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ROUNDTABLE ON FIDELITY REBATES

-- Note by Israel --

15-17 June 2016

This document reproduces a written contribution from Israel submitted for Item 6 of the 125th meeting of the OECD Competition Committee on 15-17 June 2016.

More documents related to this discussion can be found at
http://www.oecd.org/daf/competition/fidelity-rebates.htm

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ISRAEL

1. In this written contribution we will focus on describing a case which was recently (December 2015) decided by the Israel Antitrust Authority (hereinafter: "**the IAA**") in which *Ashdod Port* was found to be abusing its monopoly position by setting conditional discounts. This is the first case in which the IAA decided to impose financial sanctions on what was considered by it an abuse of dominance. It is also the first case in which the IAA decided to impose sanctions not only on the violating firm but also on its executives. The decision of the IAA in this matter was appealed to the Antitrust Tribunal and the appeal is still pending.

2. The case of Ashdod Port illustrates two points that are important to take into account when assessing whether a pricing strategy is an exclusionary conditional discounting. First, the question whether the discount granted is individually "tailor made" for each customer or is uniform for all customers (or customers of the same type). Second, the question whether the discount is given retroactively for the quantity already purchased, or only for additional units after reaching the target that was set.

1. The Ashdod Port case – Background

3. Since the 60s there has been no manufacturing of private motor vehicles in Israel and private vehicles are imported from abroad. Most vehicles are imported to Israel from the United States, Europe and Eastern Asia. Vehicles imported from the US and Europe are unloaded in one of two relevant sea ports: Ashdod Port and Haifa Port.

4. According to an IAA's investigation, between the years 2010 and 2014 Ashdod Port held more than 50% of the relevant market for unloading vehicles imported from the US and Europe. Therefore Ashdod Port is considered to be a monopoly under Israeli law.[1]

5. As discussed below, the IAA found that Ashdod Port had employed a system of tailor-made discounts for vehicle importers, which were likely to harm competition with Haifa Port, and thus harm the public.

6. Ashdod Port gave vehicle importers, who met certain targets, discounts from the regular price list for handling and storage of vehicles, which the importers imported. The average discount rate was 40% for handling and 30% for storage. Agreements of this type were signed with most of Israel's vehicle importers.

7. Targets for quantities unloaded were set individually for each importer, based on its import volume during the previous year and the projection for its import volume in the coming year. In addition, discounts were given retroactively, for the entire quantity of vehicles imported by each importer to reach its individual target.

8. Additionally, examination of the agreements indicated that the agreements were periodically updated, according to the vehicle importers' projections of the quantity that the importers were to

[1] Under Israeli law, a market share of 50% or more is sufficient for a firm to be considered a monopoly and for the prohibitions against abuse of dominance to apply, without requiring further proof of market power.

import in the following year. Therefore, the result of the agreements was that if a vehicle importer diverted a portion of its import to Haifa Port, it risked losing its eligibility for the entire retroactive tailor-made discount it would have been eligible to enjoy.

9. This point can be demonstrated by taking a close look at agreements signed between Ashdod Port and vehicle importers for the year 2013 and comparing the discount mechanism to the unloading volume of each vehicle importer. The chart below shows that the unloading targets for 2013 were on average (weighted) more than 85% of the quantities actually imported in the years 2012 and 2013:

Vehicle importer	Unloading target compared to 2012 volume	Unloading target compared to 2013 volume
A	82%	91%
B	109%	100%
C	138%	92%
D	55%	117%
E	111%	50%
F	83%	90%
G	92%	63%
H	110%	79%
I	95%	71%

10. From the chart we can easily see that, as a rule, an importer interested in being eligible for a discount for meeting its unloading target should unload all the vehicles it imports, or at least the vast majority thereof, at Ashdod Port. Diverting some of its import to Haifa Port might endanger the importer's ability to meet the unloading goal, thus leading to losing out on the discount it would receive under the agreement and forcing it to pay the full price for those vehicles it imported at Ashdod Port.

11. In addition, some of the agreements stipulated that if the importer did not meet its target, it could still be eligible for the discount, but only if the importer had done everything in its ability to ensure that all the vehicles it imported were unloaded at Ashdod Port. Thus, importers who were likely to fail to meet their unloading goals were given an alternate path to be eligible for the discount, in exchange for their loyalty to Ashdod Port. If the importer were to divert a portion of their vehicles to Haifa Port, it risked being pushed out of this path and losing the discount.

12. Ashdod Port's discount policy created a significant barrier to expansion for Haifa Port and constitutes an abuse of dominant position in a manner likely to reduce competition and harm the public.

13. As mentioned, the yearly unloading targets stood at a weighted average of 85% of all the vehicles imported by the importers in 2013 (and in more than a few cases, at 100% or more of the volume unloaded in the prior year). By setting these targets, Ashdod Port left Haifa Port a competitive arena of less than 15% of all the vehicles (hereinafter: "**the unrestricted quantity**"). It should be noted, that Haifa Port was not aware of what quantity was left for it to compete on.

