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

-- 2011 --

*This report is submitted by Iceland to the Competition Committee FOR INFORMATION at its forthcoming meeting to be held on 13-14 June 2012.*

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## **1. Executive Summary**

1. In enforcing competition rules and advocating for competition, the Icelandic Competition Authority (ICA) places emphasis on the need to speed up economic recovery.

2. In 2011 the ICA allocated considerable resources to significant markets such as the financial market, telecommunications and groceries/food. Most undertakings which have been subject to fines and other interventions, such as conditions and annulments of mergers, are operating on these markets.

3. Five companies were fined a total of 5.6 million EUR in 2011. The ICA took 26 decisions following merger investigations in 2011. The Authority intervened in 17 of them by annulling or imposing conditions. Thus the ICA intervened in around 60% of notified mergers.

4. Several reports have been issued during the past months where the ICA has analysed competition conditions in given fields and provided guidance to ensure sound application of competition laws. Recently the ICA has issued reports on the groceries market, the banking market, and the financial restructuring of companies.

5. Since the banking collapse the ICA has monitored closely the state of play in the financial restructuring of debt-ridden undertakings. Recent analysis indicates significant improvements in 2011 in terms of financial restructuring of companies. Despite this positive development, Icelandic firms are still highly leveraged in international comparison. Undertakings that are highly leveraged can neither provide competitive restraint nor operate efficiently in the market.

6. Grocery prices in the retail market have risen almost 60% during the six-year period from the beginning of 2006 to the end of 2011. The price increase can first and foremost be attributed to external conditions and particularly to the collapse of the exchange rate of the króna in 2008. The analysis indicates that there are considerable entry barriers to the grocery market. The root of some of these barriers can be traced to the different terms that suppliers offer grocery retailers.

7. According to legislative amendments made in 2011, the ICA has powers 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. Following the amendments the ICA has been preparing the application of the new powers. To that end ICA has issued a consultation paper outlining a new type of a market investigation aiming to identify competition restraints and possible remedies thereto.

8. The ICA's budget has decreased by 8% since the beginning of the financial crisis in 2008. At the same time the number of pending cases had risen by around 80% in 2011. The ICA has vigorously advocated for a larger budget to better address serious adverse effects to competition in times of crises, but in vain.

## **2. Enforcement of competition laws and policies in times of crisis**

### **2.1 Abstract**

9. Competition enforcement is particularly important in an economic crisis as increased competition helps to speed up economic recovery. With this in mind the ICA has striven to identify and terminate any breaches to the prohibition rules, as collusion and abuse of a dominant position can be a response to companies' difficulties in times of crisis. The deterrence effect of administrative fines is critical to this end. Likewise the ICA has endeavoured to intervene in any mergers that adversely affect competition.

10. At the same time as the ICA endeavours to conduct an effective enforcement of the competition rules, it attempts to facilitate healthy operations of businesses through active advocacy. Several reports have been issued during the past months where the ICA gives guidance in terms of good practices. This has recently applied to the groceries market, the banking market, and the financial restructuring of companies (see chapter 3).

11. In 2011 investigations and decisions of the ICA were in most part forcefully opposed by the relevant parties before the Appeals Committee and the courts. Increasingly, large companies are seeking expert advice from abroad. On the other hand, a large majority of interventions in merger cases were settled.

12. The ICA took part in two dawn raids in 2011, concerning possible collusion in the markets for construction supplies and beverages. In the former case the ICA reported possible infringements of individuals to the police authorities. Parallel to the police investigation of the individuals, the ICA conducts further investigations into the possible collusion of the companies involved. Good cooperation channels have been opened to ensure the proper handling of the case.

## 2.2 *Fines imposed in a range of areas*

13. In 2011 five companies were fined a total of 5.6 million EUR. These decisions involve a range of areas. One case deals with collusion between the largest grocery retailer and meat processors in connection with retail pricing of meat products. Two cases deal with an abuse of a dominant position, in the telecom sector and in the soft drinks market. One case deals with a violation of a prohibition to implement a merger, whilst another takes on a failure to adhere to a merger decision.

