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ANNUAL REPORT ON COMPETITION POLICY DEVELOPMENTS IN ICELAND

-- 2009 --

This report is submitted by Iceland to the Competition Committee FOR INFORMATION at its forthcoming meeting to be held on 16-17 June 2010.

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1. Executive Summary

1. The Icelandic Competition Authority (ICA) considers vigorous enforcement of competition laws to be the proper reaction to a financial crisis, and has acted accordingly.

2. Record number of cases are being processed. Nine dawn raids have been carried out from the beginning of 2009 to present date.

3. Since the banking collapse in the autumn of 2008 the ICA has fined ten companies a total of approximately 4,9 million EUR. Among the companies fined is the largest retailer in Iceland, two of the largest telecommunication companies, and one of the two largest pharmaceutical retailer-chains.

4. From the beginning of 2009 to present date the ICA has annulled or prevented four mergers and imposed conditions on eleven.

5. The ICA has established detailed conditions for banks' ownership of commercial undertakings increasingly taken over by banks because of serious financial difficulties. The ICA has addressed the fact that banks as providers of financial services can have adverse effects on competition when acting as owners of undertakings. Therefore they have to sell the undertakings within a specific timeframe and meanwhile address the ownership at an arms length basis, according to the aforementioned conditions.

6. In times of crisis, advocacy plays a significant role in the enforcement of competition law. Since the banking collapse in October 2008, the ICA has issued several opinions and reports and been active in discussions on competition policy. This work has mainly been pointed at issues related to bank's takeovers of commercial undertakings and ways to reduce barriers to entry and facilitate economic recovery.

7. Despite the heavy work-load the ICA, of 22 employees, suffers serious budget cuts.

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

2.1 Abstract

8. While the ICA was fairly busy in the period leading up to the collapse of the banks, the strain has increased considerably as a result of the collapse. In this context it should be underlined that the ICA considers vigorous enforcement of competition laws to be the proper reaction to a financial crisis, and has acted accordingly.

9. The ICA published 49 decisions on its website in 2009. The number of decisions published on the Authority's site, however, does not reveal the full picture. For instance, from the collapse of the banks at the beginning of October up until the end of 2009, the ICA worked on approximately 300 cases. Of these, approximately 130 cases were still under investigation at year-end 2009. Never before have so many cases been processed at the same time.

10. The Competition Appeals Committee has been kept very busy since the collapse of the banking sector. The Committee has never made as many rulings as in 2009, when it made 19, as compared to 11 in 2008. The same may be said about initiated court proceedings.

11. The ICA carried out four dawn raids in 2009 while none were carried out in 2008. One of the raids involved the suspected abuse of a dominant position and three involved suspected collusion. One of the latter cases also involved violation of a previous decision issued by the ICA. Three dawn raids have been carried out in the first half of 2010.

2.2 *Fines imposed*

12. Since the banking collapse in the autumn of 2008 the ICA has fined ten companies a total of approximately 4,9 m EUR. The most substantial fines for abuse of dominant positions were imposed on the largest retailer in Iceland, *Hagar*, the largest telecommunications company, *Síminn hf.*, and one of the two largest pharmaceutical retailers, *Lyf og heilsa*, that company being in a joint dominant position with another large pharmaceutical company. The largest fine for collusion was imposed on the second largest telecommunication company in Iceland, *Og Vodafone*, the case also dealing with a violation of a previous merger decision.