14. The IAA's investigation revealed that in order to compete with Ashdod Port beyond the unrestricted quantity of a particular importer, Haifa Port had to offer to some importers such price that would compensate the importer for the loss of the discounts as a result of failing to reach the target set by Ashdod Port (hereinafter: "**the restricted quantity**"). In other words, Haifa Port faced an obstacle for expansion. The restricted quantity varied from importer to importer, but was a significant portion of those importers' total vehicles.

15. The implication is that Haifa Port was forced to either operate in the market on a small scale or else above a certain scale, which was in practice determined by the dominant competitor in the market – Ashdod Port. This discount mechanism actually posed an even greater potential harm to competition, and *de facto* prevented Haifa Port from competing for a quantity even greater than the restricted portion, as we will now explain.

16. There are three shipping lines that call at the relevant ports in Israel – one of them (the Adriatic line) stops at both Haifa and Ashdod Ports, while the other two (Neptune and Euromed) visit only Ashdod Port. In some cases, for Haifa Port to capture the restricted portion or a quantity greater than that for a particular importer, it needed to unload vehicles imported both on the Adriactic Line and on one of the other two lines. To do so, Haifa Port had to reach an agreement with the majority of the other importers whose vehicles were on the same ship as the particular importer in question on the Neptune or Euromed line. Needless to say, the importers have different interests, *inter alia* because of their individually set unloading targets, so that divert a particular ship might lead to the other importers on the ship not meeting their unloading targets in Ashdod Port and losing their discount. Under these circumstances, the chance that diverting a certain ship, on the Neptune or Euromed line, from Ashdod to Haifa, would be worthwhile for all the importers with vehicles on that ship, is very low.

17. Therefore, an importer could succeed in diverting a ship to Haifa Port only if Haifa Port would unload **all** the restricted quantities of **all** the importers whose vehicles were on that ship at a price that would compensate all the importers for their loss. The implication is that Haifa Port had to overcome a high barrier created by Ashdod Port – diverting a number of shipments, requiring coordination between a number of importers with different incentives. Adding to this fact, Haifa Port has a capacity limitation that – in the near future – limits unloading and storage of more than half of the vehicles imported from Europe and the US, a limitation that made it even harder for Haifa Port to adopt this (already complex) strategy.

18. These restrictions were not part of competition on the merits. By setting unloading targets and giving retroactive discounts for meeting them, Ashdod Port abused its dominant position in a manner likely to diminish competition.

19. As stated above, the case of Ashdod Port illustrates two points that according to the IAA are significant when examining whether a pricing strategy is an exclusionary conditional discount:

2. Tailor-made discounts

20. Individually tailoring discounts to customers can make them more effective at ensuring *de facto* exclusivity and minimizing a competitor's ability to offer a more attractive price. Tailoring discounts requires familiarity with the customers and their projected demand.

21. In the Ashdod Port case, there were a relatively small number of relevant customers and Ashdod Port had years of familiarity with them. Ashdod Port set different terms for each customer, making it clear that the discounts had been individually tailored to them and their projected demand.

22. In other cases, the tailoring may be less easily identifiable. For example, when a supplier publishes a uniform price list with uniform quantity discounts, this would sometimes serve as an indication that the discounts have not been individually tailored. However, in an industry with only a few relevant customers or customers that can be divided into clear homogenous groups, a company can set seemingly objective and uniform discounts that in reality have been tailored to the quantities that the supplier knows each customer (or group of customers) will require. This makes it difficult for the competition authority to identify whether a discount is tailor-made or not.

3. Retroactive discounts

23. As mentioned above, the discounts which Ashdod Port offered were retroactive, applying to all the units unloaded by an importer as soon as the importer reached its target. Since the "price" for the last unit includes the discount for all the prior units, retroactive discounts may lead to negative prices for the marginal unit (as compared to the original price).

24. We will illustrate this with a hypothetical example:

Let us assume that the target set for a certain importer is to unload 100 cars in the relevant year. Let us further assume that the price for handling and storage is $ 1 per vehicle, so that for unloading 100 vehicles the importer would pay $ 100. For meeting its target (unloading 100 vehicles), the importer is given a discount of 30% for all the vehicles unloaded. Thus, for unloading 70 cars the price would be $ 70, for unloading 80 cars the price would be $ 80, for unloading 99 cars the price would be $ 99, but for unloading 100 cars the price is only $ 70. Meaning the price for the last car is $ (-)30.

25. It should be noted that a retroactive discount does not necessarily make the dominant firm sacrifice its profits, since the losses involved in the grant of discount is spread across a large number of units.

26. Moreover, the discount can be granted not only as a direct price reduction but also as any other kind of benefit like free units, discount in other products etc.

4. Conclusion

27. The Ashdod Port case recently handled by the IAA illustrates some of the considerations which are relevant in assessing the competitive impact of a conditional discount offered by a dominant firm including whether the discount is tailored to each customer and whether the discount is retroactive. Both practices together are likely to strengthen the exclusionary effect of a conditional discount and therefore this type of discount is more likely to harm the competition.