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ANNUAL REPORT ON COMPETITION POLICY DEVELOPMENTS IN ICELAND

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This report is submitted by Iceland to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 27-28 October 2015.

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1. Executive Summary

1. The ICA endeavours to base its enforcement as well as its advocacy activities upon well defined competition policy objectives and clear priorities. ICA's current policy objectives are to open up markets for new competition and improve productivity, especially in the domestic services sector.

2. In December 2014, each of the three largest banks in Iceland, together with the two largest payment card companies, reached a settlement with the ICA. These settlements brought significant changes to the payment market, including reduced interchange fees.

3. In March 2015, the ICA issued a report on competition in the groceries market. In the report the ICA identified many obstacles to competition, although some improvements have already been made. The report summarises earlier recommendations and interpretations, concerning competition in the market and the conduct of companies. The compilation also addresses desirable changes in the agricultural sector, advocating for more competition.

4. The ICA has fined two of the largest hardware store chains in Iceland for serious violations of the ban on collusion, i.a for regular, collusive exchange of information on price, inventories, in order to raise prices and fight against price reductions of the so called rough hardwares, such as timber, rockwool and steel.

5. The ICA found that due to the slot allocation arrangements at Keflavik Airport, the incumbent competitor, Icelandair, has enjoyed a de facto priority as concerns the most vital slot times. This also applies to the allocation of new slots that have become available. The arrangement has therefore limited the ability of other competitors to compete with Icelandair. The ICA has informed the Minister of the Interior and the Icelandic Transport Authority of these concerns and requested that this issue be addressed.

6. A possible merger between the ICA, Post and Telecom Administration, the Media Commission and the electricity regulator is currently being considered at ministerial level. The ICA has warned against this, arguing that the merger would unavoidably weaken competition enforcement in Iceland. The other authorities have also raised their concerns.

7. The ICA has had to apply rigorous prioritisation to meet budget cuts. Through prioritisation the ICA has managed to reduce the number of pending cases.

2. Competition policy and priorities in enforcement and advocacy

8. The ICA endeavours to base its enforcement as well as its advocacy activities upon clear policy objectives and well framed priorities. These policy objectives and priorities are reviewed periodically, taking into account budgetary constraints.

9. In the aftermath of the banking collapse the ICA sought to employ the competition rules to speed up economic recovery. With that in mind, the ICA has conducted firm enforcement, delivering the message that businesses should not be allowed to transfer their financial difficulties to their customers through illegal collusion or an abuse of a dominant position. Merger rules have also been used as a vehicle to intervene into bank's acquisitions of failed businesses, with the aim to speed up financial restructuring.

10. With the economy picking up, the ICA has reviewed its policy objectives. In doing so the ICA has taken into account that the domestic services sector in Iceland is lagging considerably behind in terms of productivity, when compared to neighbouring countries. Included in the domestic services sector is wholesale and retail, financial services, and other sectors in the field of service and manufacturing, serving primarily the domestic market.

11. Improved efficiency in the domestic services sector contributes directly to economic growth. Furthermore, it is generally acknowledged that healthy competition is the best stimulator for improved productivity.

12. With this in mind, the ICA's current policy objectives are to open up markets for new competition and improve productivity in the domestic services sector. This means that barriers to entry into markets that are protected from foreign competition should be reduced considerably. Furthermore, many areas in the public sector, such as waste management, health care and education should benefit from competition.

13. These policy objectives are in good conformity with recommendations put forward in the OECD Economic Surveys for Iceland, published in September 2015. In the report the OECD encourages the authorities to set the course for productivity growth, i.a. through competition policy implementation. This is explained in the following manner: *"Despite the recovery, income per capita remains lower than in other Nordic countries and near the OECD average, reflecting weaker productivity. While Iceland has a business-friendly environment, it can be difficult for new firms to enter markets, thus deterring innovation. Due to the small size of the economy, ensuring competition can be a challenge."*

14. Based on its policy objectives, the ICA has prioritised important markets, such as the financial market, groceries and agriculture, construction, the public sector, as well as transportation, which is a sector that affects many areas of the domestic services sector.