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

Table 1: Fines imposed by the ICA since the banking collapse in October 2008 to present time

	Decision	Company	Nature of infringement	Fines (EUR)*	Appeals Committee
1	4/2010	Lyf og heilsa (pharmaceuticals)	Abuse of a dominant position	950.000	
2	41/2009	Síminn hf. (telecom. company)	Abuse of a dominant position	952.000	315.000
3	37/2009	Eignarhaldsfélagid Fengur ehf. (holding company)	Violation of prohibition to implement merger	63.4000	Not appealed
4	27/2009	Teymi hf. (telecom. company)	Collusion and violation of a previous decision issued by the ICA	393.500	Not appealed
5	23/2009	Sena ehf. (entertainment industry)	Violation of prohibition to implement merger	84.000	84.000
6	22/2009	Hagar hf. (retail, groceries)	Violation of prohibition to implement merger	112.000	112.000
7	14/2009	Vélar og verkfæri ehf. (key systems)	Abuse of market dominant position	89.400	59.600
8	9/2009	Farmers Association of Iceland	Collusion within association of enterprises	56.600	42.500
9	5/2009	Federation of Icelandic Trade	Collusion within association of enterprises	6.800	Not appealed
10	64/2008	Hagar hf. (retail, groceries)	Abuse of a dominant position	2.206.000	2.206.000
				*(Euros at time of decision)	4.916.000

2.3 *Merger interventions*

14. In 2009, the ICA made over 20 decisions regarding mergers as compared with just under 40 decisions on mergers in 2008. This, however, does not reveal the full picture; although the number of merger decisions has decreased compared with previous years, the ICA has never intervened in as many mergers as in 2009. From the beginning of 2009 to present date the ICA has annulled or prevented four mergers and imposed conditions on eleven mergers. Interventions in mergers have continued in 2010, as special attention has been paid to banks taking over commercial undertakings (see chapter 2.4)

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

Table 2: Mergers in 2008 and 2009 which the ICA considered detrimental to competition

	Decision	Mergers	Conclusion
1	15/2010	Íslandsbanki's, Landsbanki's and Arion banki's (banks) joint takeover of Reitir (real estate management)	Conditions imposed on merger
2	16/2010	Íslandsbanki's (bank) takeover of Bevis (car rental)	Conditions imposed on merger
3	10/2010	Landsbanki's (banki) takeover of Húsasmíðjan (hardware stores)	Conditions imposed on merger
4	8/2010	Íslandsbanki's (bank) takeover of B&L and IH (car dealership)	Conditions imposed on merger
5	6/2010	Arion banki's (bank) takeover of Hagar (retailer)	Conditions imposed on merger
6	7/2010	Landsbanki's (bank) takeover of Teymi (telecom. and IT)	Conditions imposed on merger
7	48/2009	Glitnir Bank hf. (resolution committee) takeover of Íslandsbanki (one of three biggest banks in Iceland)	Conditions imposed on merger
8	49/2009	Kaupthing Bank hf. (resolution committee) takeover of Arion banki (one of three biggest banks)	Conditions imposed on merger
9	40/2009	Merger of Kaupfélag Skagfirðinga svf. and Mjólka ehf./Eyjabú ehf. (dairy industry)	ICA not permitted to intervene due to legislation applicable to agricultural goods
10	33/2009	Íslandsbanki's (bank) takeover of Icelandair Group (airliner)	Conditions imposed on merger
11	30/2009	Merger of Geysir Green Energy and HS Orka (geothermal power companies)	Conditions imposed on merger
12	20/2009	Merger of Hagar hf. and BT verslana ehf. (retail)	Merger cancelled due to initial findings of the ICA
13	15/2009	Myndform's (cinema company) purchase of a 50% shareholding in Thrijúbíó ehf. (cinema)	Merger voided
14	12/2009	Merger of Sena ehf. and Skífan ehf. (entertainment industry)	Conditions imposed on merger
15	6/2009	Merger of Árvakur hf., Fréttablaðið ehf. and Pósthúsið ehf. (newspaper; edition, printing and distribution)	Merger voided
16	3/2009	Valitor's (VISA Iceland) acquisition of all shares in Euro Refund Group North á Íslandi ehf. (tax free refund)	Merger voided

2.4 Banks' takeovers of commercial undertakings

16. In 2009, particularly in the latter part of the year, there was considerable debate on bank takeovers and the competitive position of undertakings. Various complaints and recommendations were received by the ICA. At the same time, the Authority was taking decisions and investigating a large number of company takeovers executed by banks. For this reason, the ICA issued a discussion paper in December 2009 on banks and company restructuring. The discussion paper covers the debt problems of Icelandic companies and competition issues relating thereto and puts forward core views that the ICA considers should be kept in mind during the reorganisation of commercial concerns. The discussion paper was sent to a large number of entities for comment. The Authority received a number of useful reviews which have been of use in investigations into company takeovers executed by banks.

