

JOINT COMMENTS OF THE AMERICAN BAR ASSOCIATION SECTION OF ANTITRUST LAW AND SECTION OF INTERNATIONAL LAW ON THE PROPOSED AMENDMENT NO. 11 TO THE ISRAEL RESTRICTIVE TRADE PRACTICES LAW

September 12, 2008

The views stated in this submission are presented jointly on behalf of these Sections only. They have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and therefore may not be construed as representing the policy of the American Bar Association.

The Section of Antitrust Law and the Section of International Law of the American Bar Association (collectively, the Sections) offer the following comments on the amendment proposed by the Israel Antitrust Authority (IAA) to the Restrictive Trade Practices Law, 5748-1988 (Law) for the purpose of regulating oligopolies. Restrictive Practices Law (Amendment No. 11), 5768-2008 (Amendment). The comments are based on unofficial English translations of the Amendment and excerpts from the IAA's official legislative memorandum of June 19, 2008 (Memorandum). The translations are attached as Exhibits A and B, respectively, to these comments. The Sections appreciate the opportunity to review and comment on the Amendment.

The Sections recognize the substantial concern of the IAA with the difficult issue of the appropriate treatment of oligopolies under competition law and its efforts to improve the Law's treatment of that issue. The Sections' comments are based on our members' extensive experience with U.S. antitrust law and international competition laws.

Executive Summary

The Amendment would empower the General Director (GD) of the IAA to make a determination that a market is an oligopoly, based on findings that: (1) a "small" number of firms together hold more than a 50 percent market share; (2) there is slight competition, or conditions exist to allow for slight competition; and (3) an order of the GD can be fashioned that

will increase competition, create conditions that will do so, or otherwise prevent harm to the public or to competition. If the GD makes such findings, the Amendment authorizes the imposition of orders, including the termination of “activity that facilitates coordination among firms in the market.”

The Sections respectfully submit that international competition law norms reflecting a consensus of economic, academic and judicial learning avoid the imposition of regulatory or judicial orders to address oligopoly behavior. These authorities recognize that in markets with few sellers, each participant will consider the reactions of competitors to its pricing, output and other competitive decisions. These authorities further agree that such conduct is inevitable and cannot be regarded as a form of wrongful collusion absent actual agreement among competitors. Moreover, though oligopoly behavior may result in market outcomes that are inferior to those achievable under perfectly competitive conditions, no form of legal compulsion can be devised that can effectively prevent a competitor from considering its rivals’ conduct in its decision-making. Thus, the effects of any attempt to impose such compulsion is likely to be worse than the effects of any interdependent behavior in an oligopoly. For these reasons, the Sections respectfully recommend that the IAA not seek enactment of the Amendment.

Comments

I. Introduction: An Overview of the Amendment.

The Sections understand that Israeli competition law, like similar statutes in many jurisdictions, is aimed at preventing the acquisition or wrongful maintenance of market power that reduces efficiency or injures competition through restrictive arrangements, mergers, or abusive monopoly practices. Under the Law in its current form, the GD can find that a group of firms acting in a market with only limited competition among them is an oligopoly, and the

finding subjects them to the legal regime applicable to monopolies,¹ The GD has authority to issue directives to prevent significant harm to competition or to the public interest from a monopoly,² but has rarely made oligopoly findings.³ As discussed in Part III of these comments, there are sound economic reasons not to make such a finding unless there is evidence of collusion.

The Amendment reflects a material change in the policy of the IAA, because it would empower the GD to take action against conduct that involved neither concerted action nor an exercise of monopoly power. The GD would have authority to determine that firms acting in a market constitute an oligopoly when the following conditions are met:

1. A small number of firms hold in the aggregate a market share of over 50 percent;
2. Conditions allowing for “slight business competition” among the firms or in the market in which they operate exist, or competition among the firms or in the market is in fact limited; and
3. The GD determines that there are directives which s/he can order that may:
 - increase competition in the market;
 - create conditions for the increase of competition in the market; or
 - prevent harm or potential harm to the public or to competition in the market (or between firms comprising that group).

Under Section 31A(c) of the Amendment, the GD would determine whether conditions of slight competition exist by considering, among other factors, entry barriers, transition barriers

¹ Section 26(d) of the Law, available at <http://www.antitrust.gov.il/Antitrust/en-US/LawandRegulations/RestrictiveTradePracticesLaw.htm>.

