Ruling

of the Competition Appeals Committee

in cases No 17-18/2003,

Icelandair ehf. and Iceland Express ehf.

versus

the Competition Council

I.

By letter dated 12 August 2003, Icelandair ehf. has appealed Decision of the Competition Council No 22/2003 delivered on 14 July 2003. By letter dated 12 August 2003, Iceland Express ehf. has appealed the same decision. The Competition Appeals Committee decided to combine the two cases.

In the appealed decision, the Competition Council concluded that Icelandair ehf. had violated Article 11 of the Competition Law No 8/1993. by promoting and selling certain airline tickets (so-called *Vorsmellur* and *Netsmellur* airfares) as well as by reducing its business class airfares for certain departures on the routes between Keflavik and Copenhagen, on the one hand, and Keflavik and London, on the other hand. In addition, the Competition Council declared, with reference to Article 17 of the Competition Law, that Icelandair ehf. was prohibited from promoting and selling the abovementioned *Netsmellur* and *Vorsmellur* offers. Furthermore, with reference to the same provision, the said reduction of business class airfares was annulled.

Icelandair ehf. demands that the decision under appeal be annulled.

Iceland Express ehf. demands that the Competition Appeals Committee reconsiders certain aspects of the grounds on which the decision is based, as well as its results. More specifically, the demands relate to the following points:

1. When assessing the legality of the *Vorsmellur* and *Netsmellur* offers of Icelandair ehf. to London and Copenhagen, the approach in the appealed decision is to focus on so-called fully allocated costs. The presentation of the Competition Council regarding fully allocated costs apparently indicates the view that the legality of Icelandair's *Vorsmellur* and *Netsmellur* offers may depend on whether the airfares are above or below fully allocated costs. The appellant demands that the assessment of the legality of the relevant measures should as a minimum be made with reference to average total costs for the relevant routes instead of merely fully allocated costs.

2. When assessing the total costs per passenger of Icelandair ehf. on the routes Keflavik–Copenhagen and Keflavik-London, the cost is spread on the total number of seats on offer for the relevant time period. The appellant objects to this approach and demands that the assessment be based on the costs of Icelandair ehf. per passenger on the relevant routes instead of costs per seat.

3. In the appealed decision it was concluded that the value of each frequent flyer point in Icelandair's customer club amounted to ISK 0.63. The appellant demands that the value of each point be evaluated as one ISK as a minimum.

4. In the appealed decision it was concluded that Icelandair ehf. had violated Article 11 of the Competition Law by reducing its business class fares for flights to London and Copenhagen. The relevant reduction applied only to flights departing at the same time as those of the appellant, Iceland Express ehf. The grounds of the Competition Council decision have been interpreted by Icelandair ehf. to mean that Icelandair ehf. was authorised to reduce its fares for all departures to London and Copenhagen, notwithstanding the fact that fares to other destinations are still sold at full price. The appellant demands that the Competition Appeals Committee rules that a reduction of business class fares applying only to the same destinations as those of the

appellant, independent of departure times, shall be deemed to constitute an infringement of Article 11 of the Competition Law.

5. The appellant demands that Icelandair ehf. shall be ordered to pay a fine in accordance with Article 52 of the Competition Law.

The Competition Authority demands that the appealed decision be upheld, with reference to the grounds on which it is based.

II

The facts of the case are that on January 9, 2003, Iceland Express ehf. commenced operations in Iceland. The undertaking sells airfares on the Keflavik – London and Keflavik – Copenhagen routes. The cheapest return tickets for those routes are from ISK 14460 for the Copenhagen route and from ISK 14160 for the London route. The first scheduled flight took place on 27 February 2003.

At the end of January 2003, Icelandair ehf. announced a special offer named *Vorsmellur,* in terms of which it is claimed that the undertaking offered thousands of seats on the same routes for ISK 14900. It came to the Competition Authority's attention that the undertaking's offer applied only to the same routes as those served by Iceland Express ehf. The Competition Authority announced in its letter to Icelandair ehf., dated 4 February 2003, that it was commencing an inquiry into whether the offer might be in breach of Article 11 of the Competition Law. The letter also requested detailed information from Icelandair ehf.

On 14 February 2003, the Competition Authority received a complaint from Iceland Express ehf. The complaint made reference to the aforementioned inquiry and the Authority was asked to take a preliminary decision in accordance with the first paragraph of Article 8 of the Competition Law, as the undertaking was of the view that a delay of the investigation and action by the competition authorities could lead to substantial damage. The complaint also contained an exposition clarifying the background to the establishment of Iceland Express ehf. and the grounds on which the

undertaking claims that Icelandair ehf. had in various ways and systematically tried to prevent its entry into the market. Reference was for instance made to the fact that on 16 October 2002, Iceland Express ehf. had announced the prices for its scheduled routes. On the same day Icelandair ehf. announced new types of airfares, *Netsmellur*, which the undertaking planned to offer during the winter time. The lowest offers of ISK 19800 applied to the same destinations as those which Iceland Express ehf. planned to serve. In addition, Icelandair ehf. also offered frequent flyer bonus points on *Netsmellur* tickets for those destinations. Iceland Express ehf. contented that once the value of bonus points had been taken into account, the ticket price for *Netsmellur* was actually ISK 14800. Iceland Express ehf. also pointed out that before it commenced operations, the lowest ticket price on offer to Copenhagen was ISK 28900 or similar to tickets to other destinations in Europe. The complaint of Iceland Express ehf. was forwarded to Icelandair ehf. for comments.

On 21 February 2003, the Competition Authority received two letters from Icelandair ehf. relating to the complaint by Iceland Express ehf. and the inquiry made by the Competition Authority. In these letters Icelandair ehf. denies that its conduct represents a violation of the Competition Law through predatory pricing strategies, discriminating customer treatment, or any other means aiming for the exclusion of Iceland Express ehf. from the market. In the letters, Icelandair ehf. explained *inter alia* the events leading up to its decision regarding the airfares in question. It was emphasised that Icelandair ehf. always retained the right to meet competition.

In its letter to the Competition Authority, dated 4 April 2003, Iceland Express ehf. raised for discussion the reduction by Icelandair ehf. of its business class fares. This letter was forwarded to Icelandair ehf. for comments. In a letter dated 7 May 2003, Icelandair ehf. reaffirmed its position that it had not violated the Competition Law through the price reductions in question.

The Competition Authority did not take a provisional decision in the case, as Icelandair ehf. announced that it would cease sale of the *Vorsmellur* fares or comparable airfares and abstain from the marketing and promotion of the cheapest *Netsmellu*r fares to Copenhagen and London.

Reference is made to the text of the decision under appeal, where the Competition Authority's procedure is otherwise described.