17. Among the views stated in the paper, the following may be mentioned:

- First, the ICA is of the opinion that only companies that have a reasonable hope of successful operation should be assisted, and that resurrecting or keeping uneconomic companies in operation should be avoided.

- Second, it is to the advantage of consumers and the economy as a whole that banks write off debts or otherwise reduce the debt burden of going concerns. The application of competition legislation should not prevent this.
- However, it is important that banks and holding companies operating on their behalf make clear profitability demands of reorganised companies and maintain such demands to the fullest extent. If such views are not followed, there is a risk that debt relief will be used for market advancement without being supported by realistic criteria.
- Moreover, it is necessary to minimise the risk of too much debt burden being fished out of consumers' pockets in the form of higher prices.
- Furthermore, banks should sell restructured companies as soon as possible in as transparent a sales process as possible. Listing them on an exchange would be a good option.

18. Some of these opinions were put forward without taking into account whether the ICA would be able to follow up on them on the basis of competition legislation. In January 2010, however the Competition Appeals Committee issued a ruling that provides the ICA with increased scope to establish a binding framework for company restructuring. In the ruling, the authorisations of the ICA for intervention in the takeover of Teymi by Vestía (a holding company operated by Landsbankinn) were interpreted in a wider sense than the Authority believed was allowed. Thus the Appeals Committee took account of the unusual conditions in competition markets and the status of the banks in that context. It came to the conclusion that the ICA was authorised to establish conditions in the case that ensured the independence of the company vis-a-vis the bank and that its sale should take place within a reasonable time.

19. The ICA has subsequently established detailed conditions for the banks' ownership of specific companies based on the previously described discussion paper and the ruling of the Appeals Committee. These conditions are stated in decisions issued in each merger case (see table in chapter 2.3). More decisions will be forthcoming.

20. The three banks and the entities acting on their behalf have shown the ICA full co-operation in the formulation of these conditions. Thus they have to date agreed to all the conditions that the ICA has believed necessary for allowing the takeovers. The conditions consist of rules that the banks have undertaken to follow, subject to government fines in the event of deviations from the rules.

21. The competitive effects of bank ownership on a commercial concern is evaluated in each individual investigation. Nevertheless, the rules established are similar from one company to another and the same basic views are used as a foundation.

22. When establishing the rules, the ICA has kept in mind that companies that are taken over by the banks should not stop competing or reduce their competitive efforts. This would be detrimental to customers and public interests. On the other hand, it must be ensured that the ownership of the banks does not lead to harmful disruptions to competition as a result of the unusual circumstances now present in the Icelandic economy. In other words, the role of banks as owners of commercial companies accords poorly with their traditional role of providing financial services to such companies.

23. The competitive problems may be summarised in the following manner:

- There is a certain risk that at the long-term bank ownership of a commercial company is detrimental to competition.
- There is a risk that sensitive operating information about a company in a business relationship with a specific bank could be communicated to a competitor owned by the bank.

- A bank may have a vested interest in having a company subjected to a takeover direct its business to other companies in which the same bank has vested interests, thereby excluding competitors from important business.
- A bank may discriminate against its customers by granting companies controlled by the bank better business terms without there being reasonable causes to do so.
- A bank may be tempted to fund the continuously loss-making operation of a company that has been taken over, e.g. for the purpose of increasing or maintaining market share.
- Finally, mention should be made of the moral hazards facing managers and employees of a commercial company that has been taken over, which might stem from the bank's ownership of the company. The problem lies in the fact that employee and management incentive to run the company responsibly can decrease if the people in question believe that a financially strong entity, such as the bank, will come to the rescue if risky plans fail.