² Sections 30(a) and (b) of the Law, available at <http://www.antitrust.gov.il/Antitrust/en-US/LawandRegulations/RestrictiveTradePracticesLaw.htm>.

³ The GD made a finding under Section 43(a)(4) of the Law in *Club Hotel Network* (1996) that a concentrated group of six firms controlled by the same persons that marketed each other’s products constituted an oligopoly, available at <http://archive.antitrust.gov.il/files/5835/1329.pdf>. In light of the common control of the competing firms, that ruling did not involve a classic oligopoly. The GD could have declared the firms a monopoly under Section 26(f) of the Law as affiliated persons without making an oligopoly determination.

(switching of customers between suppliers and suppliers between customers), and cross-ownership among competitors.

Upon a determination by the GD that an oligopoly exists, Sections 31B(a) and (b) would authorize the GD to take any of the following actions:

1. Terminate barriers to customers moving their business to another firm in the market, e.g., long-term supply contracts;
2. Order removal or reduction of entry barriers to a market;
3. Terminate activity that facilitates coordination among firms in the market;
4. Prohibit transfer or dissemination of information among firms in the market or to any other person which facilitates coordination among firms in the market;
5. Order divestiture of cross-holdings of shares or assets among firms in the market.

This list is not exhaustive; under Section 31(B)(a)(5) of the Amendment the GD would have general authority to issue further decrees aimed at preventing harm to competition or at increasing competition.

II. The IAA Already Has Authority to Address Oligopolies Believed to Cause or Threaten Anticompetitive Harm.

Antitrust scholars and practitioners have devoted considerable attention to dealing with oligopoly competition and they commonly view effective merger and anti-cartel policies as the optimal enforcement tools for addressing the problems caused by oligopolies.⁴ These two prongs of antitrust enforcement enable agencies to prevent formation of uncompetitive markets or distortion of competition through collusion. The IAA already has authority to apply those policies under the Law. The Sections respectfully submit that the Amendment is therefore

⁴ See, e.g., OECD COMPETITION COMMITTEE, OLIGOPOLY 34 (1999) (noting that “[m]erger review is the most direct and probably effective measure that competition agencies can apply to reduce the probability of co-ordinated interaction” among members of an oligopoly, in addition to “rigorous enforcement against explicit collusion”)[hereinafter OLIGOPOLY], available at <http://www.oecd.org/dataoecd/35/34/1920526.pdf>.

unnecessary, and further suggest that the effect of the Amendment may be much worse than the perceived problem it is intended to address, possibly creating substantial disincentives to doing business in Israel, a country that has had an enviable record of attracting foreign investment. The type of regulation that the Amendment would create also could result in replacing efficiently operating markets with markets that may well be far less efficient.

III. The Amendment Would Regulate Normal Conduct of Firms in a Concentrated Market.

Section 31A of the Amendment would authorize the GD to regulate a market and its members based solely on the structural characteristics of the market, subjecting firms to regulation in the absence of any evidence of any “arrangement” among them to restrain trade,⁵ or any evidence that they collectively can or do wield monopoly power. The GD thus would have power to intervene in a market solely by virtue of oligopolistic conditions, dispensing with the need for any evidence of wrongful conduct by competitors.⁶

As a matter of economics, it is perfectly rational for a firm in a concentrated market to take into account its competitors’ likely reactions to a price change, new product introductions or