15. With these objectives in mind, the ICA has maintained firm enforcement and endeavoured to broaden its advocacy role. Examples of this are described in chapter 3.

3. Delivering the message – examples of enforcement and advocacy

3.1 Financial sector – Significant changes in the payment market

16. In December 2014, each of the three largest banks in Iceland (Arion banki, Islandsbanki and Landsbanki), together with the two largest payment card companies (Valitor and Borgun), reached a settlement with the ICA. These settlements brought closure to an extensive investigation into certain anti-competitive practices in the payment market.

17. In the settlements, each of the banks admitted that the arrangement used for determining interchange fees violated the ban on collusion in Article 10 of the Competition Act and Article 53 of the EEA Agreement. Valitor on the one hand, and Borgun on the other, were given the authority to determine the interchange fees on behalf of the banks in question and this arrangement violated the ban on collusion. In this context Valitor and Borgun were considered to have been associations of undertakings at the time when the violations in question took place.

18. In the settlements, each of the banks admit that the implementation of awarding loyalty points for the use of Icelandic VISA credit cards at Icelandic vendors, violated the provisions of the Competition Act.

19. As a result of these violations, and in order to prevent them from recurring, the parties to the settlements agreed to significant changes as to their operations and arrangements. The main goal is to ensure fair competitive conditions in the field of acquiring services and in the field of card issuing services. Furthermore, the goal is to reduce the risk of conflicts of interest in the operation of financial undertakings in the payment market, and generally to encourage more active competition in the fields of card issuing and acquiring services.

20. This included changed ownership of the payment card companies, not allowing the banks to own the companies jointly. The settlements also establish restrictive conditions as to the involvement of the owner in the operation of each of the payment card companies. Prohibition of any co-ordination of business terms and conditions were also stipulated. Furthermore it was agreed that the payment card companies should make a clear separation between acquiring services and card issue operations within these companies.

21. The settlements also introduced steps to reduce interchange fees. The settlements applied to activities relating to the brands of VISA and MasterCard, which are by far the most common payment card brands in Iceland. According to the settlement, the maximum interchange fee paid to issuers for the use of consumer payments cards may not be higher than 0.20% of the value of each transaction in the case of debit cards and not higher than 0.60% in the case of credit cards. In this respect the ICA took account of regulatory developments taking place in Europe.

22. Due to the violations and for the purpose of creating deterrent effects, the ICA imposed fines on the undertakings amounting to a total of 1.620.000.000 ISK (10.500.000 EUR).

23. This settlement follows a series of interventions into the Icelandic payment card market. In 2013, Valitor, the largest payment card company, was fined for abuse of a dominant position. In 2008, the two largest payment card companies and the operator for electronic payment systems reached settlements with the ICA, admitting to serious violations of the Competition Act. This case is described in an OECD report on Competition and Payment Systems, DAF/COMP(2012)24, page 61-67.

3.2 *Report on the groceries market and the agricultural sector*

24. In March 2015, the ICA issued a report on competition in the groceries market. The report was partly a follow-up of a report from 2012, where considerable barriers to entry into the market were identified. There were indications that these barriers could partly be traced to the different terms that suppliers offer grocery retailers. The ICA found that smaller retailers enjoyed very small margins from their sales if they tried to match the prices offered by larger retailers. The suppliers had in many cases failed to give reasoned explanations as concerned the difference in terms.

25. In the new report the ICA identified that many of the obstacles to competition had prevailed, although some improvements had been made, due to earlier interventions on behalf of the ICA. An intervention in 2008, where the dominant retailer, Hagar, was fined for predatory pricing, is significant in this context. The investigation showed that Hagar's price strategy was designed to exclude competitors from competition. Following the decision Hagar was forced to change its pricing strategy, slowly leading to improved competition conditions.