24. With the rules that the ICA has established, an effort is made to limit or remove these competition problems. This is done by various means:

- First, the commercial company that has been taken over should be sold by the bank within a specified time limit. On evaluating this aspect, there is conflict between the view of selling a company as soon as possible to limit competition disruptions and the view of ensuring that the bank has reasonable scope to increase or maintain the value of its assets. Sales deadlines differ according to circumstances in each case. Such deadlines are confidential because, if made public, they could have an unnatural effect on the sales process and price.
- Second, the bank must ensure that the company that has been taken over operates as an independent competitor in the market. This is done, among other things, by appointing an independent holding company owned by each bank to operate the undertaking in question. The premises of the holding company may not be located on the bank's premises. Moreover, conditions are set for membership on the boards of the said holding companies and the commercial concerns in question. Among other things, the majority of the board members of the holding companies or the commercial concerns must be independent of the banks.
- Third, the bank is under obligation to impose reasonable demands for profitability on the commercial company in question. This is important to prevent banks from seeing it as in their interest to increase the value of companies subjected to a takeover by funding dumping bids or increasing market advances and thereby increasing the market share of the company in question. These conditions are also intended to limit the afore mentioned moral hazards.
- Fourth, the banks are prohibited from initiating business relations between companies subjected to takeovers and other companies in which the banks own a shareholding. Thus, an effort is made to prevent companies that have been taken over and other companies connected with the bank from diverting business to each other without reasonable criteria for business terms being used as reference.
- Fifth, the banks are prohibited from initiating business relations between companies that have been taken over and the customers of the banks. Moreover, it must be ensured that the same entities within each bank are not key account managers of, on the one hand, the company that has been taken over and, on the other, the customers or competitors of that company. Furthermore, it must be ensured that sensitive information does not flow between these companies.
- Sixth, transparency in the operation of companies that have been taken over must be ensured. Thus the annual financial statements and six-month financial statements of a company that has

been taken over must be made public. Moreover, diverse information on the operation of holding companies and the companies taken over must be made public, together with information on the implementation of the conditions.

- Seventh, comprehensive and ongoing monitoring within the banks as regards the implementation of the conditions must be carried out, as must regular reporting to the ICA. This monitoring is in addition to the general monitoring that the ICA uses to ensure that companies comply with competition legislation and established conditions.

25. The ICA expects the banks to ensure compliance with the rules. Likewise the ICA expects market entities to keep a watchful eye on compliance. It is possible to send the ICA suggestions and complaints if appropriate. If the rules are violated, the ICA will respond to such violations with the tools it has at its disposal, such as administrative fines as appropriate.

3. Advocacy in times of crises

26. In times of crisis, advocacy plays a significant role in the enforcement of competition law. Since the banking collapse in October 2008, the ICA has issued several opinions and reports and been active in discussions on competition policy. A few opinions and reports are outlined below.

3.1 *Formal opinion on decisions of Banks Concerning Commercial Undertakings.*

27. In the present circumstances in Iceland, the commercial banks, and in particular the three largest banks, play a key role in the country's economic progress. Immediately after the collapse of the banking sector, it was clear that these banks would more or less control whether companies survived or not, and thereby have a substantial effect on the development of competitive markets in a number of economic sectors.

28. To address this issue, the ICA issued a formal opinion, No. 3/2008, as early as the beginning of November 2008, where banks and public authorities making significant decisions affecting competition were asked to produce a competition impact assessment, taking into account the long-term interests of the public and the economy, in order to ensure the continued survival of active competition in the greatest possible number of markets in Iceland.

29. The formal opinion was included in the government's initial strategy to deal with the crisis and has served as a useful tool to advocate for competition.

