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The Concept of Potential Competition – Note by Israel

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More documents related to this discussion can be found at https://www.oecd.org/daf/competition/the-concept-of-potential-competition.htm

Please contact Mr Antonio Capobianco if you have questions about this document.
[Email: Antonio.CAPOBIANCO@oecd.org].

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Israel

1. This paper will provide an overview of the potential competitor doctrine under Israeli law, as well as address a few points looking forward[1] [2].

2. Israeli law recognizes the applicability of the potential competitor doctrine. It is present in Israel's competition legislation, mostly within the block exemption regulations, and it has been discussed and applied by both the Israel Competition Tribunal (hereinafter the **Competition Tribunal)** and the Israel Supreme Court. Furthermore, the Israel Competition Authority (hereinafter **the ICA)** incorporates the potential competitor doctrine in its guidelines, opinion papers and decisions in the framework of mergers assessment as well as enforcement proceedings.

1. Potential Competitor Doctrine Under Israeli Competition Legislation and ICA Guidelines

3. **ICA's Horizontal Merger Guidelines** (January 23, 2011)[3] address the concept of potential competition as part of the merger assessment guidelines, by addressing players on the market's threshold as competitors in circumstances similar to those found in the potential competitor doctrine.

Box 1. ICA's Horizontal Mergers Guidelines' (January 23, 2011) – How to Identify Competitors

The 2011 guidelines detail how to identify competitors in a relevant market during the preliminary review of a merger and its effect on competition. They state as follows:

"In general, the competition in a given market is affected by two types of players: (1) existing competitors, who at the time of the merger assessment produce or supply goods in the relevant market, and; (2) competitors who are at the threshold of the relevant market, but have yet to actually supply goods within said market. In general, the ICA will consider a player as a competitor if it can - and is expected to - supply goods to the relevant market in the near future – usually, within no longer than one year – and that doing so will not entail significant sunk costs of entering or exiting the market".

4. More recently, competition legislation in Israel anchored the concept of potential competition in Israeli law (secondary legislation), through the 2018 amendment to legislation regarding **block exemptions**, as demonstrated in the Antitrust Rules (block exemption regarding Non-horizontal Arrangements that do not Include Certain Price Restraints) (temporary order) – 2013 (hereinafter the **Block Exemption regarding Non Horizontal Arrangements)**. This amended block exemption defines "competitors" *inter*

[1] Note, that this contribution does not purport to address all aspects of the issue, nor does it constitute a legal advice or a pre-ruling by the Israel Competition Authority.

[2] Note, that all translations included in this paper are unofficial, non-binding translations prepared for the convenience of the reader.

[3] Israel Competition Authority, *Public Statement 1/11 Regarding Guidelines for Examination of Horizontal Mergers* (November 23, 2011)

alia as potential competitors, in effect classifying arrangements to which they are a party as horizontal rather than vertical, and thus excluding arrangements to which they are a party from the scope of the block exemption. This is a clear demonstration of the way the Israeli legislator views potential competitors, as important competitive factors. In this regard, see also above, the Explanatory Notes to legislation amendment of competitors definition in the Block Exemption regarding Non Horizontal Arrangements.[4]

Box 2. Explanatory Notes to Legislation Amendment of Competitors Definition in the Block Exemption regarding Non Horizontal Arrangements

Amended definition of "competitors" in the Block Exemption regarding Non Horizontal Arrangements:

"Competitors – each of the following:

…(3) those who likely would compete with each other (as defined in sub-paragraph (1) or (2) hereto) were it not for the restrictive arrangement, or those who can produce goods which are substitutes in the eyes of the consumers, or to immediately supply such goods without acquiring existing manufacturing or marketing activity from another, or those who disclosed their intent to begin manufacture or supply of such products in the near future, either by beginning preparations for said production, or by other means of disclosure, or that are likely to do so."

Explanatory notes for the amended definition: "this definition for competitors was enacted in order to include potential competitors, i.e. cases in which during the period the restrictive arrangement was signed or during the period beforehand, the parties to the arrangement did not compete with one another, but there is a probable likelihood that were it not for the arrangement they might compete in a future time … restrictive arrangements between potential competitors regarding the goods as to which they are potential competitors might have a horizontal effect on competition, in present or future time, thus should be reviewed as horizontal agreements and be excluded from the block exemption."

