

Summary

The preliminary findings of the Icelandic Competition Authority (ICA) conclude that there are circumstances and conduct in the fossil fuel market that harm competition to the detriment of public interests. At this stage of the investigation, it is the opinion of the Authority that it is necessary to apply remedy, or remedies, to encourage increased competition to the benefit of the public.

Importance for homes and the economy

Fuel is important for all forms of manufacture and thereby the Icelandic economy. Active competition in the fossil fuel market, therefore, can have considerable and positive effects on the nation's economy and Iceland's competitiveness. Almost all transport vehicles use fossil fuels as a source of energy, as do important sectors such as the fishing industry. The significance of the market is of great importance to consumers but Icelandic households spent approximately ISK 45bn on fuel in 2012. Fuel costs, moreover, comprise a major proportion of the expenses of many sectors. Oil purchases for the fishing fleet, for instance, amounted to 13.7% of their operating expenses in 2013, and the cost of fuel for Icelandair was 28% of its expenses during the same year.

Market developments

The fuel sector in Iceland was deregulated in 1991–1992. The basic premise for deregulation was that instead of government intervention in prices and import agreements, competition in the market was to wholly ensure the interests of consumers and other customers of the fuel companies. The fuel companies (at the time, Olís, Skeljungur and Olúfélagið) responded with engaging in an illegal cartel, a conduct which lasted to the end of 2001. Once the cartel ended, a period of competition ensued with the establishment of Atlantsolía having a positive effect thereto. The preliminary findings of the ICA, however, indicate that competition has decreased in the sale of road fuel (petrol and diesel) in recent years. There are indications that competition is more active in sales to major users.

Market structure, operating companies and delimitation of the investigation

The Icelandic fuel market can be roughly divided into the following three stages:

1. Importation and wholesale of fuel.
2. Storage and distribution of fuel.
3. Retail sales of fuel, both at fuel forecourts and directly from fuel tanker trucks / storage tanks to customers.

The main companies operating in the market are as follows:

- Atlantsolía ehf. (hereinafter Atlantsolía)
- Skeljungur hf. (hereinafter Skeljungur)
- N1 hf. (hereinafter N1)
- Olíuverzlun Íslands hf. (hereinafter Olís)
- Olíudreifing ehf. (hereinafter Olíudreifing)

The preliminary report and the competition assessment of the report revolves mainly around the storage of fuel and the retail stage in the sale of road fuels at fuel forecourts, with the underlying investigative period generally being from and including 2005 to and including 2012.

High prices, high mark-ups and misallocation of capital

Road fuel prices in Iceland, excluding taxes and other public levies and taking into account shipping costs and the smallness of the market, is higher than in most other western countries. In other words, the difference between fuel prices is greater than to the extent explainable by greater costs in Iceland, such as the location of the country or climate. In addition, the ICA's investigation shows that the mark-up on road fuel is higher than might be expected even when account is taken of the wholesale mark-up of the companies themselves, retail mark-up of independent retailers in the UK and the actual cost of the companies in purchasing, storage and distribution. Mark-ups of other fuel types (other than road fuels sold at fuel forecourts), however, appears to indicate greater competition between the fuel companies.

An analysis of the profitability of the companies reveals a correlation between profitability and deflated mark-up on fuel. In addition, a correlation can be seen between changes to the exchange rate of the króna and profitability. Thus, it appears that weakening of the Icelandic króna generally leads to better returns for the fuel companies as opposed to when the króna strengthens. When the profitability of the companies is compared with the estimated weighted average cost of capital (WACC), they cannot be seen to have systematically returned excess profits over the past decade. These results may probably be traced to misallocation of capital, as there are a great number of fuel stations in Iceland and their utilisation is poor in international comparison.

Aspects that should normally have an impact on the price decisions of competitors in an active competitive market do not do so in the price decisions of the fuel companies as regards road fuels. Price decisions, therefore, do not appear to take account of the number of competitors, different economies of size, differences in distribution costs, inventory, etc.