At the Competition Council's meeting on 14 July 2003, a decision was taken in the matter. The operative part of the decision is as follows:

> "Through the promotion and sale of the airfare *Vorsmellur*, in the amount of ISK 14900, which was made available to the customers of Icelandair ehf. for the period 1 March to 15 May 2003 on the routes between Keflavik and Copenhagen on the one hand, and Keflavik and London, on the other hand, Icelandair ehf. violated Article 11 of the Competition Law No 8/1993. The promotion and sale by Icelandair ehf. of its cheapest Internet airfares of ISK 19800, the cheapest so-called *Netsmellur* on the same routes also constitutes a violation of the same article.
>
> Through a reduction of business class airfares on the flights FI204 and FI205 between Keflavik and Copenhagen and flights FI425 and FI453 between Keflavik and London, Icelandair ehf. violated Article 11 of the Competition Law No 8/1993.
>
> With reference to Article 17 of the Competition Law, the Competition Council declares that Icelandair ehf. is prohibited from promoting and selling airfares similar to the abovementioned *Vorsmellur* offer in the amount of ISK 14900 and the cheapest *Netsmellur* offer in the amount of ISK 19800 on the routes between Keflavik and Copenhagen, on the one hand, and Keflavik and London on the other hand. The Competition Council furthermore annuls the abovementioned reduction of business class airfares for the routes previously mentioned.
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> This decision enters into force upon its publication"

The case was brought before the Competition Appeals Committee by means of oral and written testimony. Written testimonies of the parties reached the Committee on 2 September 2003 and oral pleadings were heard on 22 September 2003.

III

Arguments of the Appellant, Icelandair ehf.

On behalf of the appellant it is noted that it cannot approve of the following findings of the Competition Council:

"1. That the appellant is in a super dominant position on the defined markets.
2. That the appellant's pricing entailed predatory pricing; more specifically in this regard:
    a) that the appellant is prohibited from offering prices below all relevant long-term costs that have been allocated to individual operational units of the undertaking, i.e. long-term fully allocated relevant cost.
    b) that, when assessing whether pricing was predatory, the appellant's lowest fares are taken into account but not the average fare for a certain period of time.
    c) that, for the assessment of possible predatory pricing, each frequent flyer point should be evaluated at ISK 0.63, and the resulting amount deducted from the appellant's reference fare.
    d) that the appellant had through illegal means tried to prevent Iceland Express ehf. from establishing itself in the defined markets.
3. That the appellant had exceeded permissible limits when meeting competition.
4. That the appellant's specific reduction of business class fares had been illegal."

In addition, the appellant claims that it had been denied the right to be heard when the Competition Council did not give it the opportunity to contest the use of the criterion fully allocated costs per seat, when assessing possible predatory pricing, as was the

case in the appealed decision. Moreover, the appellant claims that the Competition Authority did not inform it of the fact that the appellant's reduction of business class fares was subject to investigation as to whether it involved breach of Article 11 of the Competition Law. Consequently, the appellant did not have the opportunity to exercise its right with respect to the right to be heard in that respect.

The appellant claims that the Competition Council's finding that the appellant is in a super dominant position within the defined markets cannot be upheld. The appellant believes that when determining whether an undertaking is in a super dominant position, the Competition Council had made too lenient demands and given too little weight to the fact that barriers to entry in the defined markets are limited.

The appellant points out that the Competition Council's conclusion concerning the undertaking's market position is based on the undertaking's market shares, the number of seats on offer, overall operations of the Icelandair group, Icelandair's services and network of routes with Keflavik as a hub or connecting point, the Amadeus booking system, Icelandair's customer club and the view that access restrictions to aviation markets are generally deemed considerable. In the opinion of the appellant, many of these factors have little bearing in the evaluation of the appellant's market position. However, the last factor does carry significant weight. The appellant stresses that  n air carrier founded in Europe is considered a potential competitor on routes between Iceland and other destinations in Europe, including on the defined markets. This is the result of liberalised aviation transport within the European Economic Area.

The appellant believes that the Competition Council's criterion of fully allocated costs does not hold and that it is illegal. The undertaking disagrees with the Competition Council on the conclusions which may be drawn from EU Regulation No 2409/92 on fares and freight fares for air transport services and considers it to be clear that provisions of the regulation, to which reference was made, do not pertain exclusively to the lowest (or highest) fares. On the contrary, there seems to be no doubt that the overall operating results of the respective routes are taken into account and compared to all long-term fully allocated costs of an airline. The judgement in the case of

Ahmeed Saeed Flugreisen should be explained in the light of this, as the discussion of that case is based on similar provisions in the preamble to Regulation No 2409/92.

The appellant believes that it goes against the objective of the Competition Law to base the assessment of predatory pricing in air carrier operation on the criterion of long-term fully allocated costs per seat. This would result in reduced competition and prevent the appellant from utilising efficiently its productive resources. In the pleadings, the appellant had from the outset emphasised that it was irrational to look exclusively to particular fares (in fact the lowest fares) when assessing whether pricing was illegal. In air carrier operations, losses do not occur on particular routes due to the lowest fares only.

In addition, the appellant believes that the Competition Council's approach to the calculation of frequent flyer points is based on a misunderstanding. There, the value of the points are evaluated from the viewpoint of the consumer; but the outcome of that calculation is then applied when assessing whether the appellant's revenue from the fares sold cover the long-term fully allocated costs of the respective routes.

The appellant does not agree with the Competition Council's finding that the timing of the undertaking's actions further confirmed that the undertaking's pricing on the defined markets was aimed at preventing effective competition. The appellant had introduced a price structure on 16 October 2002, including the *Netsmellur* fares to Copenhagen and London ranging from ISK 19800. The decisions introduced at this time had been under preparation for a long time and could be traced to the basic changes made in the appellant's pricing structure. The lowest *Netsmellur* fares have been applied since October 2002, whereas Iceland Express ehf. started selling fares on these routes in early January 2003. Iceland Express ehf. commenced its flights at the end of February of the same year. The appellant contests that the conclusion can be drawn from the aforementioned events that the "timing of actions" would support the view that their aim was to eliminate Iceland Express ehf.

With regard to the *Vorsmellur* offer, the appellant points out that contrary to the *Netsmellur* offer, this offer represents a competitive reaction to the entry of Iceland Express ehf. to the market, the aim being to temporarily forestall a foreseeable drop in

revenue. The *Vorsmellur* promotion entailed special offers, valid for a limited period of time and only aimed at a limited group of customers. The decision to offer that promotion was not made before it was clear that competition from Iceland Express ehf. would have a significant impact on the appellant's ticket-sales within the defined markets. Furthermore, it should be noted that the decision was made around the same time as when it became evident that the war in Iraq would have a considerable effect on demand in foreign markets. This explains the timing of the measure.

The appellant bases its position on the fact that a dominant undertaking is authorised to react to new and increased competition on the market. Only conduct that involves an undertaking reacting to competition by deliberately taking on a foreseeable loss of income for a short period of time with a view to harming the competitor in such a manner that it has to exit the market, can be seen as predatory pricing. In addition, evidence would need to be presented to the effect that the respective undertaking could have anticipated to recover the losses by raising prices after the competitor had been forced to leave the market. Other conduct is generally legitimate.

The appellant does not believe that it has exceeded admissible limits in meeting competition with the *Vorsmellur* and the lowest *Netsmellur* offers. It could never be considered unreasonable to react to competition through sensible and moderate actions. In the opinion of the appellant, the right to meet competition includes at least sensible actions to minimise a drop in revenue that can be anticipated with the entry of a new competitor in the market.

