Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development

29-May-2015

English - Or. English

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

HEARING ON OLIGOPOLY MARKETS

-- Note by Israel --

16-18 June 2015

This document reproduces a written contribution from Israel submitted for Item 5 of the 123rd meeting of the OECD Competition Committee on 16-18 June 2015.

More documents related to this discussion can be found at www.oecd.org/daf/competition/oligopoly-markets.htm.

JT03377404

DAF/COMP/WD(2015)17
Unclassified
English - Or. English

ISRAEL

Introduction

1. Israel's economy is small relative to other developed countries. This is partly due to the small scale of local demand and the existence of various trade barriers, including; geographical isolation, political barriers and language barriers. These characteristics limit the number of players that can operate effectively in many of the markets in Israel. As a result, many markets in Israel are characterized by a small number of players.

2. In 2012, an amendment was passed to the Antitrust Act -1988 that provides the Director General of the Antitrust Authority with tools in order to deal with market failures that result from such oligopolies.

3. Dealing with oligopolistic markets presents a major challenge for competition authorities. Firms in such markets may refrain from competing vigorously, while no detectable restraints of trade are present, and no firm is necessarily dominant.

4. In the following paragraphs, we will describe the mechanism created in the relevant sections of the Antitrust Act that deal with oligopolistic markets. Later on we will demonstrate how these sections of the law were implemented by the Director General in two cases, one concerning baby formula and the other concerning the Israeli ports.

1. The collective dominance section of the Antitrust Act

5. In the original version of the Antitrust Act (which was passed in 1988), the Director General was given the authority to determine whether a collectively dominant group can be considered together as a dominant firm. A collectively dominant group was defined narrowly, as a group in which competition does not exist between two or more individuals or exists to an only limited extent. However, the attempt to eliminate market failures in oligopolistic markets using the this provision was not successful, since proving non-existence, or existence to only a limited extent, of competition turned out to be impractical.

6. In view of the failure of the original provision, and in light of the importance of eliminating market failures in the many oligopolistic markets in the Israel, the original provision was replaced by a new one and a new chapter dealing with collectively dominant groups was added to the Antitrust Act.

7. The goal of the amendment, according to the introduction to legislative proposal, was to "deal with competitive failure due to market power, which in many markets is caused by collectively dominant groups (oligopolies) that are the result of a small number of competitors and high barriers to entry into the market and which have an adverse effect on consumers and the economy."

8. Once the amendment was approved, the Act provided the Director General with the authority to determine whether "a small group of firms who control more than half of the supply of assets or provision of services or purchases is a collectively dominant group."

9. In order to determine whether such a group of firms is collectively dominant, the Director General must show that two conditions are met: first, that there is limited competition between firms

or there are *conditions* for limited competition. Second, that there are measures that can be taken to prevent harm or probable substantial harm to competition among the members of the group or in their market or prevent substantial harm to the public or measures that may substantially promote competition in their market or create conditions for substantial promotion of competition in the market.

10. The most significant change brought about by the new provision in comparison to the previous provision was that there is no requirement for the Director General to prove limited competition in order to be able to declare a group of firms as collectively dominant. Instead, it is sufficient to prove the existence of *conditions* for limited competition.

11. Proving conditions for limited competition can be based, inter alia, on proving the existence of entry barriers, combined with at least two out of the six following conditions:

1. The existence of switching barriers (e.g., barriers consumers face for switching between suppliers).
2. The existence of cross-ownership between members of the collectively dominant group.
3. The market shares of the members of the collectively dominant group are similar to each other.
4. The products or services provided by the members of the group are similar to one another.
5. The existence of a large number of customers (or suppliers-in the case of a collectively dominant group of purchasers).
6. Transparency of transactions.

12. While conditions (1) and (2) can, in appropriate circumstances, be conductive to either unilateral or coordinated market power (caused by tacit collusion), conditions (3) to (6) are typically associated, to some extent, with the facility of sustaining and coordinating tacit collusion in the industry.

13. As mentioned, it suffices to show only two of these six conditions, together with the existence of entry barriers. Also, in principle, conditions for limited competition can also be shown via alternative methods. The primary concern that the amendment is aimed at addressing is the existence of market power in oligopolistic markets. Hence the legislator granted flexibility in determining how the market is characterized by conditions for limited competition.

14. After establishing the first requirement, of conditions for limited competition, the second requirement for being able to proclaim firms as collectively dominant is the existence of measures that can prevent substantial harm to competition or that could substantially enhance competition. That is, in order to be able to proclaim a group of firms as collectively dominant, it is not enough that their market is oligopolistic and has conditions for limited competition: There need to be appropriate and enforceable measures that can substantially mitigate market failures or substantially promote competition.