The Competition Authority's preliminary assessment

When the conclusions of the competition assessment in Chapter 9 are summarised, it is the preliminary assessment of the ICA that certain circumstances or conduct, described in Chapters 4 to 8 in the report, limit or have harmful effects on competition in the market. In short, the main circumstances or conduct are as follows:

- *Coordination:* There are strong indications that the fuel companies co-ordinate their conduct through tacit collusion in the market for retail sales of vehicle fuel¹. Indications of such coordination can be seen in the fact that prices and mark-up on road fuel, excluding taxes and other public levies, are, as previously stated, quite high in comparison to that in other countries even when account is taken of market conditions and discounts. In addition, analyses indicate that the prices of road fuel tend to better follow increases in import prices than decreases. Moreover, price changes appear to be led by certain entities in the road fuel market, there are relatively little fluctuations in market share and mark-ups in the sale of road fuel in comparison to fuel types sold only to companies. Road fuel prices appear to be extremely sticky, and aspects that should normally have an impact on market prices where competition is active (such as the number of competitors, differing cost of storage and distribution costs) do not appear to do so in the road fuel market.
- *Vertical integration and entry barriers:* The fuel companies (and related companies) operate in all levels of the market (such as importation, storage, distribution, wholesale and retail sales) and are, therefore, all vertically integrated. The investigation shows that they have the incentive and ability to exclude new competitors by refusing to sell fuel on a wholesale basis or prevent their access to storage space. There are also indications that companies have taken advantage of storage space in certain areas to prevent the entrance of competitors.
- *Regulatory framework and implementation by the authorities:* The distribution by Flutningsjöfnunarsjóður olíuvara (Transport Cost Equalisation Fund for Fossil Fuels) of detailed information about the fuel companies' market share is likely to have an adverse effect on competition. The same applies to the opportunity of the companies to have some involvement with the Fund's board. The framework and implementation of planning and land allocation for fuel stations are also likely to harm competition. The Planning Act does not ensure that account is taken of competition assessment in municipal planning and the allocation of land. In addition, Reykjavík City's policies in its municipal zoning plans for the allocation of land for fuel stations is likely to have a detrimental effect on competition in the market.

¹ This means that competitors take mutual account of each other and follow each other in price changes. The co-ordination is tacit in the sense that the transparency in the market allows competitors to monitor each other's changes without having direct or indirect communications. Co-ordination that occurs without direct or indirect contact between competitors is harmful but not illegal. If there are any direct or indirect communications, however, such conduct is regarded as illegal collusion. This preliminary report only takes a position on whether the fuel market shows evidence of tacit collusion. No position is taken as to whether the coordination can, wholly or partly, be traced to direct or indirect communications between the competitors in question. It must be kept in mind, however, that the conduct that appears to be the result of the type of market structure can in fact be the result of direct or indirect communications between competitors. No indications of such violations have been found in this investigation.

Overcharge

The circumstances and conduct that have been assessed and analysed in the preliminary report are of such a nature as to be detrimental to consumers. In the opinion of ICA, the circumstances and conduct lead to a greater number of fuel stations than would otherwise have been the case and to higher road fuel prices. There are also indirect effects, as fuel prices have an impact on the expenses of other producers and thereby on the prices of other goods and services which affects the consumer price index. In the preliminary assessment, the direct overcharge due to higher road fuel prices have been assessed in the following manner:

- Mark-up on vehicle fuel was abnormally high, up to ISK 18, including VAT, per litre of petrol and ISK 20, including VAT, per litre diesel in 2012.
- In 2014, consumers spent ISK 4,000–4,500 million too much for road fuel in retail sales, including VAT, i.e. in comparison with prices as would be expected if the above circumstances and conduct were not evident.
- Increased competition would release forces that would benefit the society, e.g. through the fuel companies' more economical operation which in turn would lead to lower prices for consumers. Thus, one would expect the number of fuel stations in Reykjavík to decrease considerably in an environment of active competition where the stated competition restrictions had been removed.

Possible improvements

On basis of the preliminary assessment of the ICA it is important to react to the following circumstances and conduct that are harmful to competition:

- a. Circumstances and conduct that facilitate coordination in the sale of road fuels.
- b. The incentive and ability of established companies to exclude new competitors by impeding access to wholesale fuel or storage space.
- c. The regulatory framework and implementation by the government that restricts competition.

The ICA considers that it is possible to take actions intended to:

- a. Ensure third-party access to wholesale fuel and fuel storage space. This would create an environment where new competitors could enter the market at less cost and, at the same time, reduce the risk of coordination.
- b. Ensure operational independence of established companies, e.g. by withdrawing joint ventures at the distribution and storage level. This would lessen the interests of the companies to coordinate, and they would be less able to analyse the behaviour of their competitors.
- c. Through the above, and other actions, efforts will be made to encourage independent retailers and, as appropriate, grocery stores, to sell road fuels.
- d. Attention must be paid to official legislative framework and implementation. This includes ensuring that competition is not distorted in the preparation of zoning plans and that changes are made to the operation and arrangement of Flutningsjöfnunarsjóður olíuvara.