⁵ Section 4 of the Law prohibits a restrictive arrangement, defined under Section 2(a) as an arrangement in which at least one of the parties restricts itself in a manner that is liable to eliminate or reduce competition between it and another party to the arrangement or between it and third party. Since the Amendment would subject oligopolies to regulation without regard to any finding of restrictive arrangement, consideration of what constitutes an “arrangement” among firms in an oligopoly would be moot. The Sections recognize that there are different thresholds for liability for joint conduct, depending upon the antitrust enforcement regime. *Compare* Section 1 of the Sherman Act, 15 U.S.C. § 1, (prohibiting contracts, combinations, or conspiracies in restraint of trade), *with* Article 81(1) of the European Community Treaty (EC TREATY art. 81(1)) (prohibiting agreements between undertakings, decisions by associations of undertakings and concerted practices preventing, restricting, or distorting competition within the Common Market). The Sections also are aware that the European Court of Justice has construed “concerted practices” under this provision not to require “an agreement properly so called,” but to require knowing coordination. Case 48/69 *Imperial Chem. Indus. v. Comm’n*, 1972 E.C.R. 619, ¶¶ 64 and 65; Case 172/80, *Züchner v. Bayerische Vereinsbank, AG*, 1981 E.C.R. 2021, ¶ 12; Commission Decision 2004/206/EC (Food Flavour Enhancers), 2004 O.J. (L 75). Despite these differences, however, there appears to be no competition law (EU law not excluded) that permits structural remedies to be ordered against an oligopoly in the absence of collusive or other coordinated anticompetitive conduct by its members.

⁶ Section 31(B)(a) of the Amendment.

other competitive conduct affecting output or demand.⁷ This kind of interdependence is distinctly different from collusion or coordination, and it raises no issues under Section 1 of the Sherman Act, 15 U.S.C. § 1, or any competition law in any jurisdiction with which the Sections are familiar.⁸

While courts and academics have recognized that interdependent behavior that typifies oligopolies may result in higher prices or otherwise fail to maximize consumer welfare as would perfect competition,⁹ they have recognized that such unilateral behavior does not constitute unlawful collusion¹⁰ and have concluded that no practical regulatory or judicial mechanisms exist to effectively ameliorate the less than perfectly competitive outcomes of such behavior.

As Judge, now Justice, Breyer wrote:

⁷ Donald F. Turner, *The Definition of Agreement under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 HARV. L. REV. 655, 665-66 (1962) (“[T]he rational oligopolist is behaving in exactly the same way as is the rational seller in a competitively structured industry; he is simply taking another factor into account [the reactions of his competitors] . . . which he has to take into account because the situation in which he finds himself puts it there.”)[hereinafter *Turner*]

⁸ *E.g.*, *Bell Atl. Corp. v. Twombly*, 127 S.Ct. 1955, 1964 (2007) (while evidence of parallel conduct or interdependence may be consistent with the existence of a conspiracy, it is equally consistent with “a wide swath of rational and competitive business strategy unilaterally prompted by common perceptions of the market”); *Clamp-All Corp. v. Cast Iron Soil Pipe Inst.*, 851 F.2d 478, 484 (1st Cir. 1988) (“individual pricing decisions (even when each firm rests its own decision upon its belief that competitors will do the same) do *not* constitute an unlawful agreement under section 1 of the Sherman Act”)(emphasis in original; Breyer, J.); Gregory J. Werden, *Economic Evidence on the Existence of Collusion: Reconciling Antitrust Law with Oligopoly Theory*, 71 ANTITRUST L.J. 719, 779 (2004) (“Interdependence is normal and innocent in oligopoly. Rational oligopolists typically monitor rivals closely and react to their price changes or other strategic moves. There is nothing even remotely suspicious about such actions.” (footnote omitted)).

⁹ *See, e.g.*, *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 227 (1993) (observing that firms in a concentrated market might, through “oligopolistic price coordination or conscious parallelism” and without violating the antitrust laws, set “their prices at a profit-maximizing, supracompetitive level by recognizing their shared economic interests and their interdependence with respect to price and output decisions”). Judge Posner has noted that the small number of significant participants in oligopolistic markets may facilitate “tacit collusion,” i.e., interdependent conduct among competitors falling short of actual agreement or explicit communication. Richard A. Posner, ANTITRUST LAW 69 (2d ed. 2001). Prof. Stigler has noted that, if it is assumed that firms are profit-maximizing, firms in oligopoly markets will recognize that the “combined profits of the entire set of firms in an industry are maximized when they act together as a monopolist,” which is a natural consequence of the fact that, in such markets, “there are no major uncertainties as to the profit-maximizing output and price at any time.” George J. Stigler, *A Theory of Oligopoly*, 72 J. POL. ECON. 44, 44 (1964).

¹⁰ *In re Brand Name Prescription Drugs Antitrust Litig.*, 186 F.3d 781, 735 (7th Cir. 1999) (finding that each competitor’s exercise of market power, including price discrimination, did not tend to exclude the possibility that “each was embarked on an individual rather than a concerted course of action”) (Posner, J.).