The appellant does not protest that a reduction of business class fares had occurred and that this price cut was limited to similar departure times as those of Iceland Express ehf. However, it is not correct, in the applicant's view, that the action taken had been illegal and it was a serious oversight on the part of the Competition Council to deduce that there were no other "evident reasons for the dissimilar conditions than to exclude customers from the flights of Iceland Express". It was clear that due to the commencement of operation by Iceland Express ehf., the general fares of that carrier had become an alternative to the business class fares of the appellant when traveling to Copenhagen and London. As the price difference was substantial it was clear that the appellant had to react to the situation to be able to hold onto customers by

continuing to offer realistic flight options and to reduce the anticipated drop in revenue due to competition from Iceland Express ehf. In light of this it was decided to lower the appellant's business class fares on the respective routes and departure times down to ISK 59500.

The appellant points out that a price cut meeting cost criteria can only constitute a violation of the Competition Law in absolutely exceptional cases and only if it can be proven that an undertaking with a market share of approximately 90 per cent or more deliberately takes on a foreseeable loss of revenue for a short period of time through price cuts that are only aimed at a limited group of customers and with a view to eliminating a competitor from the market. In addition, evidence needs to be presented to the effect that the respective undertaking could have anticipated to recover the losses by raising prices after the competitor had been forced to leave the market.

Finally, the appellant, Icelandair ehf., believes that a reduction of business class fares can never entail discrimination within the meaning of Article 11 of the Competition Law.

Arguments of the Appellant, Iceland Express ehf.

The appellant does not consider it correct, in the light of the Competition Council's assessment of the dominant position of Icelandair ehf., the aims of the measures concerned and the special needs considered necessary to protect a new entrant in the aviation market against measures of dominant undertakings, to rely on the criterion of fully allocated costs when assessing whether the pricing of Icelandair ehf. has been in breach of the provisions of the Competition Law. There was no doubt that the measures taken by Icelandair ehf. were aimed at preventing the appellant from establishing itself in the market. In such circumstances the appropriate criterion is that Icelandair ehf. must at least not sell tickets below total costs. The appellant also objects to the view that all general administrative costs should be excluded from the concept of fully allocated costs. Nothing appears in the EC directive No 2409/92 or the judgement of the EC Court of Justice in the Ahmeed Saeed case which supports that view. Moreover, the appellant contests the approach to distribute costs on each

seat on offer to London and Copenhagen, whether calculated in relation to the fully allocated costs, as defined by the Competition Council, or the total costs of Icelandair ehf.

The appellant claims that the decision by the Competition Council in relation to the value of the frequent flyer points is irreconcilable with the fact that Icelandair ehf. determines the frequent flyer prices itself at a substantially higher value. The undertaking invites the members of its frequent flyer club to buy up to 20 per cent of the required points they need to be able to go on the relevant flight. Thus, 7 600 points are priced at ISK 8400. It was also correctly stated in the decision of the Competition Council that the price of airfares which can be swapped for 38 000 points, can amount to up to ISK 40 – 50 thousand. There are no grounds for using the second cheapest *Netsmellur* fare to evaluate the value of each frequent flyer point.

The appellant points out that in the decision under appeal it was concluded that the reduction of business class fares by Icelandair ehf. for one specific departure time on each route in the range of 41–43 per cent was in breach of Article 11 of the Competition Law. Consequently, that price cut was annulled. Icelandair ehf. reacted to that decision by reducing all business class fares on departures to London and Copenhagen by 41-43 per cent. Business class fares on the undertaking's other routes remained unchanged. If the decision of the Competition Council is interpreted to the effect that Icelandair ehf. is permitted to implement such substantial and specific price cuts for business class fares to London and Copenhagen only, it was clear that the appellant's competitive position has deteriorated through the decision of the Competition Council. These reductions are directly aimed at the appellant and they are designed to substantially reduce the difference between the highest fares of the undertaking and the business class fares. If one adds the various benefits attached to the tickets of Icelandair ehf., over and above those of the appellant, it was clear that the price differential was small. It was also difficult to see how this reduction concurs with the assertions of Icelandair ehf. that a high turnover of sales of business class fares to the two abovementioned destinations justifies an increase in the supply of the cheapest fares.

The appellant claims that there were sound reasons to levy high fines on Icelandair ehf. The undertaking was in a super dominant position on the aviation market in Iceland and it was correspondingly under the obligation not to abuse that position. The undertaking had blatantly violated this obligation and instead used this position to do anything possible to prevent the appellant from establishing itself in the Icelandic aviation market. Such conduct seriously contravenes the basic objective and provisions of the Competition Law and would in the long run have prevented or greatly impeded competition in the Icelandic aviation market, to the serious detriment of Icelandic consumers. In this connection, consideration should be given to general preventive effects. It should furthermore be taken into account that it must have been clear to the management of Icelandair ehf. that their behaviour was in breach of provisions of the Competition Law.

Arguments of the Competition Council

The Competition Council objects to the claim that Icelandair's right to be heard had not been respected in the Council's proceedings of the case. The Competition Council points out that it is not required that the views of a party to a case be expressed due to the initiative of the respective authority. The authority only needs to ensure that the party becomes aware of the case and its particulars. According to Article 13 of the Administration Procedures Act, a party to a case shall only be given the opportunity to "express his views", before the authority takes a decision. The scope of an official investigation may change and expand from what was originally foreseen, and Icelandair ehf. was aware of the changes to the subject-matter of the investigation and did in fact comment on the legality of discounts of business class fares. In a letter to the Competition Authority, dated 4 April 2003, Iceland Express ehf. has raised the issue of discounts given by Icelandair ehf. on business class fares to Copenhagen and London. This letter was sent to Icelandair ehf. on April 8, 2003. In a letter from Icelandair ehf. dated May 7, 2003, the abovementioned price reduction was discussed and the undertaking did not contest that the Competition Authority's investigation was directed at this aspect.

The Competition Council believes that the competition authorities have a wide discretion for determining when action on the basis of Article 17 of the Competition Law is needed against abuse of a dominant position infringing Article 11 of the Law. The competition authorities are entitled to base their decisions, based on the above mentioned Articles, on any arguments which may be deemed objective. It may be inferred from Supreme Court decisions that there are few restrictions as to which arguments the competition authorities are allowed to use as a basis for their decisions based on Articles 11 and 17 of the Competition Law.

In its decision, the Competition Council considered whether the offers in question would impair competition. With that in mind the Council deemed it appropriate to find a realistic criterion for Icelandair's costs for each seat sold. This is a difficult task due to the nature of airline operations. The Council therefore endeavoured to research case law and practices abroad, with the aim of seeking ideas and guidance. That research led to the conclusion of the Council to apply the criterion of "fully allocated costs per seat ".

The Competition Council points out that in its decision it endeavoured to respect proportionality. The Council chose a realistic approach to assess whether Icelandair's actions were damaging to competition, and it considered that less inflictive means would not achieve the goal of promoting competition. The criterion proposed by Icelandair ehf. seemed in many ways imperfect and was not suited for the special conditions prevailing in air transport.