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

**Table 1: Fines imposed by the ICA from 2011 to present time**

	<b>Decision</b>	<b>Company</b>	<b>Nature of infringement</b>	<b>Fines (EUR)*</b>	<b>Appeals Committee</b>
1	11/2011	Vífilfell (Coca Cola distiller in Iceland)	Abuse of a dominant position	1.611.000	495.000
2	23/2011	Landsbanki Islands (Resolution committee of Landsbanki)	Violation of prohibition to implement merger	242.000	42.000
3	24/2011	Forlagið (Publishing house)	Failure to adhere to a merger decision	151.200	147.000
4	30/2011	Síminn (telecom company)	Abuse of a dominant position	377.000	367.000
5	36/2011	Langisjór (food, meat producer)	Collusion	508.000	508.000
6	7/2012	Síminn (telecom)	Abuse of a dominant position (margin squeeze) and false and misleading supply of information	2.700.000	Under appeal
<b>*(Euros at time of decision)</b>				<b>5.589.200</b>	

### 2.3 *Intervention in 60% of merger cases*

15. The ICA took 26 decisions following merger investigations in 2011. The Authority intervened in 17 of them by annulling or imposing conditions. Thus the ICA intervened in around 60% of notified mergers.

16. Three mergers were annulled in 2011. These mergers adversely affected competition in telecommunications, in the financial market and in the production of pork.

17. Conditions were imposed in 14 cases, mainly dealing with banks taking over commercial undertakings. As a result of the banking collapse in 2008, the three banks which were established upon the ruins of the collapsed banks, have taking over commercial undertakings which have suffered from excessive debts and contraction in demand. In these cases the ICA has established detailed conditions for the banks' ownership of these companies, in order to ensure that the ownership does not lead to harmful disruptions to competition.

18. Further information on merger interventions by the ICA can be found in the following table:

**Table 2: Mergers in 2011 which the ICA intervened with annulment or conditions**

	<b>Decision</b>	<b>Mergers</b>	<b>Conclusion</b>
1	1/2011	FSÍ's (an equity fund jointly owned by pensions funds and Landsbanki) acquisition of Vestia (ownership company)	Conditions imposed on merger
2	2/2011	The Central Bank's acquisition of Greiðsluveitan hf. (credit and debit cards transactions).	Conditions imposed on merger
3	5/2011	NBI's hf (Landsbankinn) takeover of Björgun ehf (dredging, mining and related activity)	Conditions imposed on merger
4	7/2011	Arion bank's (commercial bank) takeover of Sigurplast (plastic container manufacturer)	Conditions imposed on merger
5	8/2011	Islandsbanki's (commercial bank) and Glitnir's (resolution committee) acquisition of Bláfugl ehf. (cargo flight operator)	Conditions imposed on merger
6	12/2011	Arion bank's (commercial bank) takeover of G-7 (real estates)	Conditions imposed on merger
7	13/2011	Merger of ST eignarhaldsfélag ehf. (holding company) and Steypustöðin ehf. (concrete plant)	Conditions imposed on merger
8	16/2011	Arion bank's (commercial bank) takeover of Fram Foods (seafood producer)	Conditions imposed on merger
9	17/2011	NBI's (Landsbanki, commercial bank) takeover of Pizza Pizza ehf. (fast food).	Conditions imposed on merger
10	18/2011	Regin's (subsidiary of Landsbankinn) takeover of Laugahús (real estate).	Conditions imposed on merger
11	20/2011	Arion bank's (commercial bank) and Búvellir's (holding company) joint control over Hagar (retailer)	Conditions imposed on merger
12	26/2011	Horn fjárfestingarfélag's (subsidiary of Landsbankinn) takeover of Promens hf. (plastics manufacturer)	Conditions imposed on merger
13	27/2011	Merger of Stjörnugrís hf (a piggery) with Braut ehf. And LS2 ehf. (piggery)	Merger annulled
14	28/2011	Landsbankinn's (commercial bank) takeover of Sólning ehf (tyre services)	Conditions imposed on merger
15	31/2011	Merger of Tal and Vodafone (telecommunications)	Merger voided
16	34/2011	Landsbankinn's (commercial bank) acquisition of shares in Verdis hf. (securities back office)	Merger voided
17	41/2011	Landsbankinn (commercial bank) sells shares in Toyota á Íslandi (car importer)	Conditions imposed on merger