Courts have noted that the Sherman Act prohibits *agreements*, and they have almost uniformly held, at least in the pricing area, that . . . individual pricing decisions (even when each firm rests its own decision upon its belief that competitors will do the same) do *not* constitute an unlawful agreement under section 1 of the Sherman Act. That is not because such pricing is desirable (it is not), but because it is close to impossible to devise a judicially enforceable remedy for “interdependent” pricing. How does one order a firm to set its prices *without regard* to the likely reactions of its competitors?¹¹

Antitrust laws should not prohibit rational firm behavior in concentrated markets without regard to fault or collusive anticompetitive conduct by firms in the market. There is a consensus in economic learning¹² that the fact of concentration, standing alone, does not justify regulation,¹³ despite the fact that, as shown above, there is also consensus among judges and economists that less than perfect competition may result from an oligopoly market.

IV. The Amendment Would Substitute Administrative Regulation for Antitrust Enforcement.

More than a hundred years of antitrust enforcement have led competition authorities worldwide to the conclusion that they should act primarily as enforcement agencies, not

¹¹ *Clamp-All Corp.*, 851 F.2d at 484 (emphases in original; citations omitted); *see also Turner, supra* note 7, at 669 (An injunction that “prohibited each defendant from taking into account the probable price decisions of his competitors in determining his own price or output” would “demand such irrational behavior that full compliance would be virtually impossible.”)

¹² *See, e.g.,* Herbert Hovenkamp, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE 172 (3d ed. 2005) (“[b]reak-up of oligopoly firms will certainly yield an industry with more firms, and they will likely price their output closer to their costs, but their costs could be higher . . ., [and] it is doubtful that the result of structural reorganization of oligopoly industries would be efficient”); *see also* E.I. du Pont de Nemours & Co. v. FTC, 729 F.2d 128, 137, 139 (2d Cir. 1984) (rejecting attempt by the U.S. Federal Trade Commission to enjoin parallel pricing and other conduct in a concentrated industry that was “non-collusive, non-predatory and independent” and requiring “at least some indicia of oppressiveness . . . such as (1) evidence of anticompetitive intent or purpose on the part of the producer charged, or (2) the absence of an independent legitimate business reason for its conduct”) (footnote omitted).

¹³ Darryl Snider and Irving Scher, Conscious Parallelism or Conspiracy?, in 2 ABA SECTION OF ANTITRUST LAW, ISSUES IN COMPETITION LAW AND POLICY 1143 at 1144 (2008) (“As most economists, lawyers, and judges have now recognized, members of an oligopoly acting as ‘profit maximizers’ must take into account the actions and anticipated reactions of their rivals when making pricing decisions. No enforceable rule can be prescribed that would preclude such companies from thinking about and acting upon such information. They have a duty to their shareholders to manage their businesses so as to maximize profits. Although the result might be higher consumer prices or lower output, such mutual recognition of interdependence is rational, efficient behavior.”).

regulators.¹⁴ Focusing on enforcement means that antitrust agencies seek to redress past harms and deter wrongful conduct that harms competition rather than guess what steps may foster competition. This approach is part and parcel of the antitrust enforcers' duty to protect the competitive process rather than attempting to manage that process or dictate outcomes. A virtue of antitrust enforcement in recent decades has been its grounding on economic theory and common methodology, which has avoided the inconsistent results that general economic regulation can produce. The Sections understand that the IAA itself has held similar views for many years and has been reluctant to assume regulatory duties.¹⁵

The Amendment would shift the orientation of the IAA from being a market protector to being a market planner. The Sections suggest that such a shift could weaken the credibility of the IAA and generate uncertainty about the competitive process.

The Amendment would effectively bypass antitrust analysis of concentrated markets and subject them to a regulatory regime untethered to any meaningful antitrust or economic standards. While Israel is of course free to decide that concentrated markets should be subjected to regulation in the manner of public utilities, such a change would depart from international norms of competition law enforcement.