26. In order to facilitate more changes in the market, the new report compiles earlier recommendations and interpretations, concerning competition in the market and the conduct of companies. The compilation also addresses desirable changes in the agricultural sector, allowing for more competition.

3.3 *Hardware stores - collusion*

27. In July 2014, a former owner of one of the largest hardware store chains in Iceland, Húsasmiðjan, reached a settlement with ICA, admitting to serious violations of the ban on collusion.

28. The violations concerned an extensive illegal collusion with a large competitor Byko. This included i.a:

- Regular, usually weekly, collusive exchange of information with Byko on price, inventories i.a., in order to raise prices and fight against price reductions of the so called rough hardwares, such as timber, rockwool and steel.
- Collusive discussions with Byko with the aim of raising prices on all price offers of hardware in periodic steps.
- Collusion with Byko with the aim of preventing price competition on the market for impregnated timber.
- A joint effort with Byko to convince Múrbúðin, a new competitor on the market for rough hardware, to participate in collusion on hardware prices.

29. The settlement included a fine of 325.000.000 ISK (2.100.000 EUR).

30. As concerns Byko, the ICA reached a decision in May 2015. The ICA concluded that Byko violated the Icelandic Competition Act and the EEA-Agreement with extensive collusion with Húsasmiðjan. The ICA imposed a fine on the parent company of Byko, Norvik, amounting to 650.000.000 ISK (4.600.000 EUR).

31. The decision concerning Byko was brought before the Competition Appeals Committee. In its ruling from September 2015, the Appeals Committee confirmed that Byko had violated the Competition Act but reduced the fines to 65.000.000 ISK (460.000 EUR), as it found the violations not to be as serious as the ICA had concluded. An appeal to the District Court is now being considered on behalf of the ICA.

32. The Special Prosecutor has, simultaneously with the investigation of the ICA, investigated the alleged breaches of certain employees of the undertakings based on a complaint from the ICA. According to the Competition Act such breaches are to be investigated by the police when the ICA has reported the breach. Earlier this year the Special Prosecutor prosecuted certain employees of the undertakings. The District Court acquitted 11 employees and convicted one employee for violation of the ban on collusion. The case has been appealed to the Supreme Court.

3.4 Slot allocation at Keflavik Airport

33. Air transport is of vital importance for the Icelandic economy and consumers. The geographical position of the country means that other means of transport to and from the country are not a feasible option for most passengers. Therefore all constraints or hindrances to competition in this field can be very harmful. Similarly, active competition in this field can improve the living standard of the public and strengthen the Icelandic economy in many ways.

34. For this reason the Icelandic Competition Authority (ICA) has repeatedly investigated the conditions for competition in markets that are related to air transport. These investigations have mostly concentrated on the behaviour and the market position of Icelandair ehf. (hereafter Icelandair), the largest Icelandic airline, and the actions of the Icelandic aviation authorities and the operators of Keflavik Airport, the most important international airport in Iceland.

35. In August 2013, the ICA instructed Isavia, which operates Keflavik Airport, to ensure that a new competitor, WOW Air (complainant) would be given access to vital airport slot times, to be able to compete on the market. The ICA found that due to the allocation arrangements at the airport, the

incumbent competitor, Icelandair, enjoyed a de facto priority as concerns the most vital slot times. This also applied to the allocation of new slots that had become available due to changes being made to the airport building. The system had therefore limited the ability of other competitors to compete with Icelandair and hence damaged competition in an important market. This case is described in detail in a report to the OECD Competition Committee, [DAF/COMP/WD\(2014\)45](#), *Airline Competition – Note by Iceland*.

36. The decision was brought before the Competition Appeals Committee. In its ruling, the Appeals Committee annulled the ICA's decision, on the grounds that the ICA should have directed the case towards the airport coordinator. The Committee found that the airport coordinator, which is a Danish employee at Airport Coordination Danmark (ACD), had been given administrative powers to allocate slots at Keflavik Airport in an independent manner.