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

#### ***3.1 Resurrection of companies – Profit generators or zombie firms?***

19. In June 2011, the ICA issued a detailed report under the heading “*Competition after the collapse*”. The report is based on the ICA’s investigation into the financial position and financial restructuring of 120 large companies in selected competitive markets. Moreover, the report reviews the financial position and development of business sectors since the collapse, assesses whether account has been taken of competition policy in the restructuring of companies and gives a status-report on a plan to open up markets that the ICA put forward in November 2008, shortly after the banking collapse. The report and its findings are described in the ICA’s annual report for 2010 (DAF/COMP/AR(2011)7).

20. In a new report, issued in March 2012 (No. 3/2012) the issue is revisited. In the report the ICA concludes that significant improvements have been made in 2011 in terms of financial restructuring of companies that were debt-ridden following the financial crisis in Iceland. Great efforts have been made on the financial restructuring of firms controlled by the banking system. The restructuring of numerous larger firms is now complete and, in many cases, their sale has been finalised. In the opinion of the ICA, the banks’ control of undertakings has been significantly reduced, although there is still some way to go.

21. Despite this positive development, Icelandic firms are still extremely leveraged in international comparison. It is noteworthy that the debts of firms that have completed their restructuring remain quite high. Approximately a third of the managers of larger Icelandic firms that have been sold and restructured consider that their firm cannot meet its current debt obligations, or that it is unclear whether it can meet such obligations.

22. The ICA is of the opinion that there are numerous risks posed by leveraging companies too highly. Undertakings that are highly leveraged can neither provide competitive restraint nor operate efficiently in the market. There is a risk that such companies decide the price of their goods or services in accordance with their poor debt position, if at all possible. This risk of this becomes ever greater the less the competition in the market in which the firm operates and the greater the market share it has.

23. It is important that the debts of companies that have a sound operating basis are adjusted to their payment ability and their ability to return a profit. A healthy economy is the foundation by which the growth and development of the banks must inevitably be governed. An over-leveraged business sector, therefore, benefits neither the long-term interests of the banks nor the economy.

24. In the near future, the ICA plans to direct its attention to two aspects in connection with its monitoring of company restructuring; on the one hand monitoring the profitability goals of firms controlled by the banks and, on the other, ensuring that the banks’ actual control of firms is transparent. Requirements for profitability are intended to reduce the risk of banks funding costly marketing efforts that make it possible for the overtaken company to grab an increased market share in the market in question, and maybe even drive its competitors out of business.

25. The ICA has recently been examining several cases where bank control of companies, according to competition legislation, is considered to have developed. This is a particularly important question at present in light of the high leverage of companies and the ability of banks to have an impact on the operation of undertakings through terms in loan agreements and provisions for calling in debts.

#### ***3.2 Competition in the financial market***

26. In April 2011 the ICA issued a consultation paper on competition in the banking market. The paper identifies increased concentration in the market with fewer competitors, and HHI (Herfindahl

Hirschman Index) close to 3000 points, as compared to 2000 points before the banking collapse in 2008. The paper also identifies considerable barriers to entry into the market and elaborates on the need to use opportunities in the midst of the restructuring of the market, to make entry to the banking market easier and to decrease the cost for customers of switching between banks.

27. With this in mind, the ICA has allocated considerable resources into the financial market. Table 3 represents an overview over significant cases that have dealt with competition concerns in the financial market.