V. The Basis for Determining an Oligopoly Does Not Rest on Defined Standards.

Under Section 31(A)(a) of the Amendment, the GD must first determine the existence of a “concentration group,” i.e., an oligopoly, from evidence of (i) a “small number of persons holding a concentration of over half of the supply of goods and services, or their purchase” and

¹⁴ See OECD COMPETITION COMMITTEE, EVALUATION OF THE ACTIONS AND RESOURCES OF THE COMPETITION AUTHORITIES 187 (2005), available at <http://www.oecd.org/dataoecd/7/15/35910995.pdf>.

¹⁵ See the position of the GD on this issue in “The Position of the General Director of the Antitrust Authority Regarding Commercial Practices Between Dominant Suppliers in the Food Industry and Large Retail Chains,” May 29, 2003, available at <http://www.antitrust.gov.il/Antitrust/en-US/Decisions/>.

(ii) only “slight competition” in the market. “Small” is undefined. It is not difficult to envision a market within the definition of “concentration group” that in fact has none of the attributes of a concentrated market. If three firms together held 51% of a market, for example, each could hold no more than 17% and still be subject to the Amendment. A market that might have a dozen or more participants, of which only three have 17% each, could qualify as an oligopoly. Such market conditions are far from unusual and are commonplace in many large countries with relatively unconcentrated economies, and especially in smaller countries such as Israel. Competition laws should avoid undue interference with the operation of markets. Markets work best when competitors do not face a “chilling effect” that inhibits normal competitive behavior.

Section 31A(c) of the Amendment identifies specific factors to be taken into account in evaluating whether there are conditions in a market for “slight competition,” but the factors, barriers to entry, barriers to customers or suppliers switching, and cross-ownership, are insufficient to support a conclusion as to whether a market is functioning efficiently. For example, in many cases both customers and suppliers would incur significant costs in switching to alternatives, even though there may have been intense competition at the point when each made the initial decision on from whom to buy or to whom to sell.¹⁶

These factors also are not sufficient for the GD to determine whether the concentration is attributable to conduct of firms in the market as opposed to external circumstances, such as costs of investment, limited resources, or limited demand, over which the firms have no control. For example, the introduction of expensive new product capabilities by several competitors that require long-term contracts to make their investments worthwhile could be challenged under the

¹⁶ See, e.g., *Eastman Kodak Co. v. Image Tech. Servs.*, 504 U.S. 451, 476 (1992) (noting that even though copying machine manufacturer had small share of original equipment market, customers might be “locked in” to the machine and willing to bear supracompetitive pricing for aftermarket parts and service if the cost of switching to another equipment brand were high).

Amendment. If the GD required these innovative competitors to allow their customers to switch before the end of the initial contract term and recoupment of their investments, future innovations could be inhibited, with a potentially deleterious effect on the Israeli economy. More fundamentally, the term “slight competition,” despite the conditions set out in the Amendment, is a subjective term without sufficient rigor to allow firms to recognize, and avoid, the conditions or conduct that would support intervention by the IAA.

VI. Remedies for “Regularization” of an Oligopoly May be Imposed Without Identifying Any Likelihood of Harm and Are Not Statutorily Confined.

The Amendment would give the GD authority to act against an oligopoly even though there may be no evidence of likelihood of harm to competition or likelihood that a remedy would be beneficial to competition. Section 31A(a) provides that the GD may act against oligopolies if s/he “realizes that mandating certain measures . . . may prevent harm, or the likelihood of harm . . . [or] may increase competition in the sector or create conditions that similarly increase such competition.” This is a speculative and imprecise test on which to invite regulatory interference in a market that may have many participants, none of which may have a significant market share, and in which there is no evidence of collusion.

The listing of measures that the GD may take to achieve “regularization” of an oligopoly raises questions about the factual and economic premises of the Amendment. The provision for “removal or restriction of entry barriers,” Section 31B(a)(2) of the Law, assumes that the IAA should be able to mandate and achieve structural changes in markets without regard to fault or wrongful conduct of firms in the market. While competitors may be responsible for some entry barriers, e.g., control over supplies through vertical integration or long-term contracts, other entry barriers will not be caused by, or within the control, of competitors, but are the result of external factors such as cost of investment, constraints on available resources, transportation

costs, exchange rates, and lack of skilled labor, among others. The Memorandum itself recognizes “the modest volume of local demand,” “geographic isolation,” “geopolitical barriers,” and “language barriers.” An order requiring divestiture of ownership in a supplier or termination of a long-term supply contract could subject a firm to loss of investment and other costs disproportionate to any gain in competition that may result, especially in the absence of any evidence of collusion, agreement, or other coordination among market participants. An order requiring reduction of entry barriers that are outside the control of market participants could be ineffectual and potentially harmful.¹⁷

