Competition - Israel

Food sector on target: new competition regulations become effective

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Introduction

The mass protests of Summer 2011 marked a turning point in Israeli antitrust law. The high cost of living brought thousands onto the streets, sparking a series of wide-ranging reforms. The protests placed an emphasis on expenses that were tangible to the average consumer, with the food sector at the centre of public attention. The government appointed a committee to examine the level of competitiveness in the Israeli food sector, which formed the basis for a legislative proposal that followed soon thereafter (for further details please see "Food sector regulation targets big food companies").

On March 19 2014 Parliament passed the Advancement of Competition in the Food Sector Law 2014. According to the law's explanatory notes, its main objective is to increase competitiveness in the food sector in order to reduce product prices for consumers. While this objective is noble, it is unclear whether the law will appropriately and effectively achieve it.

Principal provisions of new law

The law adopts two approaches to achieve its objective. First, it prohibits, limits and regulates certain practices that could potentially be used by major suppliers or retailers to limit competition. Second, it empowers the antitrust commissioner to intervene when retail markets are geographically concentrated and authorises him, among other things, to order dominant retailers to divest or limit their natural expansion.

In many of its provisions, the law deviates significantly from well-established antitrust principles and raises fundamental questions with regard to the role of antitrust law in a free market economy – specifically, what sort of regulatory intervention is necessary and appropriate in fostering competition, and to what extent such intervention should occur.

The first layer of prohibitions applies to all suppliers and retailers, regardless of their market characteristics, and forbids any attempt by suppliers or retailers to intervene in the prices of their competitors.

The law also creates specific prohibitions for both large suppliers and large retailers. It defines such competitors based not only on their market power (or market share as a proxy), but mainly (and for large retailers only) on their annual turnover, thereby deviating from fundamental antitrust principles. The use of such definitions by the law can at best have little or no effect on competition, and at worst reduce competition, thereby having the opposite effect from that intended.

Among other restrictions, the law sets out the following prohibitions on large food suppliers and large retailers:

- A large supplier may not physically arrange or intervene in any way in the arrangement of its products on the shelves of a large retailer. However, this provision does not preclude a large supplier from providing guidance as to proper care of its products.
- A large supplier may not dictate, recommend or intervene in certain matters with regards to a retailer, including:
  - being involved in any way in the pricing decisions of retailers regarding their own products, including by way of recommended pricing (this provision contradicts the economic literature, which attributes efficiencies to, and regards as competitively

benign, most price recommendations and resale price maintenance arrangements, especially maximum resale price maintenance);

- persuading retailers to allocate to suppliers any amount of available shelf space or off-shelf displays;
- granting any incentives to retailers conditioned on sales targets in a certain category (this provision contradicts the underlying assumption rooted in antitrust law that price competition, including by way of discounts and rebates, should not be regulated if assumed by a non-dominant company); or
- being involved in retailers' decisions to source competing products (eg, quantities of such products and allocation of shelf space thereto).

Despite the desire to increase competition, the above restrictions may inversely assist in perpetuating monopoly power. For instance, a small competitor with a high annual turnover that meets the threshold applicable to large suppliers will no longer be able to compete aggressively with a competing monopoly, since it can no longer ensure a decrease in the retail price of its products, nor can it buy the shelf space needed to achieve public awareness. This will leave the incumbent monopoly uncontested. The same issue applies in a wide range of circumstances (eg, when a supplier which is a monopoly in Market X attempts entry into Market Y, where a different monopoly exists).

Only slightly dulling the blow, the law empowers the commissioner to grant specific or block exemptions regarding most of the above-mentioned provisions limiting large suppliers and large retailers. However, in light of the broad extent of the limitation imposed by the law, the authority to grant exemptions fails to offset the potential harm to competition caused by the provisions.

While the restrictions allow for exemptions where certain actions appear benign to competition, Article 8 of the law wholly precludes large suppliers and large retailers from performing a set of actions, the effects of which are highly disputed and controversial in antitrust literature. The most notable problem with these provisions is that they describe practices that may exclude competitors when assumed by dominant suppliers, yet the law applies them to any supplier with significant turnover, regardless of its market power. The following are a few examples of such provisions:

- A large supplier and a large retailer may not engage with each other in a transaction where a certain portion of goods is sold below the marginal cost of carrying out that transaction. The provision does not apply with regard to new products (ie, products that have been supplied in Israel for less than one year).
- A large supplier and a large retailer may not engage with each other in a transaction where the price of goods or a set of goods offered by the supplier is lower or equal to the price offered by the supplier for the purchase of a smaller amount of the same product or for a narrower set of products. This provision aims at preventing economic tying or 'predatory bundling', as described by the Antitrust Authority.
- A large supplier contracting with a retailer (regardless of its size) may not link between the sale of one of its products and the purchase of another of its products.

In addition to explicit prohibitions, the law authorises the commissioner to give instructions to large retailers who sell at least one product of a large supplier. These instructions may relate to steps that should be taken by such retailers regarding:

- the specific product sold by the large supplier;
- substitute goods for that product;
- instructions regarding shelf space allocation for such products; or
- issues relating to payment.

The law further empowers the commissioner to restrict retailers with respect to their private labels if he believes that this is necessary to prevent significant harm, either to competition or to the public. This is an extremely intrusive measure, especially in light of the relatively small market shares of private labels in Israel today.

The commissioner may also attempt to increase competition under the new legislation by defining a geographic catchment area for each branch of a large retailer and identifying the competitors in each catchment area. The commissioner will then send a notification to any retailer whose share in a relevant catchment area exceeds either 30% or 50%. Any expansion by such retailer, including a unilateral decision to open a new branch in that location, will require the commissioner's approval. The law provides that such approval will be denied unless the retailer is able to show that its expansion is not likely to pose any danger to competition (the standard is higher for retailers whose market share exceeds 50%). Further, the law stipulates that the commissioner may recommend to the Antitrust Tribunal that a retailer whose share in a catchment area exceeds 50% and which operates at least three stores in that area cease operations in a certain store or sell that store to a third party.

Apart from these radical structural remedies, the constitutionality of which is in doubt,

the law includes behavioural directives aimed at increasing transparency for consumers. Large retailers are now obliged to post online the prices of their products in each of their branches, as well as other details about their products (eg, product descriptions and applicable discounts).

Similar to violations of the Antitrust Law, the new law imposes criminal, administrative and civil liability on corporations and their officers.

Comment

The public demand for a lower cost of living in Summer 2011 justifiably led to a thorough analysis of many sectors in the Israeli economy. Unfortunately, in trying to remedy the problems that were uncovered, the legislature appears to have missed the mark. Although the law is based on the right intentions, the tools used in carrying them out are arguably too intrusive and insufficiently in touch with sound economic principles. The use of broad and formalistic definitions and prohibitions is likely to produce anti-competitive outcomes, as well as potentially stifling the food sector in general.

Initial implementation of the law will hopefully bring its failures to light and lead the relevant authorities to review the law and amend it accordingly. This way, the positive elements of the law can be retained while avoiding the excessive collateral damage that currently overshadows it.

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