15. The Act requires that the Director General consult with the regulator of a market (when one exists) regarding the measures ordered that are meant to prevent harm or a concern of significant harm to the public or to competition. In case of measures that are aimed to promote competition, the Director General must also obtain the consent of such a regulator.

16. Since the amendment was passed, the Director General has made use of the new chapter on collectively dominant groups in two cases: the market for loading and unloading of containers in the seaports and the baby formula market.

17. On November 26th 2013 the Director General proclaimed the incumbent seaports of Haifa and Ashdod to be collectively dominant in the market for loading and unloading of containers in seaports. Moreover, remedies were issued in order to achieve two significant goals vis-a-vis the expected construction and operation of two new seaports in Israel in the upcoming years:

- The incumbent seaports are prohibited from taking any part in the operation of the new ports, either directly or indirectly.

- The incumbent seaports are prohibited from taking any action, either of commercial nature or of operational nature, which might impede the successful entrance and operation of the new ports. Competition on the merits is, of course, not prohibited.

18. It is noteworthy that not only are the new ports adjacent to the incumbents, but they are also supposed to receive crucial operational services from them.

19. The incumbent seaports appealed against the Director General's decision. Recently a consent decree was signed with the Port of Ashdod, after some minor changes in the remedies were agreed upon, while leaving the proclamation of the collectively dominant group intact. The position of the Port of Haifa regarding joining the consent decree is not yet clear. This case is pending on appeal before the Antitrust Tribunal.

20. Below we will describe in more detail the second case, concerning the baby formula market.

1.1. The baby formula case

21. On February 27th 2013, the Director General issued hearing notifications to four companies that supply baby formula in Israel and notified them of his intention to rule that they are a collectively dominant group. Baby formula serves as a substitute for the nourishment of a baby in cases where the mother is not able or prefers not to nurse the baby. The formula is based on cow's milk or soya, with the addition of various nutritional supplements. It is important that the formula include all food groups, minerals and vitamins that a baby needs for normal development.

22. The Director General found that this market possessed only a few competitors and high entry barriers. The entry barriers include large financial investments required for research and development, equipment and technology and market penetration, in addition to significant regulatory requirements of the Ministry of Health. Moreover, the market was characterized by switching barriers, due to high brand loyalty of customers and their reluctance to try a baby formula that their baby is not accustomed to.

23. The Director General identified an additional substantial barrier to entry, stemming from the commercial relations between the baby formula suppliers and the hospitals. Usually, a baby formula supplier, especially, the two largest suppliers, who had the lion's share of the market, paid hospitals substantial sums for exclusivity. In addition, the baby formula was supplied to the hospital at no cost. Consequently, typically parents did not have any choice between baby formula products in the hospital. This forced them to feed their babies using the only brand available. In many cases, parents preferred to continue buying the brand they received in the hospital, even if its price was higher than the alternatives, thereby essentially becoming captive consumers of the supplier. This created an entry or expansion barrier for any new or small supplier, creating an adverse effect on competition.

24. In addition to the above-mentioned entry barriers and switching barriers, the IAA found the following additional conditions (included in the above-mentioned list of possible conditions for limited competition) were met in this case:

- Homogeneity of the products

  Even though consumers attribute importance to the particular brand, the baby formula products were sufficiently homogenous with respect to the manner of preparation and the intended use of the product.

- A large number of customers

  The baby formula suppliers sold their product to more than one thousand retails, who each sold the product to hundreds of thousands of end consumers.

25. The main measures considered by the Director General at first were as follows:

- Prohibition of exclusivity in the supply of baby formula to a hospital.
- Obligation to ensure that any parent in any hospital is given the opportunity to choose among at least two suppliers of baby formula.
- Prohibition of supply contracts with hospitals exceeding two years.
- A single supplier cannot supply hospitals exceeding 70 percent of all yearly births.

26. Before making a decision, the Director General held a hearing procedure, during which he reached a consent decree with the baby formula suppliers. The consent decree was approved by the Antitrust Tribunal.

27. According to the consent decree, baby formula suppliers may not pay the hospital that does not grant equal access to all baby formula suppliers that wish to supply to this hospital. Also, payment by a baby formula supplier to the hospital will be proportional to the supplier's actual share in the supply of baby formula to that hospital. Hence, baby formula suppliers pay according to the number of new-borns that consume their product relative to the total number of new-borns that consumed baby formula in that hospital. The consent decree also sets a maximum amount (80 NIS) that may be paid per new-born.

28. This mechanism, on the one hand, incentivizes the hospitals to offer parents a choice among all baby formula products while not creating a burden on small or new baby formula suppliers.