates that there are considerable entry barriers to the grocery market. There are indications that these barriers can partly be traced to the different terms that suppliers offer grocery retailers. The ICA found that smaller retailers enjoy very small margins from their sales if they try to match the prices offered by the discount supermarkets within the larger retail groups. In several product categories the lowest retail prices offered by the discount supermarkets were in fact lower than smaller outlets paid to suppliers.

17. Following the report the ICA called for reasoned explanations for substantial differences in prices to small retailers as opposed to large retailers. Most suppliers have failed to demonstrate proper reasoning for this. As a result of that, the ICA engaged in an in-depth investigation of the pricing policy of certain large suppliers. The investigation is still on-going.

### 2.3 Firm enforcement of competition law

18. Enforcement of competition law is particularly important in the aftermath of an economic crisis as increased competition helps to speed up economic recovery and enhances economic growth. With this in mind the ICA has striven to identify and terminate any breaches to the prohibition rules, as poor economic conditions of undertakings often lead to collusion or an abuse of a dominant position.

19. In 2012 the ICA concluded around 150 cases. Of those, 34 cases were concluded with a decision published on the ICA's website. In 2013 to present date, 17 decisions have been published. From the beginning of 2012 to present date, 7 cases have been concluded with administrative fines. These include 3 cases dealing with collusion and 4 cases dealing with abuse of a dominant position.

20. These decisions involve a range of areas. Three of the cases deal with the telecoms market, both retail and supply, two concern waste management, one deals with the credit card market and one case with transport and tourism.

21. Further information on fines imposed by the ICA can be found in the following table:

**Table 1: Fines imposed by the ICA from 2012 to present time**

|                                     | <b>Decision</b> | <b>Company</b>   | <b>Nature of infringement</b>  | <b>Fines (EUR)*</b> | <b>Appeals Committee</b> |
|-------------------------------------|-----------------|--|--|---------------------|--------------------------|
| 1                                   | 7/2012          | Síminn (telecoms)  | Abuse of a dominant position (margin squeeze) and false and misleading supply of information | 2.617.000           | 2.320.000 (abuse upheld) |
| 2                                   | 30/2012         | Jeppavinir (tourism and transport)   | Collusion (Settlement)   | 2.200               | n.a.                     |
| 3                                   | 33/2012         | SORPA, Metan, N1 and OR (manufacturing, distribution and selling of metan gas) | Collusion (Settlement)   | 55.000              | n.a.                     |
| 4                                   | 34/2012         | SORPA (waste management)   | Abuse of a dominant position   | 278.000             | 278.000                  |
| 5                                   | 6/2013          | Síminn (telecoms)  | Abuse of a dominant position (Settlement)  | 1.878.000           | n.a.                     |
| 6                                   | 7/2013          | Tæknivörur and Hátækni (import and distribution of mobile phones)              | Collusion (Settlement)   | 314.000             | n.a.                     |
| 7                                   | 8/2013          | Valitor (credit card)  | Abuse of a dominant position   | 3.220.000           | Under appeal             |
| <b>*(Euros at date of decision)</b> |                 |  |  | <b>8.364.200</b>    |                          |

22. Furthermore the ICA has been forced to intervene in some mergers that would otherwise have affected competition adversely. In 2012 the ICA concluded 20 merger investigations, 13 of which were concluded with an intervention. Of those 13 interventions, 11 were concluded by setting conditions to prevent harmful effects of the mergers, and two mergers were annulled or prohibited. In 2013 (until present date) 9 merger investigations have been concluded. Of those, the ICA has intervened in 3 mergers by imposing conditions.

## **2.4 Interpretation of the competition act scrutinised in courts**

23. In 2012 and in the beginning of 2013, some of ICA's most significant decisions have been tested in the courts. A decision can be appealed to the Competition Appeals Committee and subsequently can go before the courts, either by the initiative of the undertaking concerned or the initiative of the ICA.

24. In the last 18 months, the District Court of Reykjavik has concluded 4 cases, and the Supreme Court has concluded 6 cases. In the Supreme Court, 3 cases concerning various forms of abuse of a dominant position were upheld, as well as 2 annulments of mergers. The Supreme Court also dismissed a judgement by the District Court, which had decided to annul all fines in the biggest cartel case in Iceland so far, concerning the fuel market. This means that the ruling by the Appeals Committee, where the ICA's decision was upheld, still stands.

