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The Promotion of Competition in the Food Sector in Israel

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I. INTRODUCTION

The past couple of years have seen many significant and influential developments in Israeli competition law and in the enforcement authorities of the General Director of the Israeli Antitrust Authority (the “General Director”), *inter alia*, against the backdrop of unprecedented social protest against the increase in the cost of living. One such significant development is a new and revolutionary law, enacted in March 2014, which is aimed at bringing about a reduction in food retail prices, mainly by regulating the relationship between suppliers and retailers in the food sector.

In this paper we will review the background of this new legislation. We will then follow with a detailed description of some of the new legislation’s prominent provisions, and will conclude with some critical comments.

II. BACKGROUND: THE ISRAELI SOCIAL PROTEST AGAINST THE INCREASE IN THE COST OF LIVING

In the summer of 2011, an acute public social protest arose in Israel against the increase in the cost of living. The roots of this social protest, which also became a synonym for the protest, lay in the “Cottage Cheese Protest,” a consumer boycott to obtain a significant reduction in the prices of cottage cheese. Later on, the social protest expanded to other areas, focusing on food and housing prices. In 2012, public pressure regarding the prices of food products continued (although it lessened somewhat), existing to a certain extent still today.

The protest against the cost of living brought about a change in consumer consciousness and enhanced awareness of the pricing of products. In addition, the protest created a new governmental regulatory discourse and a new agenda, whose avowed purpose was to reduce the cost of living for consumers—and, in particular, the price of food products. The full impact of the protest is yet to be understood, but it can be easily marked as an important turning point in Israeli antitrust law, especially with respect to the food sector.

Following the protest, a public committee was set up to effect social and economic change, headed by Prof. Manuel Trajtenberg (the “Trajtenberg Committee”). In September 2011 the Trajtenberg Committee published a detailed report, which was soon adopted by the Israeli Government. The Trajtenberg Committee’s recommendations included proposals for reducing the cost of living. With regard to the food industry, the Trajtenberg Committee determined that

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there was a high level of both economic concentration in the manufacturing/import sector and protections against competition (quota-based and other protections).

The Committee also recommended transferring the findings to a specific team that would analyze competitiveness in the food and consumer product market. The team (the "Kedmi Committee") was headed by Mr. Sharon Kedmi, at the time the Director General of the Industry, Trade and Labor Ministry (currently named the Economy Ministry). It was set up to formulate recommendations for enhancing competition and reducing prices of food and consumer products.

The Kedmi Committee published its report in July 2012. The report included recommendations, *inter alia*, concerning: the removal of trade barriers (such as customs duties), the opening up of the market to parallel imports, increased regulation in respect of supplier-retailer relationships, enhancing the level of awareness of the Israeli Antitrust Authority (the "IAA") with regard to mergers and acquisitions in the sector (which may have an adverse effect on competition), and providing assistance to small manufacturers in competition over shelf space at food chains, etc. In October 2012 the Government approved the implementation of some of the recommendations of the Kedmi Committee.

These recommendations formed the basis for new legislation that followed soon thereafter, as addressed below.

III. THE NEW LEGISLATION: THE PROMOTION OF COMPETITION IN THE FOOD INDUSTRY LAW

Further to the Kedmi Committee's work, the Government placed before the Knesset (the Israeli Parliament) the Promotion of Competition in the Food Industry Bill, 5774-2013 (the "Bill"). The Bill was enacted in the Knesset in March 2014 (the "Law"). The discussions of the bill took place in a Joint Committee of the Economy Committee and the Finance Committee of the Knesset, which was set up for the purpose of promoting competition in the food sector.

A. Summary of the Main Points of the Law

The declared purpose of the Law is to bring about a reduction in retail prices by increasing competition in the food and the consumer goods sectors. The Law concerns a number of key matters: regulating suppliers' and retailers' activities, price transparency, powers of enforcement, penalties, and financial sanctions.

B. Activities of Suppliers and Retailers

The Law defines a "Large Supplier" as an entity (i) with sales turnover to retailers in Israel in the previous fiscal year exceeding NIS 300 million (approximately U.S. \$86 million) or (ii) is a monopolist (holds more than 50 percent of a relevant market). It also defines a "Large Retailer" as an entity that maintains at least three brick-and-mortar or online stores, and whose sales turnover exceeds NIS 250 million (approximately U.S. \$71 million). It sets forth a list of prohibitions for these suppliers' and retailers' activities, including:

1. Prohibition on intervention by a supplier regarding either retail prices or the terms and conditions of a product which another supplier supplies (a broader prohibition than the common RPM rules);

2. Prohibition on a Large Supplier from engaging or intervening in the shelf arrangement for goods at the store of a Large Retailer;
3. Prohibition on a Large Supplier from dictating, recommending, or intervening in: (i) the retail price of the supplier's product; (ii) the allocation of sales space for the product; (iii) the amount purchased, whether from the retailer's total purchases, or the total amount of purchases of the product and substitute products; and/or (iv) the purchase or sale of the products of another supplier;
4. Prohibition on a Large Supplier from selling part of its product units, or part of its basket of products, for a price lower than the marginal cost of the product; or selling products, including a basket of products, at a price equal to, or lower than, the cost of an extremely limited product basket or the price for the purchase of less units (predatory pricing);
5. Prohibition on a Large Supplier from tying the sale of a certain product to the sale of another product; and
6. Prohibition on the transfer and receipt of payments from a supplier to a Large Retailer, in cash or cash equivalents but through certain discounts (namely quantity discounts);

The Law also empowers the General Director, in connection with products or substitute products, to instruct a Large Retailer that is selling the products of a Large Supplier regarding sale spaces, as well as to give instructions to a retailer that is selling private label products.