3.2 *Report on opening of markets and strengthening of economic activities*

30. In November 2008 the ICA published a detailed report (No 2/2009), *Vigorous development – the opening of markets and strengthening of economic activities*. The report emphasises ways to combat barriers to entry and barriers to expansion. The ICA takes the view that fighting/combating such barriers under the present circumstances will lead to many benefits for society. In the report 15 markets are analysed, identifying the main obstacles that new undertakings or smaller undertakings face when they begin operations or attempt to further establish themselves. Moreover, actions are pointed out that could remove these obstacles or reduce them.

31. In the beginning of 2009 the ICA received many remarks and suggestions regarding the assessment put forward in the report. Subsequently the report was updated in June 2009. The Authority has followed up on many of these recommendations and suggestions, see for example formal opinions described in chapters 2.3 – 2.5. However, a great deal of work has yet to be done in this respect.

3.3 *A discussion paper on banks and company restructuring*

32. As mentioned in chapter 2.4, the ICA issued a discussion paper in December 2009 on banks and company restructuring. The discussion paper covers the debt problems of Icelandic companies and competition issues relating thereto and puts forward core views that the ICA considers should be kept in mind during the reorganisation of commercial concerns. The discussion paper was sent to a large number of entities for comment. The Authority received a number of useful reviews which have been of use in investigations into company takeovers executed by banks.

3.4 *Formal opinion, Competition Impact Assessments*

33. In late 2009 the ICA issued a formal opinion directed at the Prime Minister, concerning competition impact assessments. In the opinion (No. 2/2009) the ICA stresses the need to assess the impact on competition when new laws and regulations are prepared and introduced. The ICA proposes a certain method to facilitate this.

3.5 *Formal opinion, Regional Development, Allocation of Lots and Impact on Competition*

34. In late 2009 the ICA issued a formal opinion (No. 3/2009) directed at ministries and municipalities concerning regional development and allocation of lots. In the opinion the ICA offers guidance concerning the impact of regional development and allocation of lots on competition, and stresses the need for authorities to take competition issues into account at the early stages of preparation.

3.6 *Formal opinion, Public Procurement, Competition and Distortions to Competition*

35. In December 2009, the ICA issued a formal opinion (No. 4/2009) dealing with the usefulness of public procurement in order to allocate funding wisely and the need to prepare public procurement in such a way that it helps competition. Furthermore the opinion offers guidance as to how to detect bid rigging.

3.7 *Report of the Nordic Competition Authorities: Competition Policy and Financial Crises – Lessons Learned and the Way Forward.*

36. The Nordic Competition Authorities have used their close and traditional co-operation in order to formulate their strategies in the current financial crisis. In September 2009, the Nordic competition authorities published a joint report on what has been learned from economic depressions from their viewpoint and what should be their common policy on points of focus. The report stresses the need for vigorous enforcement of competition laws under the current circumstances. The report was introduced at a joint press-conference in Reykjavík, in connection with the annual meeting of the Nordic Competition Authorities, held in Iceland in September 2009.

3.8 *Formal opinion, Harmful Consolidation in the Dairy Industry*

37. According to Icelandic laws the ICA is excluded from conducting merger review in mergers between undertakings in the dairy industry. Following such a merger, the ICA issued a formal opinion (No. 1/2009) directed at the minister of agriculture, outlining the distortive effects of the merger to competition and requested changes to the pertinent legislation.

4. *Changes to Competition Laws and Policies*

38. The Competition Act was initially adopted in 1993. The Act was to a certain extent based upon the Agreement on the European Economic Area. The Act has been amended since in light of experience and in light of further legislation trends within the European Economic Area.