## **3. Competition challenges in major areas**

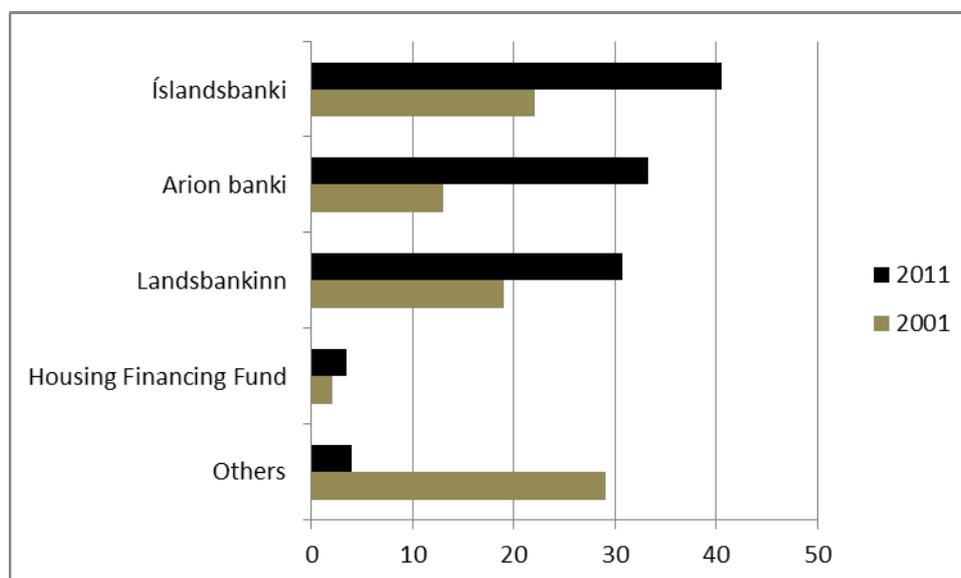
### **3.1 Competition in the financial market**

25. During the past few years, the ICA has allocated considerable resources into the financial market. This has been particularly important, as the Icelandic banks have played a significant role in the financial restructuring of Icelandic businesses in the wake of the financial crisis. The ICA has addressed this through various projects, as described in earlier annual reports.

26. Furthermore, the ICA has placed emphasis on addressing obstacles to competition in the financial market, as healthy competition of Icelandic banks can spur growth in various sectors of the economy.

*Report: "Financial Services at Crossroads"*

27. With this in mind the ICA published a report in February 2013 on competition in financial services (No. 1/2013) "*Financial Services at Crossroads*". The report identifies increased concentration in the market, as the three largest commercial banks have gained substantial market share at the cost of smaller financial institutions (see figure 1). This development can lead to decreased competition and thereby higher prices and lesser quality. The enormous concentration on the financial markets in Iceland in recent years is therefore a danger sign.

**Figure 1: Income of credit institutions 2001 and 2011 (fixed prices 2011 in billion ISK)**

28. Since the collapse of the Icelandic banking system in 2008, there has been a considerable increase in operating costs of the banks. The operations of 14 loan institutions in 2011 cost 30% more in constant prices than the operations of 32 loan institutions a decade ago. In the report, this is considered to be a sign of deficient competitive constraints in banking services as competition encourages rationalisation and increased efficiency. The high operating costs are borne by the customers of the banks through unfavourable terms of trade. High interest rate differentials are a heavy burden for homes and undertakings and impairs the competitiveness of the economy.

29. The big problem that is reflected in the high operating costs of the banks and thereby high interest rate burdens of homes and undertakings is not easily resolved. One possibility that is often mentioned in this regard is the merger of two of the three big banks. The ICA has stated very clearly that mergers of the big banks are not the solution to this problem. The reduced competition that would probably stem from such mergers would on the contrary harm consumers and the competitiveness of the economy. The stance of the ICA towards the increased cooperation of the banks, which has the aim to economize, has also been clear. Such a cooperation is possible, but only if it does not reduce the incentives of the banks to compete with one another, as competition is for the benefit of the consumers and the customers.

30. In the report the ICA advocates for increased competition as a key to rationalization and increased productivity in Icelandic banking. Competition leads to more economic utilisation of the factors of production, encourages the managers to economize in the operations of their undertakings and encourages and fosters new ideas, innovation and technological novelties.