37. The case was subsequently brought before the courts on behalf of the complainant. In the proceedings the EFTA-Court handed out an advisory opinion, answering certain questions regarding interpretation of EEA-law. In the court's ruling from December 2014, the court came to the conclusion that the ICA's interventions may neither be directed to the coordinator, nor to the airport managing body. On the other hand the ICA could reallocate slots in a case directed at the undertaking concerned, in accordance with national or EEA competition Law.

38. Following these proceedings, the ICA has now issued a reasoned opinion directed to the Minister of the Interior and the Icelandic Transport Authority. In the opinion the authorities are asked to reconsider the allocation arrangements at the airport, taking into consideration the competition obstructions identified by the ICA. The ICA furthermore proposes that the authorities should base their revision on the approach provided for in the OECD Competition Assessment Toolkit. The opinion was issued on 22 October 2015.

4. Possible changes to the institutional design of the ICA

39. On behalf of the Ministry of Industries and Innovation, responsible for competition, and the Ministry of the Interior, changes to the institutional design of the ICA are being considered. The Ministries are considering the feasibility of merging the ICA with the Post and Telecom Administration, the Media Commission and the electricity regulator.

40. All the agencies involved have warned against such a merger. In the case of the ICA, the institutional design is of utmost importance, given the difficult competition environment in Iceland. In 2005 the legislator changed the institutional design to become a single functional one, with an authority which is solely responsible for competition. The goal of the changes was to strengthen the competition enforcement and enhance the effectiveness of the ICA.

41. In December 2014 the OECD Competition Committee held a roundtable on changes in institutional design of competition authorities. In a paper presented by the ICA on that occasion ([DAF/COMP/WD\(2014\)94](#)), the ICA argues that the move in 2005 from a multifunctional design towards a single functional one, has made competition enforcement and advocacy more effective in Iceland. The fact that the ICA is "solely" responsible for competition enforcement and advocacy, has enabled a very clear goal-orientation, which in return has facilitated prioritisation and made the Authority well equipped to tackle changes in the economic environment. The institutional design has enabled the ICA to put its weight on the most important tasks at any given time, and by that facilitate quality decisions and active advocacy and guidance. The prerequisite for quality decisions is the ability to attract and maintain high-level expertise. The current institutional design has served as a basis for success in this regard. The ICA has also been able to use its focus and goal orientation to prioritise cases with the aim to improve the length of procedures.

42. It is estimated that the ICA’s interventions after the changes, on the basis of the prohibition rules of the Competition Law, has brought economic benefits that amount to almost 650 m EUR, or 0,6% of GDP pr. year (calculations from 2014). Merger interventions and other work, such as advocacy, are not included.

43. In the paper the ICA reiterates the importance to ensure the independence of competition authorities, in order to prevent undue political influence and influence by the business community. This is even more important in a small society. The institutional design of the ICA contributes to a certain level of independence.

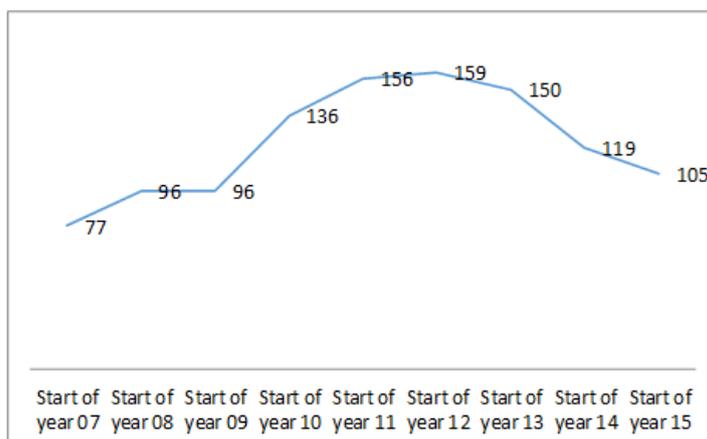
44. In discussions in the OECD Competition Committee, the ICA presented its view that the OECD should play an important role in safeguarding the independence of competition authorities and make sure that decisions on the institutional design of authorities are well grounded. With that in mind the OECD Competition Committee should develop principles or best practices for reviewing the institutional design of competition authorities. These principles should include a definition of independence in this context and instructions on the minimum level of independence of competition authorities. Furthermore, the principles should include minimum standards on how to prepare decisions on institutional design of competition authorities, in order to ensure that such decisions are based on objective assessments.