**Table 3: Significant decisions and investigations in the financial market since the banking collapse in 2008**

<b>Cases</b>	<b>Findings</b>	<b>Decision no.</b>
Around 30 merger investigations, where banks are taking over companies in distress	Conditions imposed in order to safeguard competition	Numerous decisions
3 merger cases where resolution committees have taken over operating commercial banks	Conditions imposed in order to safeguard competition	48,/49/2009 and 36/2010
7 decisions where commercial banks have been given room to work together on specific issues dealing with solutions for financially distressed households and undertakings	Detailed conditions on the implementation and supervision of the collaboration, as well as time limits.	4/2010
The Central Bank's acquisition of Greiðsluveitan hf. (credit- and debit cards transactions).	Conditions imposed on merger	2/2010
Islandsbank's takeover of Byr (formerly a savings bank)	Merger subject to the failing firm doctrine	33/2011
Landsbank's (commercial bank) acquisition of shares in Verdis hf. (securities back office)	Merger voided	34/2011
Investigation on the banks' collaboration through RB ehf. (the banks' data center)	The case settled upon detailed conditions, in order to diminish barriers to entry and safeguard competition	To be published
Investigation on the RB's takeover of Teris (IT-firm jointly owned by the savings banks)	Settled as a part of the aforementioned case	To be published
Investigation on the possible abuse of a collective dominant position of the three biggest commercial banks	In process	
Investigation on the possible abuse of a dominant position of Valitor (credit card company)	In process	
Investigation on possible collusion between credit card issuers	In process	

### **3.3 Price trends and competition in the groceries market**

28. In 2011 the ICA conducted a thorough analysis of price trends and competition in the groceries market. The findings were issued in a report (No. 1/2012) in January 2012.

29. Grocery prices in the retail market have risen almost 60% during the six-year period from the beginning of 2006 to the end of 2011. Supplier prices for these goods have developed in a similar manner. A comparison of the development of grocery prices, currency indexes and production indexes for foods and beverages, indicates that this price increase can first and foremost be attributed to external conditions and particularly to the collapse of the exchange rate of the króna in 2008. This is not to say, however, that the above rise in prices was normal and inevitable in all cases, as more dynamic competition in both the supplier and the retail sectors could have led to greater economy and lower prices than is the case.

30. The Competition Authority's investigation indicates that there are considerable entry barriers to the grocery market. The root of these barriers can be traced to the different terms that suppliers offer grocery retailers. Three large retail groups; Hagar, Kaupás and Samkaup, have a market share of approximately 90%. Shops that are not members of these retail groups pay suppliers a significantly higher price for goods, i.e. a price that is on average 15% higher than the largest retail group, Hagar, pays to suppliers. Other shops would, therefore, enjoy very small margins from their sales if they tried to match the price offered by the discount supermarkets within the larger retail groups. In several product categories the lowest retail price offered by the discount supermarkets is in fact lower than smaller outlets pay to suppliers.

31. Other retailers, therefore, have to compete on the basis of aspects other than price to attract customers, such as a beneficial mix of price policies, services, range of goods and location. Such diversity in the range of grocery stores can certainly be advantageous for consumers. The problem posed to other shops, however, lies in the increased strength of discount supermarkets, as their share in the total turnover of the groceries market has risen from approximately 20% in 1999 to approximately 63% in 2010. Other shops that do not enjoy comparable supplier business terms as those enjoyed by discount supermarkets have, therefore, limited opportunity to engage in price competition in the largest and growing part of the market.

32. There are a number of reasons that can justify suppliers offering different business terms to retailers. Thus it is natural that large retail chains enjoy bulk discounts. Bónus, for example, buys six times the average volume that retailers buy of common goods and 75 times more than the volume purchased by the smallest retailer. Efficiency in distribution systems is also important in this respect. This argument applies to a lesser degree in cases where suppliers deliver directly to shops and, in some cases, are responsible for stocking shelves and arranging the goods.