A Large Supplier is also required to give a report to the General Director once a year on its sales turnover to retailers in Israel or, alternatively, to provide a declaration that it satisfies the terms of the definition of a "Large Supplier." A Large Retailer shall provide a report on the stores which it maintains, and on its sales turnover.

In addition, according to the Law, the General Director will publish a list of "Very Large Suppliers" (suppliers whose sales turnover to retailers in Israel in the previous fiscal year exceeded NIS 1 billion (approximately U.S. \$285 million)). A Large Retailer may not allocate shelf space to products from these Very Large Suppliers (all together) at a rate exceeding 50 percent of the total shelf space in each of its major stores. This is a temporary order, which shall take effect in January 2015, and which shall remain in effect for one year, and may be extended by one additional year each time, up until a total period of four years.

The Law also allows the General Director to define for each store of a Large Retailer the competition group in a relevant region. The General Director shall give written notice, once a year, to each retailer whose market share in the relevant region exceeds 30 or 50 percent. The retailers who receive such notice shall be subject to prohibitions and various instructions, such as a prohibition from opening an additional large store in the region without obtaining the General Director's permission. The General Director is also authorized to order the termination of activities at a large store, or to order the sale of the retailer's rights therein, and to prohibit real estate transactions in the said region. The Law also includes annual reporting obligations regarding the large stores and their sales turnover.

The Law further requires a Large Retailer to publish online, for each of its stores, the up-to-date prices of all of the products being sold there as well as additional data (inventory, sales promotions, and discounts, etc.).

C. Penalties and Enforcement

The new law includes some of the harshest sanctions in Israeli antitrust law.

The General Director is authorized to impose on a corporation with sales turnover exceeding NIS 10 million a monetary sanction in an amount of up to 8 percent of the sales turnover, but no more than NIS 24 million (approximately U.S. \$6.8 million); and on an individual, a monetary sanction in an amount of up to NIS 1 million (approximately U.S. \$285,000).

In addition, with respect to the breach of certain provisions, the Law authorizes the imposition of a penalty of three years' imprisonment or a fine in the amount of NIS 2.26 million, including an additional fine for each day of a continuing offense.

The Law also imposes a penalty of six months' imprisonment, or a fine of up to NIS 1.13 million, on a director, officer, partner, etc., for a failure to supervise his/her employee's breach of the Law, and sets forth an obligation to submit information and documents to the General Director. Anyone who breaches this last obligation will also be exposed to imprisonment or a fine up to NIS 8 million.

IV. COMMENTS AND CRITIQUE

While nobody questions the positive motivation to reduce the cost of living for consumers, including the price of food products, the Law raises noteworthy and significant concerns.

The Law is comprised of provisions that are precedent-setting, globally, with regard to competition regulation in the food sector. Moreover, some of the provisions in the Law deviate from well-established antitrust principles. Among the intrusive tools given to the General Director with regards to the termination of activities at a large store, or the retailer's sales practices, are (i) restrictions on price recommendations; (ii) restrictions on suppliers' participation in consumers' sales and promotions; and (iii) restrictions on suppliers' shelf arrangements. Against this background it is not surprising that the General Director himself has acknowledged the complexity of the Law and its implementation.

Respectively, some of the above mentioned restrictions in the Law may have a counterproductive effect on consumers' welfare, and inversely assist in perpetuating the market power possessed by a few.

For example, one possible counterproductive effect is the following: Allegedly, according to the law, a small competitor in the food sector with a high total annual turnover, or a big competitor entering a new market, will no longer be able to compete aggressively against existing monopolies with strong brands in the food sector by lowering the retail price of its products or by buying the shelf space needed to achieve minimum public exposure—until it reaches enough market share. In this sense, strong brands can become even stronger and the monopoly in power will stay uncontested.

Another possible counterproductive effect is the following: In light of the fact that, in general, suppliers have a higher motivation to promote their own products than retailers, restrictions on suppliers' participation in consumers' sales and promotions is likely to reduce the

volume and variety of these practices. This possible outcome is also likely to harm consumers' welfare.

It seems that in trying to fix the problems that were identified in the market, the authorities may have missed the mark. The surgical hand needed in such industry-specific regulatory interventions was replaced by a bulldozer trying to level the field. On top of this, the uncertainty regarding some the provisions of the Law may have a chilling effect (especially with respect to the harsh sanctions mentioned above) on the market, that could overshadow some of the positive influence expected.

It is hoped that in the first period of implementation of the Law, and even before the downsides mentioned here are shown, the Israeli Antitrust Authority and the General Director will review parts of the Law and clarify them (in guidelines, for example) or exempt certain entities and practices (in accordance with the General Director's powers in the law). This could assist the market to reach a needed balance.