5. Resources of the Competition Authority

5.1 Budget and pending cases

45. The ICA is funded through the state budget. The budget for 2015 amounts to approx. 2,7 m. EUR. Since the banking collapse in 2008, the ICA has had to apply rigorous prioritisation in response to budget cuts. Through that prioritisation the ICA has managed to decrease the number of pending cases, as shown in figure 2. The number of cases is approximately the same as before the economic crisis.

Figure 2: Number of pending cases

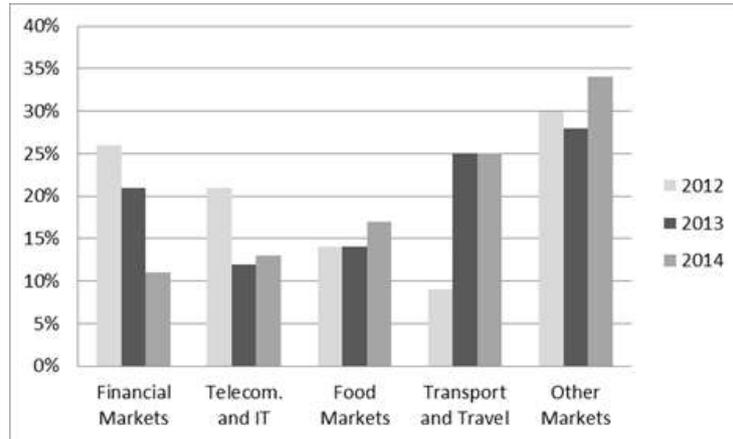


5.2 Allocation of resources

46. The ICA keeps track of and manages the allocation of employee’s work as regards various areas of responsibilities. The breakdown is based on time measurement.

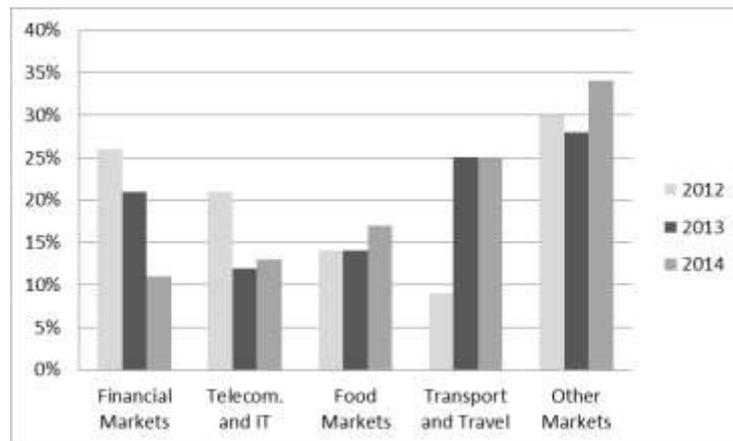
47. As shown in figure 3, cases dealing with possible abuse of a dominant position and collusion are a significant part of the ICA’s work.

Figure 3: Allocation of resources – types of work



48. As shown in Figure 4, time allocated to the financial and the telecom markets have decreased. It is estimated that time allocated to financial markets may increase again. Focus on telecom markets will decrease due to better competition environment.

Figure 4: Allocation of resources - markets



49. At the end of the year 2014 23 employees were working at the ICA.