31. The report addresses major barriers to entry into the market and other impediments to competition, that should be removed or reduced in order to facilitate vigorous competition. Furthermore, the report points at desirable actions that ministries, institutions and the banks themselves should engage in, in order to enable more vigorous competition. Possible separation of commercial banking and investment banking is also addressed.

*ICA's investigations on financial markets*

32. In addressing the competition obstacles the ICA has conducted several investigations in recent years. Among those are the following:

- In a decision in 2012, the ICA allowed for cooperation of banks through joint ownership of RB hf. (operator of clearing and settlement systems in Iceland for financial institutions), that enables the financial market to benefit from economies of scale in clearing, settlement, and IT-services. In the decision, the ICA imposes detailed conditions in order to equalize access of competitors to RB's services and to preserve competition in other ways. (Decision No. 14/2012).
- In a recent decision (No. 8/2013) the ICA came to the conclusion that the largest credit-card company in Iceland (Valitor) had abused its dominant position by predatory pricing in the acquiring market. Furthermore it was found that the company had infringed a condition imposed by the ICA in an earlier case, by using sensitive information from the issuing operations of the company, to be able to attract the customers on the acquiring side. The ICA found these infringements to be serious and therefore the company was subject to a substantial fine. The case is currently under appeal.
- Currently, the ICA is investigating a case which concerns certain loyalty inducing conditions applied by the three big banks in relation to their mortgage lending. More precisely, the investigation is primarily focused on whether conditional rebates on the banks' housing loans constitute an abuse of collective dominant position of the three largest banks. The exclusionary effects of these conditions are being investigated.
- The ICA has also been investigating the conduct of payment card issuers and card acquirers in Iceland. The investigation concerns primarily an alleged collusion through associations of undertakings in the setting of interchange fees and alleged anti-competitive actions against a competitor in the market for acquiring services.

**3.2 Major changes in the telecom market**

33. The ICA has frequently been forced to intervene in the telecoms market for the past one and a half decade, mainly as regards the Icelandic incumbent in the telecoms market, Síminn (the parent company of Síminn is Skipti hf.). During this period the ICA has reached some 15 decisions concerning the abuse of Síminn/Skipti of a dominant position. Most of these cases stem from the fact that the company is vertically integrated, as it owns the most important fixed telecoms networks in Iceland, and is the largest retailer in the market.

34. In 2012, the ICA was investigating 8 additional complaints against Skipti/Síminn. One of these cases was finalised with a major fine in the first half of that year and a statement of objections had been issued in further three cases. Under these circumstances Skipti/Síminn approached the ICA with a proposition to settle all outstanding cases. The ICA agreed to enter into talks with that aim. After thorough discussions, Skipti/Síminn and ICA entered into a far reaching settlement, where all outstanding cases were settled. Skipti/Síminn agreed to pay a fine of 300.000.000 kr. (1.880.000 Euros) and more importantly agreed to be subject to structural changes and behavioural changes in their operations.

35. The most important element of the settlement is the structural separation between retail and wholesale. The company is therefore obliged to run a separate wholesale company, independent from the retail activities, although both are owned by the same parent company. The company is subject to firm rules that will ensure that rival telecoms operators have equality of access to the company's local networks.

36. The settlement builds on the lessons drawn from cases which were under investigation and older cases as well as on an analysis of the competitive effects of the Skipti group's position in the telecommunications market. Under the settlement, substantial changes will be made in the group's organisation and thereby in the Icelandic telecommunications market. In this connection, it should be borne in mind that the predecessors of Skipti/Síminn had a monopoly position in the telecommunications markets over a span of several decades and constructed an extensive and robust telecommunications network during that period. Competition in the telecommunications sector was fully authorised in the year 1998, and the company as a whole was privatised in the year 2005, i.e. the infrastructure was not separated from the undertaking.

37. Therefore, Skipti is the owner of a countrywide local telecommunications network, which has provided the group with a substantial head start. In order to be able to compete in the telecommunications market, the competitors need access, in varying degrees, to the telecommunications network. For this reason, the competitors of Skipti cannot avoid being customers of Skipti group. This arrangement has created an on-going risk of serious competition restrictions and conflicts of interest, e.g. a risk that Siminn's retail sales would enjoy better terms, services or quality in terms of access to the telecommunications network than would the competitors. This also created the risk of abuse of confidential information and that Siminn's retail sales would enjoy a head start in terms of necessary information connected to the network.