33. It is unlikely that the terms suppliers offer to retail outlets are in all cases based on objective reasons. In many cases suppliers will find it difficult to prove this as many of their business terms agreements are not in writing. It is particularly important that suppliers consider whether the different prices offered to retailers are the result of normal volume efficiencies or competition restrictive buyer power. Abnormal pricing may also constitute a violation of Article 11 of the Competition Act if the supplier is market dominant. The Competition Authority encourages suppliers to examine their pricing policies in this respect, particularly as regards smaller retailers.

34. In January 2012 the ICA held a conference where the aforementioned report and its findings were introduced. Furthermore the report was sent to various interested parties for consultation. The input of that consultation is currently being evaluated and areas of more indepth investigations are being identified.

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

35. The Competition Act, which was initially adopted in 1993, is based upon the Agreement on the European Economic Area. The Act has been amended several times in light of experience and further legislation trends.

36. According to amendments made in 2011, the ICA has powers 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.



37. Following the amendments the ICA has been preparing the application of the new powers. To that end ICA has issued a consultation paper outlining a new type of a market investigation aiming to identify competition restraints and possible remedies thereto. The Authority is currently in the process of taking a decision on which market will be initially investigated.

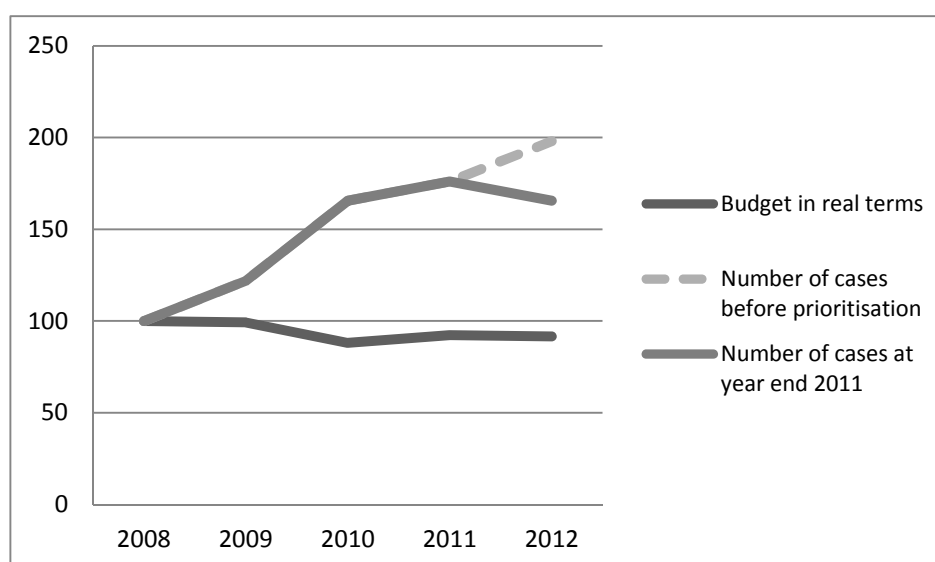
38. According to the same amendments the ICA will from now on be able to bring rulings of the Appeals Committee before the courts. This has not been the case in the past.

## 5. Resources of the Competition Authority

### 5.1 Budget and pending cases

39. The ICA is funded through the state budget. The ICA's budget for 2012 amounts to approx. 2 m. EUR. As the following illustration shows the budget has decreased by 8% since the beginning of the crisis. At the same time the number of pending cases had risen by around 80% in 2011. The ICA has vigorously advocated for a larger budget to better address serious adverse effects to competition in times of crises, but in vain.