2. Adoption of *Actual* Potential Competition Doctrine by Israel Supreme Court

5. The most prominent judgment on this issue was rendered by the Israel Supreme Court in CA 2082/09 **Eurocom DBS Satellite Services (1998) Ltd. v. Bezeq, the Israel Telecommunications Corporation Ltd.** (August 20, 2009), in which ICA's decision to object to a conglomerate merger[5] in the telecom industry was reinstated based on the risk that the merger will damage competition by removing a potential competitor from the market (hereinafter the **Eurocom Case**).

[4] Explanatory Notes to The Antitrust Rules (block regarding Non-horizontal Arrangement that do not include particular price restraints) (temporary order) – 2013, paragraph 3 (with reference to the definition of "competitors").

[5] Israeli law recognizes mergers between potential competitors as *conglomerate* mergers with horizontal consequences, which should be assessed, rather than *horizontal* merger, similar to the European Commission. See Ariel Ezrachi and David Gilo A Comparative Analysis of European and Israeli Competition Laws, 2019, 346.

Box 3. About the Eurocom Case

The parties

Bezeq, the Israel Telecommunications Corporation Ltd. (hereinafter Bezeq), a telecom company providing telephony and internet infrastructure, as well as other communication services. At the time of the case, Bezeq held 49.78% of the shares of Yes;

Yes D.B.S. Satellite Services (1998) Ltd. (hereinafter and above Yes) is one of only two providers in the multi-channel television broadcast infrastructure market and in the multi-channel television broadcasting market.

The proposed merger and ICA's decision

On August 2006, Bezeq and Yes submitted a notice of merger declaring Bezeq's intention to become the controlling shareholder of Yes, by increasing its shares of Yes to 58.36%.

The ICA (the Anti-Trust authority at the time) objected to the proposed conglomerate merger, as presenting a reasonable risk of significant harm to competition from both a horizontal and vertical perspective; from the horizontal perspective, the ICA explained that the merger is likely to significantly reduce the likelihood that Bezeq, as a potential competitor, will enter the multi-channel television market.

The appeal and the affirmation of the ICA's decision

Bezeq filed an appeal with the Competition Tribunal, which overturned the ICA's decision, ruling that the merger would be permitted subject to certain conditions. The ICA and Eurocom (an interested party) appealed to the Supreme Court regarding the merger approval, while Bezeq counter-appealed regarding the conditions set for the approval.

The Supreme Court applied the actual potential competitor doctrine to the reviewed merger, and accordingly considered Bezeq to be a potential competitor in the relevant market. The Court overturned the Competition Tribunal decision and reinstated ICA's decision to object to the proposed merger between Bezeq and Yes.

6. In its judgment, the Court acknowledged the difference between actual and perceived potential competition; the latter was not applicable to the merger in question. Regarding the former, the Court clarified that the *actual* potential competitor doctrine deals with the competition that might develop in *future time* in a specific market in case of entry by the merging company, which at the time of the merger does not participate in that market and does not constitute an external competitive restraint on that market at such time.

7. The Court applied the *actual* potential competitor doctrine to the reviewed merger, and found that two key conditions for establishing the actual competitor doctrine were present in the case – reasonable likelihood that the alleged potential competitor will enter the market, and; capability as well as sufficient economic incentive to enter.

8. The Supreme Court in the Eurocom Case also held that there are several parameters relevant in assessing whether an entity should be considered as a potential competitor under the doctrine in a manner that will justify taking into account future harm to competition caused by its elimination: the level of concentration in the relevant market, barriers to entry

to the market, likelihood of entry to the market by the potential competitor and by third parties other than the potential competitor and their willingness to do so, the dominance of existing players in the market (in merger cases – the acquiring entity's power), and the magnitude of the advantages the potential competitor might bring to competition in the market.

9. These parameters are key to the outcome of merger analysis under the doctrine. in the Eurocom Case, the Court ruled that these elements tipped the scale towards considering the merging company as a potential competitor in the relevant market, and that the harm caused by its elimination should be taken into consideration in the merger assessment, resulting in the Court decision to reinstate the ICA's decision to object to the merger.

10. Notably, while the Court did base its decision on the actual potential competitor doctrine, the justices in the Eurocom Case stressed that objecting to mergers based on this doctrine expands the scope of merger control, and that it should be done cautiously.