The Competition Council submits that its arguments with respect to determining a super dominant position had been endorsed *inter alia* in Ruling No 11/1999 of the Competition Appeals Committee, Iceland Telecom vs. Competition Council, which was confirmed by a judgment of the Supreme Court on November 8, 2001. The Competition Council considers it to be clear, with reference to the various documents of the case, that Icelandair ehf. was in a super dominant position, within the meaning of the above rulings, and has pointed to certain items in support of this view.

The Competition Council considers that the assertion made by Icelandair ehf. regarding market share is incorrect, the appellant not having sufficiently explained the

data behind this claim. In presenting the case to the Competition Authority, Icelandair ehf. relied on the number of passengers in this context and it may be assumed that the same approach was also being used here. The Competition Council can see no rationale for this approach. It is obvious that this criterion creates substantial inaccuracy as the prices paid by different passengers vary widely. It could be assumed that passengers of Icelandair ehf. pay, on average, higher fares than those of Iceland Express ehf. (due to business class passengers) and therefore that Icelandair's market share was much greater.

The Competition Council considers that the assertions of Icelandair ehf. concerning easy access of competitors to the market are not substantiated. The fact alone that there are no legal obstacles to starting competition in the market does not preclude the possibility of market dominance. There are substantial economic obstacles to entering airline markets. The Competition Council points out that economic research of the competitive behaviour of airlines in a dominant position has shown that there is motivation to impair competition through abnormally low prices. The Council thus has a problem on its hands in evaluating the available economic research on airline operations and their competitive behaviour. The research results considered to be reliable and convincing, show clearly how special price promotions of dominant airlines may harm competition.

The Competition Council believes that conditions have not changed (due to the war in Iraq and the SARS epidemic) since the time when the 2001 DoT report and the 2002 Nordic report were drawn up. Conversely, it might be that problems of this kind had encouraged airlines to counter competition through abnormal price cuts. Furthermore, wars and epidemics were well known phenomena when the above reports were issued in 2001 and 2002.

The Competition Council points out that this case centres on whether specific price offers by Icelandair ehf. are liable to impair competition. In its evaluation the Council took into consideration judgements by the European Court of Justice and decisions by the EC Commission in the field of competition, grounded on the fact that the Icelandic Competition Law is based on the EEA competition rules which are identical in substance to the corresponding rules of the EC. Furthermore, the Competition

Council believed it to be useful to look to this case-law and decision practices when there are otherwise no clear precedents, whereas the aforementioned case-law leads to varied expertise upon which the Competition Council can base its deliberations. Although the Competition Council repeatedly looks to precedents from the European Court of Justice, the EC Commission and its sister organizations in Europe, this does not alter the fact that the Council follows Icelandic law when evaluating the situation in terms of Articles 11 and 17 of the Competition Law. An evaluation of the European competition authorities of price cuts by dominant undertakings is done on a case-by-case basis. The Competition Council submits that Icelandair's assertion that it followed from the case-law of the European Court of Justice that competition authorities were obliged to prove that dominant airlines could recuperate the cost of their price cuts was unfounded. No fixed rules could be inferred from European case-law regarding the appropriate criteria for evaluating potential anti-competitive effects of price cuts in the airlines industry. On the other hand, it had been useful to have some kind of frame of reference for costs as a basis for a decision on the subject. It was therefore found appropriate, with reference to European practice, to rely on the criterion "fully allocated cost per seat" in evaluating whether Icelandair's price reduction was anti-competitive.

The Competition Council submits that neither the EC Commission nor the EC Court of Justice or the Court of First Instance have taken a stand as to whether specific or average airfares should be taken as the relevant point of reference in the airline sector, but in light of, among other things, the decision by the Bundeskartellamt in the Lufthansa case, it was decided to look especially at the *Vorsmellur* and *Netsmellur* airfares. If the assessment had been based on average fares this would have given Icelandair ehf. a chance to start a massive campaign and offer fares at extremely low prices. It was possible for the undertaking to do this because it transports a substantially higher number of business class travellers who could possibly subsidize the fares for the group targeted jointly by Icelandair ehf. and Iceland Express ehf.

The Competition Council cannot accept Icelandair's explanations with regard to the timing aspect of the undertaking's pricing policy in the defined markets. The Council points out that although the *Netsmellur* offer was first introduced in October 2002, it had been shown in the appealed decision that the supply of these fares multiplied

around the time when Iceland Express ehf. commenced operation on the defined markets. With regard to the *Vorsmellur* offer, the Competition Council points out that Icelandair ehf. appears to admit to competitive reactions. The Competition Council neither accepts that these offers were meant to be valid only for a limited time nor that they were made available only to a limited number of customers.

The Competition Council considers the assertion of Icelandair ehf. regarding the costs of frequent flyer points to be unfounded. The undertaking claimed that the Competition Council had valued the "cost" of each frequent flyer point to be ISK 0.63. This was incorrect. When performing its assessment the Competition Council assumes that passengers use the frequent flyer points as payment for flights that they would otherwise pay for in cash.

In relation to Icelandair's claim that the undertaking was required to use the same ratio between costs and fares on specific air routes, the Competition Council believes there is a misunderstanding regarding the issue. The purpose of comparing the costs of the fares in question and fares to other destinations in northern Europe was to find out whether there were cost foundations for the difference in price.

With regard to the Competition Council's prohibition on Icelandair's reduction of business class fares, the Council points out that all relevant aspects of the case must be taken into consideration when evaluating whether a price reduction by a dominant airline was liable to impair competition. Costs are only one of the many aspects that matter in this respect, cf. the judgment of the European Court of Justice in the case of Compagnie Maritime Belge Transports et al versus the EC Commission. In the decision under appeal it is shown, among other things with detailed reference to foreign experts and authorities, that the airline market was an unusual market where dominant airlines find it easy to use anti-competitive strategies against their competitors. When Iceland Express ehf. launched its operations, Icelandair ehf. had a 100 per cent market share, and in the decision under appeal it was shown that the undertaking was in a super dominant position. In the case-file there were documents from Icelandair ehf. indicating that the aim of the undertaking's reactions to the new competition had not only been to meet competition, but to restrain it. Additionally, it

must be considered that the specific price reduction was clearly aimed specially at the new competitor.

IV

Findings

1

The appellant, Icelandair ehf., claims, as defined earlier, that it was denied the right to be heard concerning the criterion "fully allocated costs per seat" and its application. The Competition Council used this criterion as one of the elements that should be taken into consideration when evaluating whether or not predatory pricing was present.

In a ruling of the Competition Appeals Committee (case no 2/2003, Iceland Telecom v. The Competition Council) it was previously stated that the Competition Appeals Committee considers the right to be heard to entail a process by which a party gains access to the documents of the case and all information introduced, including the claims, if applicable. As part of this right, a party is also entitled to present its views adequately. However, the scope of the right to be heard does not in general include access to the arguments that can possibly be used in support of the authorities' decision, nor does it serve the purpose of allowing parties to receive suggestions on how the authorities would interpret the laws or older decisions in its ruling.