**Illustration 1: Ratio of ICA's budget vs. number of pending cases (Index 2008=100)**

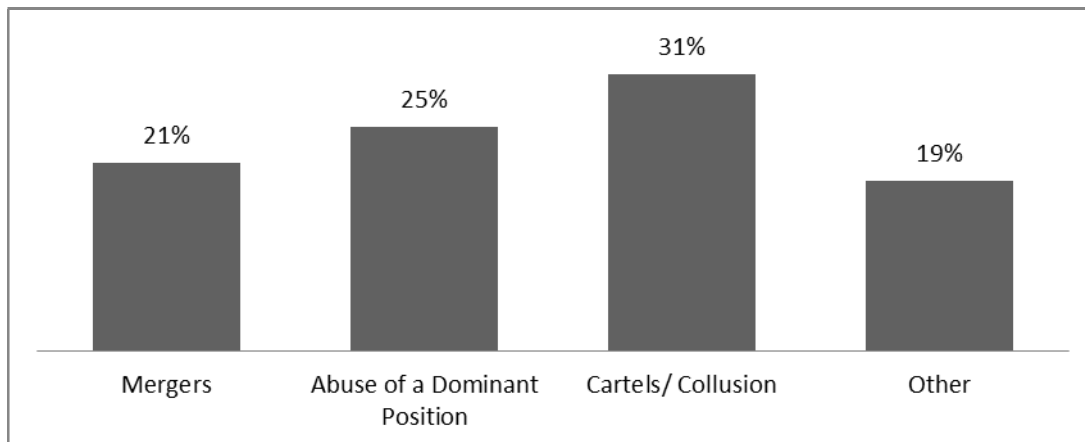


### 5.2 Allocation of resources

40. 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.

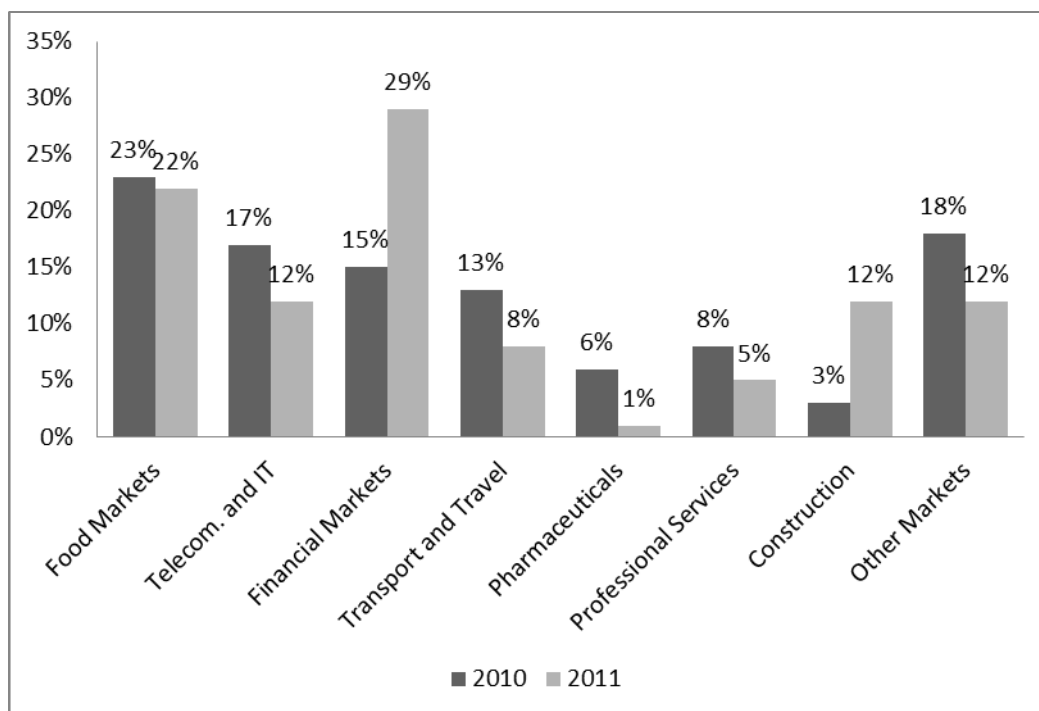
41. As shown in illustration 2, cases dealing with possible abuse of a dominant position are a significant part of the ICA's work.

**Illustration 2: Allocation of resources in 2011 – types of work**



42. As shown in Illustration 3, cases related to financial markets and food markets are at the top of the ICA’s agenda.

**Illustration 3: Allocation of resources in 2011 - markets**



43. The employees of the ICA at year-end 2011 were 23.