Competition & Antitrust - Israel

Supreme Court renders milestone decision on vertical arrangements

Contributed by **Tadmor & Co Yuval Levy & Co**

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Introduction

On August 10 2015 the Supreme Court issued its ruling concerning an appeal of the lower court's conviction of Shufersal, one of Israel's largest retail chains, along with its former executives. They were convicted of breach of merger conditions and attempting to engage in a restrictive arrangement. The Supreme Court upheld the convictions and most of the sentence determined by the Jerusalem District Court. In the framework of its analysis of the arrangement under review – and beyond what was necessary for adjudicating the case at hand – the Supreme Court outlined a new legal approach towards vertical arrangements, overturning a longstanding and highly criticised precedent. Under the interpretation of the law adopted in *Shufersal*, vertical restrictions such as exclusivity or resale price maintenance agreements will no longer be automatically condemned as restrictive arrangements; rather, they will be reviewed based on their probable impact on competition.

This decision – which in effect adopts an opinion that had been expressed by certain judges in previous Supreme Court rulings and was widely supported by academics – arguably creates a more efficient and balanced antitrust regime. However, while the ruling corrects what many see as a longstanding flaw in Israel's antitrust law, it creates an entirely new set of questions which have yet to be answered.

Vertical arrangements prior to ruling

The distinction between horizontal and vertical arrangements is fundamental to many antitrust regimes. In Israel both arrangements were treated similarly for many years as far as the definition of a 'restrictive arrangement' under the Restrictive Trade Practices Law 1988 was concerned.

The definition of a restrictive arrangement comprises:

- Section 2(a) of the law, which prohibits engaging in arrangements that, based on their probable effects, may prevent or decrease competition between the parties to the arrangement or between a party to the arrangement and a third party; and
- Section 2(b) of the law, which outlines restrictions that create an irrefutable presumption of harm to competition (eg, restrictions on price, profits, the amount or quality of products sold and market segmentation).

This means that an arrangement which contains a restriction on one of the matters listed in Section 2 (b) (ie, price, profits, market allocation and quantity or quality of assets or services) renders the arrangement illegal, regardless of its effect on competition. Section 2(b) does not differentiate between horizontal and vertical arrangements.

Under the law, it is illegal to be a party to a restrictive arrangement which:

- is not exempt under a statutory or block exemption;
- has not been approved by the Antitrust Tribunal; or
- has not received an exemption from the need to seek the Antitrust Tribunal's approval from the antitrust commissioner.

In the standard-setting case *Tivol v Shef Hayam*, the Supreme Court ruled that horizontal and vertical arrangements are subject to the irrefutable presumption of harm to competition set under Section 2 (b). Instead of differentiating between types of arrangement and applying a nuanced approach due to the understanding that vertical restrictions are typically justified and may at times be pro-competitive, the court determined a formal test which asked if the arrangement fell under one of the presumptions

of harm to competition. Thus, most vertical arrangements – such as exclusivity arrangements, resale price maintenance, most favoured customer provisions and many others – were regarded as illegal restrictive arrangements.

Since the ruling in *Tivol*, there have been many failed attempts to minimise the severe implications of the court's broad interpretation of the law. For instance, in *Extel* one of the Supreme Court justices criticised the ruling in *Tivol* and proposed to exclude vertical arrangements from the scope of Section 2(b), but was unable to garner support from the other justices. The general director enacted several block exemptions for certain vertical arrangements that were generally not seen to be anti-competitive. These attempts did not change the fundamental problem resulting from a wide condemnation of vertical restraints.

Supreme Court ruling

The Supreme Court decision in *Shufersal* overturned the *Tivol* decision regarding vertical arrangements, holding that Section 2(b) will apply solely to horizontal arrangements and vertical arrangements will no longer be automatically condemned as restrictive arrangements for technical reasons; rather, they will be reviewed based on their probable effects on competition in accordance with Section 2(a).(1) The ruling is supported by an abundance of academic literature, including work published by the retiring antitrust commissioner, which has called for such a change for some time. The court further noted that its ruling brings the Israeli antitrust regime closer to that of the United States, which generally applies a rule of reason test to vertical restraints.

Comment

While it may initially seem that the ruling clearly delineates the new legal order, it has made the existing legal situation less clear. The decision leaves room for the argument that some vertical arrangements – such as those with significant horizontal characteristics – are still subject to Section 2(b). This question was left open by the court to be determined in the future. Another question left unanswered is which competitive standard should be applied to vertical arrangements under Section 2(a) of the law. Further, the requirements of the block exemption set in place partly to lessen the categorical prohibitions of *Tivol* appear to have become a source of confusion:

- Now that vertical restrictions are subject to an effects-based test, what is the relation between the effects-based test of Section 2(a) and the requirements of specific block exemptions for certain types of vertical restraints?
- If a block exemption for a specific type of restraint does not apply, can parties to such a vertical arrangement argue that the arrangement is in fact permitted because it is not a restrictive arrangement under Section 2(a) of the law?
- Should the block exemptions become safe harbours providing certainty that an agreement is legal?

These and many other questions have yet to be determined.

Arguably, the Supreme Court decision is the most important judicial antitrust law decision in over a decade. It is likely to have sweeping implications for local and foreign firms that engage in vertical arrangements, such as exclusive supply, distribution and franchising agreements. However, as noted above, the decision has left significant questions unanswered. It is expected that the lower courts and the Antitrust Authority will address these questions in the near future, in an attempt to shape a more coherent and complete legal regime with respect to vertical arrangements.

The landmark ruling in *Shufersal* also constitutes the first instance in which a defendant has been convicted of breach of merger conditions, as well as the first instance in which such a defendant has been sentenced to prison time. However, the precedential aspects of the ruling that relate to the use of criminal enforcement against corporate executives in antitrust cases have been eclipsed by the abrupt and significant change in law.

The scope and impact of the *Shufersal* decision will be revealed in future and it depends on how the Antitrust Authority and the courts implement it.

For further information on this topic please contact Shai Bakal or Nava Karavany at Tadmor & Co Yuval Levy & Co by telephone (+972 3 684 6000) or email (shai@tadmor.com or nava@tadmor.com). The Tadmor & Co Yuval Levy & Co website can be accessed at www.tadmor.com.

Endnote

(1) For the court's decision in Hebrew, please see www.antitrust.gov.il/subject/148/item/33752.aspx.

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