The case has, from the beginning, evolved around the question whether the appellant, Icelandair ehf., as an undertaking with a dominant market position, applied so called predatory pricing strategies when marketing its airfares, thereby resulting in an abuse of this position. According to competition rules it is clear that one of the approaches that can be followed in determining whether products or services have been sold below the so-called variable cost, is to try to establish an acceptable criterion. The main elements of the criterion used in the case under appeal are well known on the market under discussion. The appellant, Icelandair ehf., who is extremely

knowledgeable about this market, should have found it easy to clarify the cost calculations relevant for the outcome of the case, including the main elements of cost calculations ultimately relied upon by the Competition Council. Based on these grounds, it cannot be accepted that the right of the appellant, Icelandair ehf., to be heard has been infringed in this respect.

2

The appellant, Icelandair ehf., also claims that its right to be heard has been infringed in that the competition authorities did not notify the undertaking of the fact that its reduction of the business class fares were subject to investigation by the Competition Council.

At first the investigation focused primarily on the so-called *Vorsmellur* offer, but that seems to have changed due to the letter of complaint by Iceland Express ehf. to the Competition Authority dated 14 February 2003, and the letter from the same to the Competition Authority dated 4 April 2003, where a complaint was made about discounts of the abovementioned business class fares. The appellant, Icelandair ehf., was afforded the opportunity to comment on the contents of the abovementioned two letters, and in fact the appellant expressed its views on the issues involved in a letter dated 7 May 2003 to the Competition Authority.

The Competition Appeals Committee is of the view that when the subject matter under investigation changes during the hearing of a case, it is for the competition authorities to define the scope of claims to be examined and investigated in each case. It should especially be mentioned that ambiguous complaints may lead to difficulties in applying the right to be heard. In line with the views of the appellant, Icelandair ehf., it can be agreed that the contents of the relevant claim were not set out as clearly as desirable. On the other hand, the contents of this claim by Iceland Express ehf. were self-evident and the appellant, Icelandair ehf., actually set forth an opposition based on it. Therefore, bearing this in mind, there is not quite enough grounds to annul this part of the appealed decision.

3

The claims of the appellant, Iceland Express ehf. are set out in five parts that have been accounted for earlier. The first three parts do not represent proper claims as the appellant does not call for a dismissal of the decision under appeal. Instead they constitute a request that the grounds on which the decision under appeal is based, are formulated differently. Thus, these parts involve views that typically appear in defense and will be treated accordingly.

In the fourth part of the claim, it is demanded that the Competition Appeals Committee stipulates that the ban on the reduction of business class fares shall not only apply to the departure times coinciding with those of the appellant, Iceland Express ehf., but to all departure times for London and Copenhagen. This claim comprises a demand that the decision of the case under appeal be dismissed in part. The fifth part of the claim of the appellant, Iceland Express ehf., demands that Icelandair ehf. pays a fine. This demand clearly involves dismissal of the outcome of the decision under appeal. The last two claims will both be heard in the manner as set out below.

4

According to the first paragraph of Article 3 of the Competition Law, the law is applicable to agreements, terms and actions that have or are intended to have an effect in Iceland. It is not disputed that the events of this case have an effect in Iceland. Therefore, the case falls under the jurisdiction of Icelandic law and has correctly been heard by the Icelandic competition authorities, independent of whether some other international authorities might have the power to hear the case. The jurisdiction of the competition authorities will thus not be placed in question in this case.

5

This case involves in particular an interpretation of Article 11 of the Competition Law. According to the first paragraph of that article, any abuse by an undertaking of a dominant position is prohibited. This article was brought into force with Law No

107/2000, amending the Competition Law No 8/1993, with subsequent amendments. It embodies a thorough change to the earlier Article 17 of the Competition Law. The new provision will here be interpreted in relation to the Icelandic legal environment as well as taking account of market conditions in Iceland. In the explanatory notes to the law bill it was stated that the provision was based on Article 53 or the EEA Agreement as well as other similar provisions of the laws of certain EEA member states. Consequently, when resolving the current case, the laws of these states will also be taken into consideration as well as comparable provisions of the Rome Treaty within the EU. It appears that there is per se no disagreement on this matter, although emphasis on individual points varies considerably amongst the parties and their interpretation is furthermore controversial.

6

To be able to define an abuse of a dominant market position in accordance with Article 11 of the Competition Law, one first has to define the market in question. The Competition Appeals Committee considers that this definition plays an important role in the application of the Article. According to Article 4 of the Competition Law, a market is the area where commodities or substitute commodities and / or services and surrogate services are sold. According to this, a market is defined in two ways: on the one hand with reference to the relevant commodities or services, and, on the other hand, with reference to the geographic market for each case. In competition law, it is customary to define the market in relation to consumers and with reference to the qualities of the commodities or services, price and usages where the question of substitution is the main aspect that will be evaluated.

According to the above, it is then correct to define the market area based on commodities or services and substitute commodities or substitute services as seen from the point of view of the consumer. The market that is primarily affected or is likely to be affected by a specific action of an undertaking in a dominant position, as based on these considerations, will accordingly be deemed to fall within the realm of Article 11 of the Competition Law. It is however quite clear that definitions of this nature cannot be exact. They can therefore generally only be used for paradigmatic purposes. This approach will also be followed in the current case.

The Competition Appeals Committee is of the opinion that the reduction of the airfares relating to specific routes by the appellant, Icelandair ehf., had, first and foremost, an influence on the routes to which they applied. Some kind of substitution consideration can be relevant with respect to other destinations than those of the appellant, Iceland Express ehf., but in view of the nature of the actions under examination, the significance of such considerations is deemed limited. Therefore, the service and geographic markets were correctly defined in the decision under appeal as:

The scheduled flights between Keflavik and London; and
The scheduled flights between Keflavik and Copenhagen.

7

Market domination is present when an undertaking has the economic strength to impede effective competition on the relevant market and the undertaking can to an appreciable extent conduct its business independently of its competitors, customers, and consumers, cf. Article 4 of the Competition Law. In this regard it is important to look at the market share of the relevant undertaking in the market that has been defined and the structure of the market. The first mentioned item is, generally speaking, the strongest indicator of market domination in accordance with traditional competition law, that is, the outcome is significant in relation to whether the specific undertaking may be considered to be in a dominant position. The second paradigm refers to several other dissimilar factors that may point in the same direction, particularly whether market entry is easy, or whether the relevant undertaking is generally speaking powerful in relation to finance, equipment, the supply of goods or services, and the number and strength of competitors, but other aspects may also need to be examined.