11. The actual potential competitor doctrine was applied in a similar manner in several additional judgments of the Competition Tribunal such as 8006/03 **Yehuda Pladot Ltd. v. The Antitrust Director General** (April 11, 2007) pp. 60-61, and 1/00 **Food Club Ltd. v. The Antitrust Director General** (May 29, 2003) pp. 43-51.

3. Potential Competitor Doctrine in Additional ICA's Decisions and Publications

12. In 2018, 9 years after the Eurocom Case, the actual potential competitor doctrine was implemented once more as the main reason according to which the ICA objected to a proposed merger, this time between two Israeli airlines – Sun D'or and Israir.[6]

Box 4. Proposed merger between Sun D'or International Airlines Ltd. and Israir Airlines Ltd.

On January 2018, the ICA announced its objection to the proposed merger between El Al Israel Airlines Ltd. (hereinafter El Al) and Israir Airlines Ltd. (hereinafter Israir). In the proposed merger, Sun D'Or International Airlines Ltd, a wholly owned subsidiary of El Al would have acquired 100% of the shares in Israir from IDB Tourism Ltd. in exchange for USD 24 million and 25% of the shares in Sun D'Or.

The ICA objected to the merger, inter alia on the grounds that the merger would have eliminated El Al as a potential competitor in domestic flights to Eilat (city in southern Israel), thus perpetuating the duopoly that Israir and Arkia Israeli Airlines Ltd. held on this route at that time.

The ICA found that the actual potential competitor doctrine applied to El Al in this case: El Al had means and financial incentive to operate flight to Eilat in the future – El Al had operated regular flights from Ben Gurion Airport to Eilat from 2010 until 2013, and El Al's exit from this route was based on safety and operational considerations (which in the meantime were resolved by the relocation of the Eilat airport), rather than economic ones; and there was a reasonable likelihood that El Al would actually enter

[6] Israel Competition Authority, *Competition General Director's reasons to object to the proposed merger between Sun D'or International Airlines Ltd. and Israir Airlines Ltd.* (January 1, 2018) **Competition** 501467

the market in the near future following the merger objection – The ICA found evidence that El Al had concrete plans to reopen the route in the future.

Furthermore, the ICA found that market's characteristics' and the competition situation were such that raised concerns that eliminating El Al as a potential competitor might result in significant harm to competition in the domestic flights to Eilat market: the market was duopolistic and therefore highly concentrated; barriers to enter the market are high and El Al was the only airline that could overcome them, and El Al's presence in the market in the past contributed significantly to competition.

Given the possible harm to competition and the loss of significant advantages to competition, El Al's possible entrance to the market had to offer, the ICA objected to the proposed merger – mainly on the grounds of the potential competitor doctrine. El Al and Israir's appeal of the ICA's decision was later withdrawn.

4. Potential Competition - Looking Forward

13. The discussion surrounding the question of potential competition reemerged recently in the international competition community, with reference to the challenges brought about by the digital economy. One aspect of such discussion is often raised around the issue of acquisitions of technological start-ups by big tech companies, and the question of "Killer Acquisitions", aimed to eliminate potential competitors. *Inter alia* on this backdrop, and vis-à-vis the roundtable conducted on this issue by the OECD in 2019, the ICA Initiated a two-part study on acquisitions of start-ups in Israel addressing this issue.

14. The first part, included a preliminary, rough 3-steps model for a first stage merger analysis; the *first* step consists of defining the product characteristics of the acquired company – interface or stand-alone product; the *second* step consists of assessment of the Acquirer's motivation for the transaction; and the *third* step classifies the transaction and determined the scrutiny level of the review. The second part of the study, was an examination of whether there is in fact evidence of acquisitions of start-ups aimed at eliminating them as potential competitors – either as potential competing new product or as having the potential of expansion into an adjacent market, where the acquiring company competes as well. This examination, did not present indications of Killer Acquisitions.[7]

15. With relation to the challenges brought by the digital economy, the ICA believes that in fast-changing digital environments there will be a growing need to think about how competition may develop and change and to take action in cases where potential harm to competition is found.