38. With the settlement, a clear and decisive separation is made, on the one hand, between the group's local networks and services for a telecommunications company which is connected to these networks and, on the other hand, Siminn's retail operations. According to the settlement, Skipti and its subsidiaries are bound by detailed conditions which ensure this and thereby serve to prevent the utilisation of Skipti's position as the owner of the telecommunications network to create an abnormal competitive head start. Thus, the settlement is an attempt to ensure that Siminn and its competitors sit at the same table when it comes to access to telecommunications networks and the purchase of telecommunications services from the group at the wholesale stage.

#### **4. Changes to Competition Laws and Policies**

39. The year 2013 marks the 20<sup>th</sup> anniversary of the Competition Act in Iceland. It was initially adopted in 1993, and based upon the Agreement on the European Economic Area. The Act has been amended several times in light of experience and further legislation trends.

40. The ICA has recently published new rules that set the framework for market investigations. This is a new type of investigation, based on recently adopted powers, which enable the ICA to take action against any situation or behaviour that restricts competition, even though that behaviour does not violate the prohibition rules in the Competition Act itself. The amendment gives the ICA options similar to those found for instance in the UK, including the option of divestiture.

41. The first market investigation has recently been launched. The investigation is directed at the fuel market in Iceland, identifying possible obstacles to competition, in retail, wholesale, as well as in the legal framework.

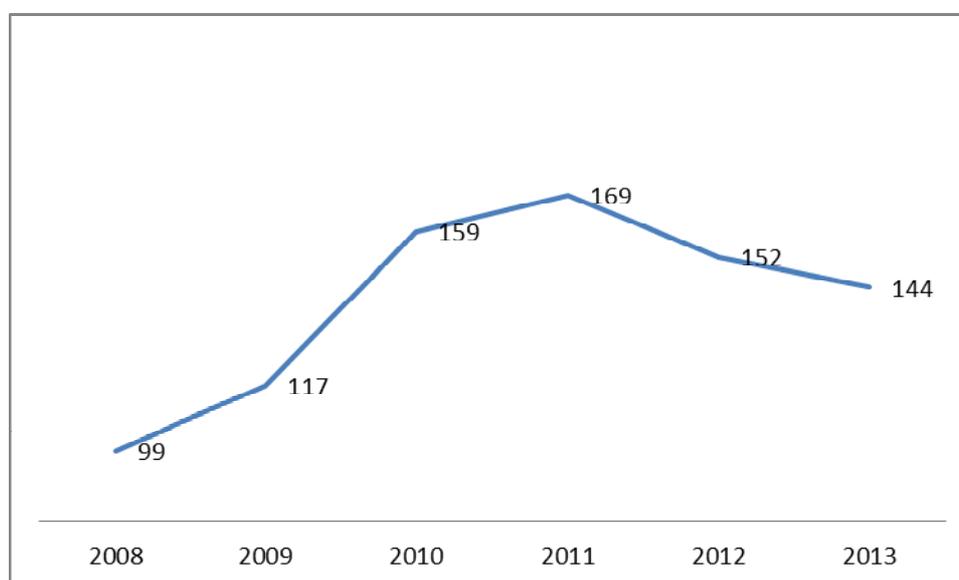
42. Earlier this year the ICA was given the responsibility to enforce new provisions in the Media Act, which enables the ICA to take action against serious lessening of diversification in media service, related to concentration in the ownership of media. The provision has already entered into force.

## 5. Resources of the Competition Authority

### 5.1 Budget and pending cases

43. The ICA is funded through the state budget. The budget for 2013 amounts to approx. 2,2 m. EUR. At present value the budget allocated to traditional work has decreased by 20% since the beginning of the crisis in 2008. At the same time the number of pending cases had risen by around 70% in 2011. The ICA has managed by rigorous prioritisation to decrease the number of pending cases since 2011, as shown in figure 2. Nevertheless, longer procedures show that the current budget does not match the burden of tasks. The ICA has advocated for a larger budget to be able to better enforce the Competition Act and address serious adverse effects to competition in times of crises, but this has yet been in vain.