As defined above, a high market share of the relevant undertaking provides an indication of market dominance, notwithstanding the fact that other aspects also count. When determining the market share, the revenue from the services under discussion are normally taken into account. From the nature of the case, it can be said

that the larger the market share of the undertaking, the stronger the indication of a market dominance. In section 2.1. of the decision under appeal a few viewpoints are expressed regarding market shares, and the revenue of the aforementioned undertakings for the first two months after the appellant, Iceland Express ehf., commenced business, are displayed. Two aspects are of relevance here: In the first place, the appellant Icelandair ehf., had a 100 per cent market share on the aforementioned routes for all-year round flights for the whole year of 2002 and until the appellant, Iceland Express ehf., commenced business in March 2003. In the second place, the market share of the appellant, Icelandair ehf., was by far the highest during the period of March and April 2003 on the routes relevant here. The Appeals Committee finds it normal and logical in relation to the latter point to take account of the revenue from the sales of the flight-tickets for the specified markets as accounted for in the decision under appeal. Therefore, it is possible to agree with the Competition Council's finding that the appellant's, Icelandair's, market share has been substantial in the previously defined markets.

In sections 2.2 – 2.4 of the decision under appeal some aspects that pertain to the structure of the market are accounted for: It is stated that there is substantial supply of seats by the appellant, Icelandair ehf., on the specified markets. In addition, there are various supportive undertakings and resources that undeniably provide the appellant, Icelandair ehf., with a considerable head start. On behalf of the appellant, Icelandair ehf., it was, on the other hand, pointed out that there are several other aspects that may illustrate that the barriers to entry were not as high in Iceland as elsewhere. In this regard the following examples were mentioned: access to airports, the transparency of the Icelandic market, reduced relevance of tourist bureaus and booking-systems, and a great supply of cheaper aircrafts. It is specifically pointed out that the appellant, Iceland Express ehf., was established with little outlays, in a short time and without specialised operating infrastructure. Notwithstanding this, the undertaking managed to acquire a substantial market share on important routes.

The Competition Appeals Committee considers that all the aspects mentioned by the appellant, Icelandair ehf., are significant; however, they do not change the overall picture of aforementioned sections of the decision under appeal. In particular it shall be mentioned that it is a fact that no airline has up to date succeeded to permanently

establish itself in the Icelandic market with regard to scheduled flights in competition with the appellant, Icelandair ehf.

The overall assessment of the Competition Appeals Committee is thus that the position of the appellant, Icelandair ehf., is extremely strong in the defined markets and other related markets.

8

An abuse of a dominant position is prohibited according to Article 11 of the Competition Act. Paragraph 2 of Article 11 lists examples of abuses and in this regard it is clear from the wording of the article that the list is not exhaustive. The examples given, nevertheless, are an important indication of the content of the concept. The examples also indicate important aspects other than those of abuse, such as unfair purchase- or selling prices, limitations that may prejudice consumers and discrimination of trading partners or that requirements are made that are not related to the subject matter of the relevant contract.

The Competition Law does not contain a specific definition of what constitutes abuse*;* however, an indication of this may be found in the provisions on the objective of the Competition Act as will be dealt with hereinafter. It is natural to interpret this article in such a manner that the fact that an abuse has taken place as a result of a dominant market position is enough reason to consider the measures used unlawful. This implies that it is not a condition for the application of this provision that the abuse has specific effect or that the measures were applied with a specifically defined objective in mind. Nevertheless, it follows from the nature of the case that if proven, for example, that the purpose of lowering a price by a dominant undertaking is to push another undertaking out of the market, it should be generally easy to show that such a measure contravenes the objective of the Competition Law. Specific measures by a dominant undertaking that are directly aimed at competitors could often be evaluated in a similar manner.

In theoretical literature as well as foreign case law much has been written on the concept of abuse of a dominant position and its more refined definition. This aspect is

dealt with in the decision under appeal and in the pleadings of the appellants. Such an approach and discussion are relevant in relation to the interpretation of Icelandic law to the extent where the specific legal texts are similar in nature, and, as stated previously, having regard to the specific features of the Icelandic market.

It follows from Article 11 of the Competition Law that an undertaking with a dominant position has the responsibility not to apply any measures that disrupt effective competition prevailing in a specific market. In relation to further particulars of the abovementioned responsibilities, reference shall be made to Article 1 of the Competition Law, in accordance with which the objective of the Law is, among other things, to:

a. prevent unreasonable limitations or barriers to freedom of economic operation,
b. prevent unfair trade practices, harmful oligopoly and restriction of competition,
c. facilitate the entry of new competitors into the market.

Therefore, it can be said that the responsibilities of an undertaking with a dominant position extend, among other things, to the duty not to contravene the objective of the abovementioned Law in any abnormal manner. An abuse of a dominant position may, therefore, include acting against the objectives of the Competition Law if the measures are not based on normal competitive principles. According to this it is also correct to say that the responsibilities of undertakings with a dominant position are in principle greater the stronger is their market position as it may be assumed that competition weakens correspondingly. In determining the outcome of this case, the objective of the Competition Law to prevent harmful oligopoly and restrictions of competition as well as to facilitate the entry of new competitors into the market must especially be mentioned.

In general, one can say that an abuse of a dominant position takes place when an undertaking applies measures in a specific market that are not compatible with normal competition, impeding the competitive forces and their growth. The same reasoning can also be expressed by stating that a dominant undertaking must not apply abnormal measures aimed at strengthening its position in the relevant market. It follows from this that other measures that are applied by a dominant undertaking in a specific

market that do not meet the abovementioned conditions are lawful. Thus, a dominant undertaking can meet competition from other competitors in defined markets as long as it does not go beyond the abovementioned boundaries.

9

The Competition Appeals Committee considers that the cost advantages of the relevant dominant undertaking through the specific pricing policy are relevant, in general, when determining whether the pricing policy involves an abuse, cf. Supreme Court judgement of 8 November 2001 in case no 120/2001: Landssími Íslands hf. vs. The Competition Council. The pricing of goods or services by the undertaking may accordingly represent an indication of a measure that can abnormally hinder competition or its growth. The so-called predatory pricing policy by a dominant undertaking is an example of an action that can constitute an abuse of a dominant position. In this connection it shall be mentioned that the setting of prices by an undertaking with a dominant position below variable costs may generally involve such abuse. The reason is that a pricing policy of this nature can hardly be justified with reference to normal operating conditions of the relevant undertaking. This conclusion is based on the fact that the pricing decisions of production and service companies are generally based on these grounds, at least when not considering the longer term. Pricing decisions of a dominant undertaking below this level will thus, as a general rule, distort competition. It can therefore be said that such measures by a dominant undertaking infringe Article 11 of the Competition Law, cf. Article 1 of the Law, unless it is possible to show that there are special reasons justifying these measures. However, this conclusion is subject to the reservation that questions can arise as to whether or not certain costs are variable. Furthermore, the term variable costs may not be equally applicable in different types of markets.

The Competition Appeals Committee is also of the view that the pricing of a dominant undertaking, which is below average total costs and above average variable costs, may involve an abuse. The criteria for this category of abuse are less clear as similar measures by the relevant undertaking can often be explained in light of normal operational and competitive grounds and with reference to normal survival efforts of the undertaking, taking into account the special features of the markets concerned.

There are two relevant aspects to consider when deciding whether a pricing policy of a dominant undertaking is, in fact, normal under these conditions. These aspects must be assessed jointly.

In the first place, consideration should be given to the size of the deviation of prices compared to average variable costs. If the price is set only slightly above average variable costs, it can generally be assumed that there is more reason for intervention than in the case where price was much higher than variable costs.