16. Such a case is currently being deliberated by the Competition Tribunal, on the subject of the separation of the two companies which operate the core of the Israeli payment systems. These companies, Automated Bank Services Ltd (*hereinafter* ***Shva***), and Automated Clearing House (*hereinafter* ***Masav***), are at the present jointly managed. The ICA's position is that Shva and Masav should be separated. This is based both on the current competition between them and also on the potential competition between them. As the advanced payment sector in Israel develops and progresses, there will be increasing convergence between different methods of payment, thus creating or strengthening the

[7] Int'l OECD, *Start-ups, Killer Acquisitions and Merger Control – Note by Israel* (June 2, 2020), and; Israel Competition Authority, *Acquisitions of Israeli Start-ups: Ex-post Examination* (December 2020)

competition between them for various uses – for example, retail payments in brick-and-mortar stores. This increasing convergence also translates to a potential for greater competition between Shva and Masav, both in terms of developing new payment infrastructures in the future, and also in terms of the increasing competition between the existing infrastructures which serve for payment card transactions and inter-bank transfers, respectively. The ICA considers it critically important to have two, separate entities, each with the ability to develop technological solutions and with the incentive to make its infrastructure and the payment methods it serves, more attractive to end-users. The competition which the ICA expects that will be advanced between these platforms, has the potential to increase and expedite innovation, as well as provide better service to consumers.

Box 5. Shva and Masav Case

Shva is the only company in Israel that serves as a switch and processor for credit and debit card transactions. Masav (Automated Clearing House) is the sole clearinghouse in Israel for bank transfers.

In May 2020, Shva and Masav applied to the Competition Tribunal to approve the restrictive arrangement between them which includes shared management, workers, infrastructure, offices and providing mutual services to each other. Their position, stated that such collaborations may in the future be considered a restrictive arrangement, given future technological changes and regulatory changes.

Following the request for approval, in September 2020 the Director General for Competition (hereinafter The Director General) submitted her position to the Tribunal, stating her objection to the request. The Director General elaborated on the competitive concerns arising from the collaborations between the companies and recommended not to approve the requested arrangement. The Director General clarified that the collaborations between Shva and Masav may already harm competition in the present, and not only in the future, contrary to the parties' claim. Therefore, the companies are already in violation of the law, which requires prior approval for restrictive arrangements. Furthermore, the General Director stated that filing a request for approval of the restrictive arrangement cannot justify the violation of the law that is in effect until the restrictive arrangement has been approved or otherwise exempted according to the Competition Law.

On December 2020, the General Director applied to the Competition Tribunal under section 50A of the Economic Competition Law, and requested an injunction to stop the violation of the Competition Law by ceasing the collaborations or receiving approval for the arrangements according to one of the mechanisms set forth under the Competition Law (including a temporary permit). The Director General clarified in the request that the violation is being committed by the two companies that operate the core of the Israeli payment system, at a critical point in time for shaping the future payments market. The payments field in Israel is currently undergoing significant changes, both as a result of legislative reforms and as a result of technological and consumer changes taking place throughout the world and in Israel. On February 2021, the Tribunal rejected the Director General's request for such an order. However, the Tribunal clarified that its decision is not intended to provide a "stamp of approval" to the current state of affairs or to prevent the Director General from exercising her powers under the Law.

In April 2021, following negotiations with the General Director, Shva and Masav applied to the Tribunal for a temporary permit to act according to the restrictive arrangement, subject to conditions recommended by the General Director. The conditions included the separation of the companies' CEO by June 2021 and other executive functions by February 2022. Furthermore, the companies will present the General Director with a detailed plan regarding all the remaining collaborations, detailing which of such collaborations can be separated in the short or long term, which of them are necessary, and how they can be maintained without harm to competition. Furthermore, the Parties agreed that they would act subject to this temporary permit or one that would be granted upon its expiry, until the end of the proceedings. The Competition Tribunal granted the temporary permit in April 2021, subject to the conditions recommended.

The main proceedings are still taking place before the Tribunal.

5. Conclusion

17. Current Israeli law recognizes and applies the actual potential competitor doctrine, as demonstrated in Competition Tribunal decisions, Israeli competition legislation and ICA's decisions and guideline papers; Israel's Supreme Court also explicitly embraced it in the Eurocom Case. Looking ahead to the future of the "start-up nation's" competition legal regime, this doctrine might become more dominant and might be further developed by both courts and the ICA, given its relevance to challenges raised by the digital economy.