**Figure 2: Number of pending cases at mid-year**

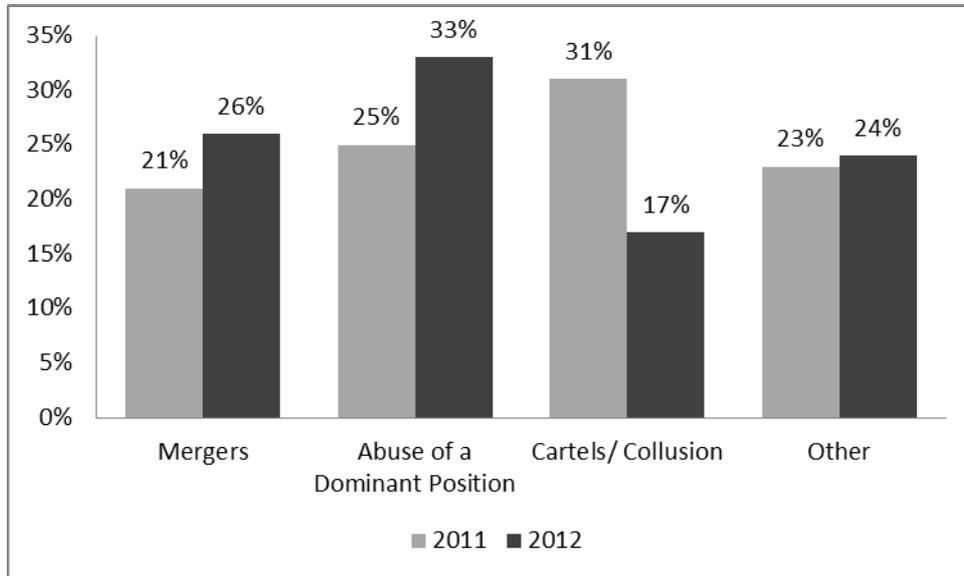


### 5.2 Allocation of resources

44. The ICA keeps track of and manages the allocation of employee's work to the various areas of the authority's responsibilities. The breakdown is based on time measurement.

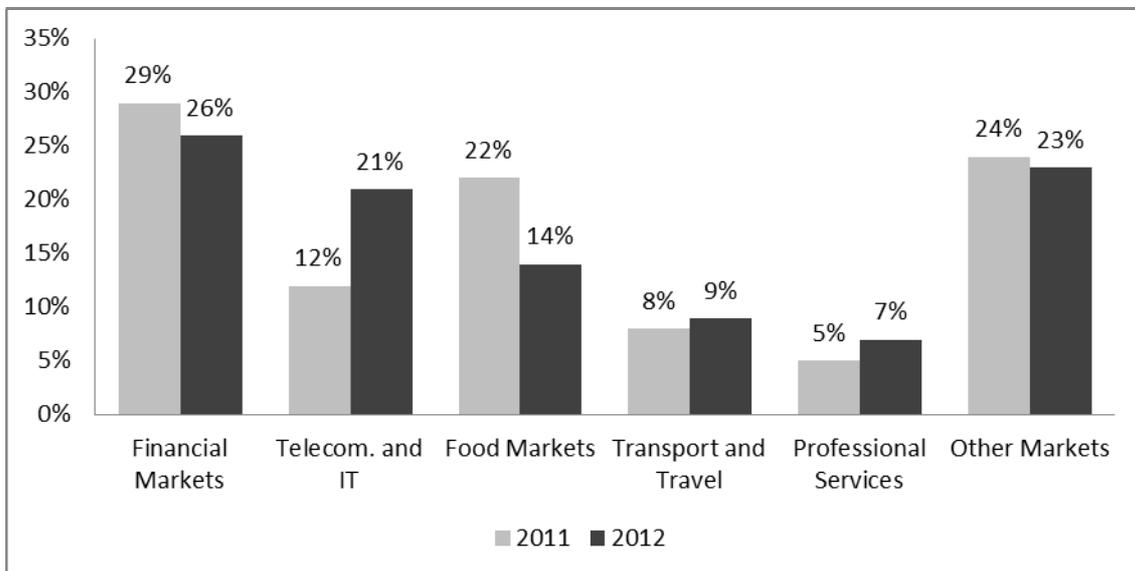
45. As shown in figure 3, cases dealing with possible abuse of a dominant position are a significant part of the ICA's work.

**Figure 3: Allocation of resources in 2012, compared to 2011 – types of work**



46. As shown in Figure 4, cases related to the financial and the telecom markets are at the top of the ICA’s agenda.

**Figure 4: Allocation of resources in 2012, compared to 2011 - markets**



47. At the end of the year 2012, 23 employees were working at the ICA.