39. Further amendments of the Competition Act are currently being discussed in the Parliament. According to the bill of law, three main changes are being proposed:

- Powers similar to those of British competition authorities, to brake up companies without having to prove actual breaches of the competition law. This is considered necessary in order to deal with the difficult competition environment in Iceland.
- The ICA will be able to bring rulings of the Appeals Committee before the courts. According to existing law only those who oppose the ICA and the Appeals Committee can bring a case before the courts.
- Those who bring cases to the Appeals Committee will have to pay a moderate fee. No fees are charged according to the present law.
- A moderate merger notification fee is being introduced for the first time.

5. Resources of the Competition Authority

5.1 Budget and human resources

40. The ICA is funded through the state budget. The ICA's budget for 2010 amounts to approx. 1.8 m. EUR, and suffered 10% budget cuts compared to the budget of 2009.

41. The employees of the ICA at year-end 2009 were 22. Their educational background is as follows:

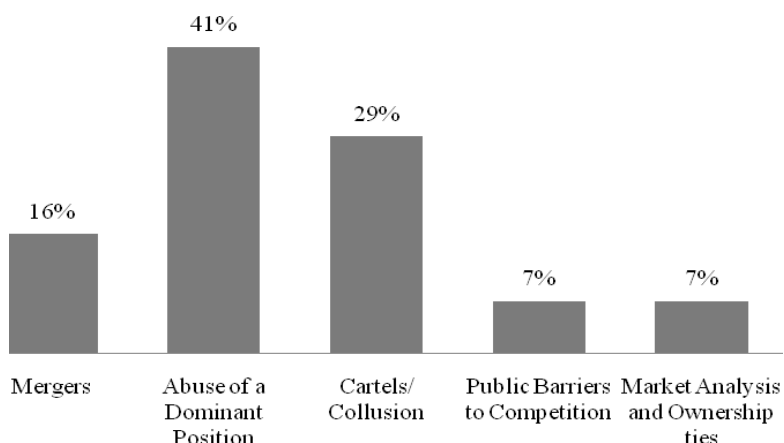
- 11 lawyers
- 7 economists, and
- 4 other education and support staff.

5.2 Allocation of resources

42. 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.

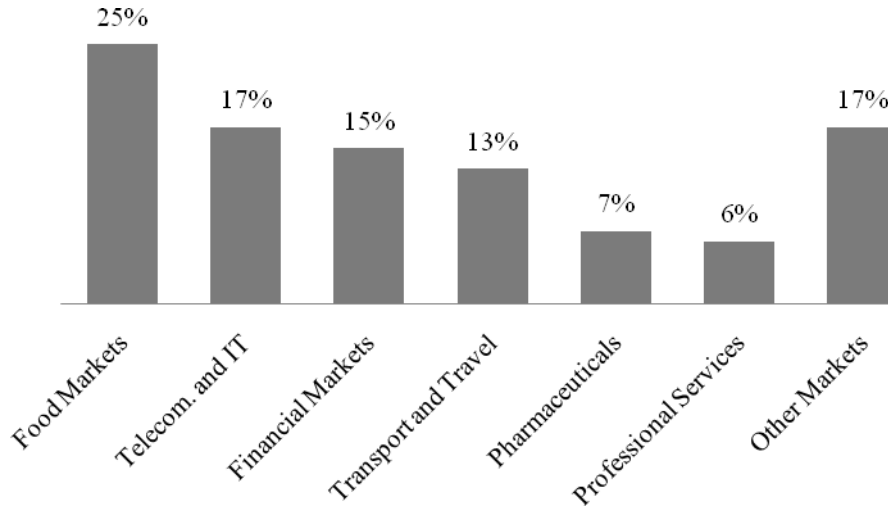
43. As shown in illustration 1, cases dealing with possible abuse of a dominant position are a significant part of the ICA's work.

Illustration 1: Allocation of resources in 2009 – types of work



44. As showed in Illustration 2, cases related to food markets are at the top of the ICA’s agenda.

Illustration 2: Allocation of resources in 2009 - markets



45. It should be stressed that the economic crisis in Iceland has had a profound impact on the ICA’s work. Record number of cases are being processed.

Illustration 3: Quarterly number of cases in process