In the second place, consideration should be given to how specific the measure is. If the measure of the dominant undertaking is directed, to a great extent, solely at those competitors that already exist in the market and not at similar markets where there is no competition or to a lesser extent, this can be an indication of abuse in the specific market which is not compatible with the provisions of the Competition Law.

Abnormal pricing policies of this nature can lead to the withdrawal of sound competitors existing on the market because they simply lack the financial resources to endure such competition in the long run. The pricing policy may therefore promote oligopoly and thus contravene the objectives of the Competition Law. In this connection one should also bear in mind that a dominant undertaking is often in the position to offer a much broader variety of services than a smaller competitor, as is true in the present case, the details thereof contained in section 2.3 of the decision under appeal. The market situation may therefore often be of such a nature that the competitors to the dominant undertaking can, in essence, only compete on low prices. If a dominant undertaking in reality matches that price this may involve a measure that is not compatible with the objectives of the Competition Law and with effective competition.

The Competition Appeals Committee points out that even in a market where a dominant undertaking operates, the basic rules of contractual freedom and the right of an undertaking to manage its own affairs still prevail. The application of these basic rules is, however, limited by, among other things, the Competition Law, as discussed earlier. In this connection it should be emphasised that the responsibilities of a dominant undertaking in a very strong market position are greater than of those

undertakings which are not in an equally strong position. Dominant undertakings are permitted to meet competition forcefully and the obligations of a dominant undertaking do not extend to protecting undertakings on the relevant market that cannot meet normal competition. These considerations should consistently be borne in mind in cases where the legality of measures taken by a dominant undertaking is evaluated.

10

Section 3.2 of the decision under appeal deals with the special features of the aviation market. It is amongst other things argued as plausible that because of the nature of this market the entry of new competing airlines is in reality not as easy as it should be, although the legal framework now stipulates an open and free market in this field. The conclusion is that there is, in general, more risk of anti-competitive measures by dominant undertakings in aviation than in other industries. It follows from the specific features of aviation that it is easy for a dominant undertaking to exclude competition through abnormal price cuts or other measures. It is also explained that aviation has the specific feature that the concept variable costs must assume a somewhat different meaning as compared to its use in industrial production. It is important to note, on the one hand, that various types of costs that are seen as fixed in other industries, such as depreciation of production equipment, varies according to use in the aviation sector and, on the other hand, when considering whether a specific cost is fixed or variable, timing is of crucial importance in the aviation sector. This implies, among other things, that about 6 months prior to a specific flight schedule is fixed, many cost items are variable. This changes as the flight date approaches and shortly before the plane takes off, almost all costs are fixed. It also matters in this connection that planes can easily be transferred between regions. Because of this, the situation can arise where a dominant airline can possibly easily and with little cost increase the supply of seats for a specific route to meet competition.

The Competition Appeals Committee concurs with these views and considers that the characteristics of the aviation market involve *inter alia* that decisions on scheduled flights are normally taken somewhat in advance of flight dates and in line with operational factors available at that time. Furthermore, the Appeals Committee

considers that it is important for resolving this case to break down the cost items, as is done in the decision under appeal, as this makes it possible to reach a conclusion on whether the contested price decision of the appellant, Icelandair ehf., may indicate an abuse of a dominant market position. Expenses that are considered to be related to the scheduled flights in question must then be determined with reference to the time when the flight schedule was fixed and until the flights commence. It follows from this that many cost items are deemed variable. This approach is to a certain extent supported by Nordic and European case-law and legislation.

On the other hand, it is clear that the categorisation of costs into fixed and variable costs, with reference to the time when the specific costs occur will never be an exact criterion. Uncertainties can also arise in relation to the seating capacity of the dominant undertaking at the time when competition started. In addition, the pricing policy of an airline may partly be based on the scenario that there will always be unsold seats, which could be disposed of by either lowering the airfares shortly before departure or by making seats available at a low price at all times.

Although the Competition Appeals Committee feels that some consideration should be given to the value of frequent flyer points in cases like this one, a great deal of uncertainly exists regarding their real value. The frequent flyer points could be seen, among other things, by many passengers as insignificant, for example in relation to uncertainties about whether and when they could be used. Nevertheless, the Appeals Committee deems it right to take into consideration the value of the frequent flyer points to a certain extent, although especially in relation to their expense side. In addition, the Appeals Committee reiterates that the appellant, Icelandair ehf., also has a competitive advantage in relation to services on offer.

The conclusion is that in aviation indications of an abuse of a dominant position, which may be deduced from the pricing of flight tickets on specific routes, are uncertain. However, the Competition Appeals Committee is of the opinion that this uncertainty can be eliminated to a certain degree if solid explanations are given for the pricing policy of the relevant undertaking.

When assessing the market behaviour of the appellant, Icelandair ehf., in this case, it is of importance to determine whether the average price of flight tickets for specific routes during a certain time period should be taken into account, or only those low airfares which are specifically under investigation. It is the view of the Competition Appeals Committee that in this assessment the following factors are of importance: the quantity of the low airfares which are on offer, the time during which they are offered, to whom the offers are directed, and lastly, when and under which circumstances they are placed on offer. The reason is that if a large quantity of low airfares are being offered over a long period of time and such offers are being presented after competition has commenced, the likelihood increases substantially that the competition prevailing in the market will be impeded. In line with the findings of the decision under appeal, the Competition Appeals Committee considers that there is no doubt that the offers of the so-called *Vorsmellur* and *Netsmellur* by the appellant, Icelandair ehf., fulfil the requirements of being of massive proportions in the defined markets.

It should be borne in mind that the relevant market has in this case been defined as scheduled flights between the specific destinations without taking low airfares into account. It cannot be excluded that the behaviour of the appellant, Icelandair ehf., can be explained with reference to total revenue from each flight or route relative to the abovementioned expenses of each flight or route. Calculations of these revenue factors are not available in this case, although they could have been used as a point of reference. The resulting uncertainty must be counted to the benefit of the appellant, Icelandair ehf., in accordance with general rules on the burden of proof.

11

The Competition Appeals Committee considers that the appellant, Icelandair ehf., has certain duties to fulfil in the relevant market with reference to its position on that market. On the other hand, the undertaking has the right to defend its commercial interests against existing as well as anticipated competition. As mentioned before, only abnormal measures by the undertaking are considered to constitute a violation of Article 11 of the Competition Law. The various considerations and criteria in this connection have been outlined above. Furthermore, it has to be kept in mind that the

onus of proof in relation to unlawful behaviour by an undertaking rests on the competition authorities, unless the undertaking concerned fails to bring forward relevant data in its possession or provides unsatisfactory explanations.

In the following sections, special attention will be given to *Netsmellur* (section 12), *Vorsmellur* (section 13) and the reduction of business class fares (section 14). Thereafter, the claims of the appellant, Iceland Express ehf., will be dealt with (section 15 and 16) and finally, a summary will be given (in section 17).