Difficulties in properly balancing the risks of over- and under-enforcement inhere in all antitrust regimes, but the risk is most acute with unilateral conduct. Whether unilateral conduct is likely to be anticompetitive may be ambiguous, fashioning effective and appropriate remedies may be difficult, and enforcement, if not carefully calibrated, may deter incentives to innovate and compete.

The remedies in Section 31B would magnify these enforcement risks. The GD would have power under Section 31B(a) to issue orders for “regularization” of an oligopoly’s activities, but the introductory words to the listing of authorized orders describe them as “[a]mong other measures.” Section 31B(a)(5) gives the GD the power, additionally, to “[o]rder any other measure necessary for regulating the activities of an oligopoly.” This open-ended remedial authority would appear to be inappropriate and would likely have the effect of chilling competition, particularly in the context of regulation of oligopoly conduct that may be competitively ambiguous.

¹⁷ It has been noted, however, that competition agencies may achieve lowering of entry barriers by promoting “adoption of internationally harmonized standards and/or an expanded use of mutual recognition agreements.” OLIGOPOLY, *supra* note 4, at 33 (footnote omitted).

VII. The Amendment Would Be Inconsistent With International Norms of Competition Law

The last two decades have seen a massive increase in international trade. One important benefit of globalization is that it has introduced new competitors to many markets. Concurrently, many jurisdictions have enacted and implemented antitrust laws, most of which have been generally consistent with current economic thinking and international norms of competition law. The general convergence of these laws has had far-reaching implications, including the promotion of international commerce, the lowering of transaction costs and the costs of compliance, and enabling businesses to enter and participate in markets in these jurisdictions with lower regulatory costs and risks. To encourage globalization, the costs of doing business in many jurisdictions have necessarily had to decrease, and convergence among antitrust laws toward accepted good practices can be an important contributor to reduced costs.¹⁸

Convergence toward sound antitrust laws and enforcement policies also has allowed new competition regimes to learn from the accumulated practice of more experienced jurisdictions. Efforts at convergence are reflected by the establishment of multilateral competition forums such as the OECD Competition Committee, which has discouraged structural deconcentration.¹⁹ As the Amendment would result in an antitrust law inconsistent with policies of virtually every other country in the world, it would move Israel's antitrust policy away from these convergence

¹⁸ For the importance of convergence, see also Randolph W. Tritell, *International Antitrust Convergence: A Positive View*, ANTITRUST, Summer 2005, at 27, available at <http://www.ftc.gov/bc/international/docs/tritellpostiveview.pdf>.

¹⁹ “[S]tructural deconcentration is undesirable because it imposes substantial costs on society, including those from the loss in efficiencies created by economies of scale and scope, the expenses of litigation incurred to force the dissolution of large enterprises, and the disruption of economic activities in the deconcentrated industry.” OLIGOPOLY, *supra* note 4, at 201 (footnote omitted).

efforts, would cause substantial uncertainty, and, as noted, may have effects that are much worse than the perceived problem it is designed to address.²⁰

VIII. Conclusion.

The Memorandum notes that a relatively large number of Israeli industries display conditions of oligopolistic behaviour. Such conditions characterize many markets in large and small economies throughout the world, and do not necessarily, or even likely, lead to the conclusion that specific anti-oligopoly legislation is appropriate. Government attempts to dismantle concentrated market structures that arise without any anticompetitive conduct may well achieve the very anticompetitive ends that the enforcement efforts sought to prevent. The Sections respectfully submit that, if enacted, the Amendment would represent a material departure from internationally accepted antitrust enforcement standards and conflict with the approach that prudence and experience recommend for competition law enforcement. For these reasons, the Sections respectfully recommend that the IAA not seek enactment of the Amendment.

²⁰ “[P]arallel behavior induced by interdependence cannot be eradicated with behavioural measures short of ongoing regulation of competitive conduct, a cure that is worse than the disease.” *Id.* at 8.