Competition - Israel

Antitrust commissioner announces major policy change on excessive pricing

Contributed by **Tadmor & Co**

January 30 2014

Authors

Shai Bakal

Ragit Moshe

Introduction

In December 2013 the Antitrust Authority published its Draft Guidelines on the Prohibition on Excessive Pricing by a Monopoly. These draft guidelines reflect a significant change in the authority's interpretation of Section 29A(b)(1) of the Restrictive Trade Practices Law 1988, which deals with the abuse of a monopoly position and prohibits any monopoly from charging unfair prices.

In the past, the authority has leaned towards an interpretation that the ban on unfair pricing referred to predatory pricing and not to excessive pricing. Moreover, the authority had launched no enforcement action against excessive pricing since it was established in 1994.

In the new draft guidelines, the antitrust commissioner has stated for the first time that charging excessive prices is deemed unfair pricing, and subsequently that this practice is deemed an abuse of a monopoly position, in violation of Section 29A(b)(1) of the law. The commissioner also made it clear that the authority will enforce the ban on excessive pricing in appropriate cases.

Ban on excessive pricing

Section 29A(a) of the law prohibits the abuse of a monopoly position in a way that might endanger competition or harm the public. In addition to this general standard, Section 29A(b) details the list of practices that constitute irrefutable presumptions of illegal abuse of a monopoly position. One of these presumptions deals with setting unfair prices (Section 29A(b)(1)).

Ever since it was enacted, Section 29A(b)(1) has raised questions regarding its application in relation to excessive pricing, due to theoretical and practical difficulties associated with this offence. From a theoretical perspective, the ability to charge supra-competitive prices is arguably the reason why companies have an incentive to compete in the first place. If companies in the market believe that their efforts to beat their competitors will be unrewarded, they will have no incentive to invest in competitive initiatives.

Another theoretical argument against interference with excessive pricing is that it attracts entry to the market. According to this argument, structural change (rather than price supervision) is the ultimate solution to the evils of monopolies. Excessive prices, so the argument goes, are therefore pro-competitive and should not be banned. The US Supreme Court's decision in *Verizon v Trinko* was based on similar reasoning.

There are also significant practical difficulties with the excessive pricing doctrine. It is difficult to determine the right price for products and services and price control, sophisticated as it may be, often sets a price that is either too low or too high.

For these reasons, to date the Antitrust Authority has not applied the prohibition on unfair prices to excessive pricing, and has even expressed doubt as to whether Section 29A(b)(1) of the law should apply to this practice. However, the new draft guidelines have overturned this policy.

Impact of draft guidelines

According to Israeli law, any party that possesses a market share exceeding 50% is deemed a monopoly, regardless of whether it is proclaimed as such by the commissioner under Section 26(A) of the law. However, according to the draft guidelines, the prohibition on excessive pricing will be enforced only against proclaimed monopolies. Nevertheless, in oral statements made subsequent to the publication of the draft guidelines, the commissioner suggested that the authority's enforcement will be extended to non-proclaimed monopolies. Whatever the commissioner eventually decides, non-proclaimed monopolies are likely to be affected, as private action can also be launched against such monopolies.

Defining 'excessive pricing'

Generally, the authority's draft guidelines stipulate that a price is deemed excessive if it exceeds the price that would have been set in a competitive market. To identify such price, the authority offers three tests (similar to those used in other jurisdictions).

The first test analyses the margin between production costs and the product's price. Production costs are determined based on the actual costs incurred by the firm, provided that they are not unreasonable. The relevant cost formula is the long-run average incremental cost, which takes into account the costs associated with entry to the market, as well as incremental costs. The draft guidelines set a safe harbour, according to which any margin between the relevant costs and the product's price of up to 20% will not be subject to enforcement by the authority.

The second test explores whether the firm is excessively profitable. As part of this review, the authority will compare the firm's actual profit margin to a comparable objective benchmark. Profitability will be measured in part by use of the return on capital employed and truncated internal rate of return indices.

The third test involves certain comparisons aimed at providing an indication of the fairness of the inspected prices. Such comparisons may include comparing the price of the inspected product with:

- the prices of competing products;
- the prices of similar products in other jurisdictions;
- the price of the product in other geographic markets; or
- the price of the product over time.

Enforcement measures

The authority acknowledged the difficulties entailed in applying a rule against excessive pricing and therefore set out several ground rules for enforcement of the doctrine. The authority stated that it will be inclined to take measures against excessive pricing where:

- the monopoly firm has been proclaimed as such by the authority;
- the monopoly position was not obtained by a competitive initiative (eg, by government franchise or by exclusion of competitors);
- there are significant barriers to entry that make entry to the market unlikely if prices soar;
- the industry in question is not regulated by another regulator (although regulated industries are not immune);
- the industry is not characterised by large investments in research and development or high-risk activities;
- the excessive price is charged for a long period and the harm to the public is considerable;
- the monopolised product is an essential good; or
- the monopoly's market share is close to absolute control over the market (ie, shares in the range of 80% and above), both consistently and over time.

Not all of the characteristics mentioned above must be met in order for an enforcement action to be likely. Moreover, these enforcement guidelines do not effect private action, including class actions, in circumstances that do not meet these characteristics.

Penalties

The penalties imposed by the law on monopolies that abuse their dominant position are diversified, and include criminal penalties where an intention to injure competition or the public has been proven (Section 47(A)(4A) of the law). Other notable penalties are administrative fines (monetary payments under Section 50D(A)(3) of the law) of up to 8% of the firm's turnover, with a ceiling of approximately $7 million.

In the new draft guidelines, the commissioner has stated that monetary penalties will be the main enforcement tool used, rather than criminal penalties. Foreign companies that may be deemed to possess a dominant position in the local market are encouraged to seek professional advice in order to assess better their possible exposure under the new draft guidelines.

For further information on this topic please contact Shai Bakal or Ragit Moshe at Tadmor & Co by telephone (+972 3 684 6000), fax (+972 3 684 6001) or email (shai@tadmor.com or ragit@tadmor.com). The Tadmor & Co website can be accessed at www.tadmor.com.