12

As stated previously, the Appeals Committee considers, with reference to the arguments presented in the appealed decision, that it may be relevant to take into consideration the co-called fully allocated costs, when evaluating which price policies can be deemed normal in this context. In accordance with research done by the Competition Authority, the revenue per passenger compared to the price of the lowest fares of the so-called *Netsmellur*, on the route to and from London, is very close to but still a little lower than the fully allocated costs per passenger at the time under consideration. On the route to and from Copenhagen, this difference is a little higher. In both cases the value of frequent flyer points were taken into consideration. On the other hand, if the frequent flyer points are not taken into account, the revenue is higher than expenditure in the first case, but about even in the latter case.

The said *Netsmellur* consisted of three price ranges, depending on the day of booking. When calculating revenue and expenditures in the decision under appeal, only the lowest *Netsmellur* airfares were taken into account. On the other hand, the Competition Appeals Committee is of the opinion that consideration may be given to the revenue from all these price ranges. The Committee furthermore reminds of its remarks in the final paragraph of section 10, on the importance of information on total revenue.

When resolving this aspect, it must be borne in mind that the so called *Netsmellur* was introduced in October 2002, long before the appellant, Iceland Express ehf., commenced operations in Iceland. As a matter of fact, it seems that at that time

preparations for establishing this undertaking or an early entry of another low-fares airline were already underway. Nevertheless, it seems acceptable to accept the explanation of the appellant, Icelandair ehf., that the *Netsmellur* fares were introduced as a general response to the competition that, to a large extent, was foreseeable to arise because of the so-called low-fares airlines by using the internet; and that preparation of these fares commenced in late summer 2002. The submitted documents support that this was the case. It is not deemed to be of importance in this respect that comparable airfares to other destinations where competition was less likely and whose operation was less profitable, were offered at higher prices. What is of importance is that the fares on offer were priced within reasonable limits and that they were non-specific with respect to potential competitors.

The uncertainty surrounding the classification of cost items to form a workable system, to be used as a paradigm aimed at evaluating whether an undertaking with a dominant position is pricing its services below the so-called variable costs, was discussed previously (section 10). Taking into consideration this uncertainty and the uncertain factors which were discussed earlier in this section, it cannot be asserted that the appellant, Icelandair ehf., has violated Article 11 of the Competition Law with its decision at the time to offer the so-called *Netsmellur* on the market. This remains valid, even if consideration is given to the fact that the services offered by Icelandair ehf. are greater than those offered by the appellant, Iceland Express ehf., on the relevant routes.

13

With respect to the Vorsmellur fares, the circumstances are somewhat different. The appellant, Iceland Express ehf., started selling tickets in this category in the beginning of January 2003 for the aforementioned routes. The cheapest fare was ISK 14160 for a return ticket on the Keflavik – London route and ISK 14460 for a return ticket on the Keflavik – Copenhagen route. The offer of the appellant, Icelandair ehf., on these routes was ISK 14900 in addition to the buyer receiving 4000 frequent flyer points. When evaluating the market behaviour of the appellant, Icelandair ehf., in relation to this offer, the following should be borne in mind:

- The price was substantially lower than the lowest *Netsmellur* offer.
- Revenue from this offer was far below fully allocated costs.
- Effectively, the low-fare price of Iceland Express ehf. was at least matched.
- The supply of these fares was substantial.
- The offer was first made after the appellant Iceland Express ehf. commenced operation.
- The offer only applied to the same routes as those of the appellant, Iceland Express ehf.

The offer was not actually subject to many restrictions, and it is undisputed in this matter that the offer was launched with a competitive objective. As stated in the decision under appeal, the appellant, Icelandair ehf., did not produce any adequate documents, such as cost calculations, in relation to preparation of the *Vorsmellur* offer, notwithstanding a request to do so. It must be deemed highly unlikely that the undertaking did not have such documents on hand.

With reference to the income- and costs analysis presented in the case and discussed earlier and with consideration to the nature of this offer, it is found that there is sufficient proof that this matter involves the application of a specific measure that, taking into account the duties of the appellant Icelandair ehf., embodies an unlawful predatory offer on the relevant routes. Consequently, this offer involves a breach of Article 11 of the Competition Law.

14

After the appellant, Iceland Express ehf., had started its scheduled flights, the appellant, Icelandair ehf., reduced appreciably the prices on its business class fares on the routes between Keflavik and Copenhagen on the one hand, and Keflavik and London on the other hand. It has furthermore been clarified that the aforementioned reduction applied only to the same or similar departure times as those of Iceland Express ehf.

Although the said measure is thus extremely specific, revenue per ticket is above the relevant fully allocated costs. In addition, the documents of this case do not contain

any accurate calculations setting forth cost-related foundations for the decision of the appellant, Icelandair ehf., to reduce the said prices. Such calculations should have been presented in this case. Moreover, it has not been shown that the aim was directly to eliminate the new competitor from the market.

Taking the above into consideration, it is concluded that there are not sufficient grounds, based on the available documents, to find that the appellant, Icelandair ehf., has, through the measures concerned, abused its dominant position.

15

The appellant, Iceland Express ehf., whose operations are in competition with those of the appellant, Icelandair ehf., is deemed to have sufficient interest in the matter to apply to the Competition Appeals Committee for review of the rejection of its demands, implicit in the appealed decision, to apply administrative fines in this case. Article 52 of the Competition Law stipulates that the Competition Council imposes administrative fines on undertakings or associations of undertakings which have violated the prohibitions of the law or decisions taken in accordance with the law, unless the violation is deemed insignificant or such fines are not considered necessary in order to promote and strengthen effective competition. When determining fines, the nature and extent of competition restrictions shall be taken into account as well as their duration.

The decision of the Competition Council not to apply sanctions in this case is not specifically reasoned in the decision under appeal. In deciding whether to impose fines in this case, consideration should be given to, among other things, the fact that this is the first time that a case of this nature is heard. Considerable uncertainty prevails as to the relevant criteria for determining whether an abuse of a dominant position is present in this case. As matters stand, there is not sufficient reason to impose a fine.

16

As stated earlier, it follows from the operative part of the decision under appeal that the appellant, Icelandair ehf., has violated provisions of the Competition Law by reducing the price of its business class fares on the said routes. The decision refers to price reductions for only those flights departing at the same time as those of Iceland Express ehf. The appellant, Iceland Express ehf. demands that the prohibition shall apply to any departure time on the said routes.

According to section 14 above, there are not sufficient grounds, based on available documentation, to conclude that the appellant, Icelandair ehf., has abused its dominant position through the said measures. For these reasons, the claim of the appellant, Iceland Express ehf., is rejected

17

With reference to the findings above, the first sentence of the first paragraph of the operative part of the appealed decision is confirmed. The claims of the parties are in other respects not accepted.

V

Ruling

Through the announcement and sale of the *Vorsmellur* flight tickets for the price of ISK 14900 made available to the customers of Icelandair ehf., for the period of 1 March to 15 May 2003 on the routes between Keflavik and London, on the one hand, and Keflavik and Copenhagen on the other hand, Icelandair ehf. violated Article 11 of the Competition Law No 8/1993.

Reykjavik, 29 September 2003

Stefán Már Stefánsson

Brynhildur Benediktsdóttir

Erla S. Árnadóttir