COMPETITION COMMITTEE

ANNUAL REPORT ON COMPETITION POLICY DEVELOPMENTS IN ISRAEL

JANUARY 2003 – APRIL 2004

TABLE OF CONTENTS

Introduction

This report summarizes major recent initiatives and developments in Israel's competition law and policy and in the enforcement of the Restrictive Trade Practices Act, 5748-1988 (hereinafter: "Antitrust Law") for the period of January 2003 through April 2004.

The IAA is an independent government enforcement agency established in 1994 under an amendment to the Antitrust Law. The IAA is mandated to prevent market power through merger control and anti-cartel enforcement, to restrain abuse by dominant firms of their positions and to preserve competition in the various markets.

An Antitrust Tribunal, sitting with the District Court in Jerusalem, has exclusive jurisdiction over non-criminal governmental antitrust proceedings. Interim orders and final decisions of the tribunal are appealable to the Supreme Court, the highest judicial authority in Israel. The District Court of Jerusalem has exclusive jurisdiction over criminal antitrust matters. The Court's decisions are appealable to the Supreme Court as well.

While the IAA has an important enforcement function, the Antitrust Law also provides for any person to independently seek a remedy from the Court.

The IAA focused its efforts selectively in 2003 on a number of specific markets, in which serious antitrust complexities were identified

Some of the most important accomplishments of the IAA were the publishing of the General Director's position regarding **commercial practices between retail chains and dominant suppliers**; the publishing of a new **block exemption** concerning **ancillary restraints to merger transactions**; the General Director's determination regarding the restrictive nature of a **copyright collective society**'s activity and regarding its dominant position in the market of administration of copyrights and the granting of licenses to users; and the handing down of an **indictment against the four largest gas companies** in Israel.

The resources of the IAA have not significantly changed from previous years, with an annual budget of 21,324,000 NIS (approximately 4.4 million USD) and 78 employees.

1. Proposed Changes in Competition Laws and Policies

1.1 Block Exemption for Restraints Ancillary to Mergers

1. In March 2004, a new block exemption for restraints ancillary to mergers came into force. The block exemption is designed to exempt parties from obtaining an approval or a specific exemption for restraints that are ancillary to a merger transaction and which do not appreciably restrict competition.

2. The drafting of this block exemption stemmed from the acknowledgement that such restraints might be necessary to assure the economic value of the transaction.

3. An ancillary restraint is defined as one of the following: (a) non-competition clause; (b) non-solicitation clause; (c) seller's commitment not to transfer any knowledge he acquired due to his holdings in the acquired business; (d) agreement between the seller and the acquired business regarding the purchase

or supply of goods under the same terms as prior to the merger or under beneficial terms, as long as the terms prior to the merger did not infringe upon the law; (e) any other restraint that is essential for the preservation of the economic value of the acquired business. The block exemption will apply on a restraint if certain terms, which are well defined, are met. The block exemption was published in the official record and came into force on March 11, 2004.

1.2 Reform in the Merger Notification Form Format

4. The Minister of Trade and Industry has recently signed new merger regulations[1] constituting two types of merger notification forms: long form and short form.

5. **The long form** expands upon the information submitted to the IAA at the initial notification of the transaction. The IAA believes that this additional information in the initial submission will suffice to enable its Economic Department to determine whether the merger appears to substantially harm competition in a large percentage of the cases, and will eventually significantly reduce the number of supplementary information requests and consequently shorten the period for decision-making.

6. The existing form has many deficiencies, and in a very high percentage of the notified transactions it is necessary to ask the parties for further basic data just to assess whether an in-depth inquiry is needed. Information requests in non-problematic transactions unnecessarily cause delays in the handling of applications.

7. In addition, the IAA recognized that submitting a comprehensive notification form is completely unnecessary when dealing with non-problematic mergers. Consequently, it followed the Canadian approach and decided to enable parties to transactions that meet certain conditions and do not raise, prima facie, competition concerns, to file a **short form**. The regulations and the forms are expected to be published shortly.

1.3 Process of Adopting a Leniency Program

8. The IAA proceeded in its efforts to adopt a leniency program. Following an extensive internal review and consultations with the Ministry of Justice and the Attorney General as well as with the USDOJ and the European Commission, additional changes in the program have been made. The IAA delivered the final draft of the program to the Attorney General for his final approval.

2. Enforcement of Competition Law and Policies

2.1 In General: Powers and Statistics

9. The Antitrust Law provides for varied remedies in cases of infringement. Antitrust Law violations are a criminal offence as well as a civil tort.

2.1.1 Criminal

10. Severe antitrust violations may be subject to criminal prosecution and may result in fines and prison terms. Liability is imposed upon the corporation and its executives.

11. The IAA holds investigational and prosecutorial powers. Although arguments rose against holding these powers in tandem, claiming that this situation does not conform to the principle of separation of powers, the Supreme Court recently determined that as long as the IAA maintains an institutional separation, this situation is legal. This ruling reaffirmed the IAA's entitlement to hand down indictments and prosecute antitrust offenders.

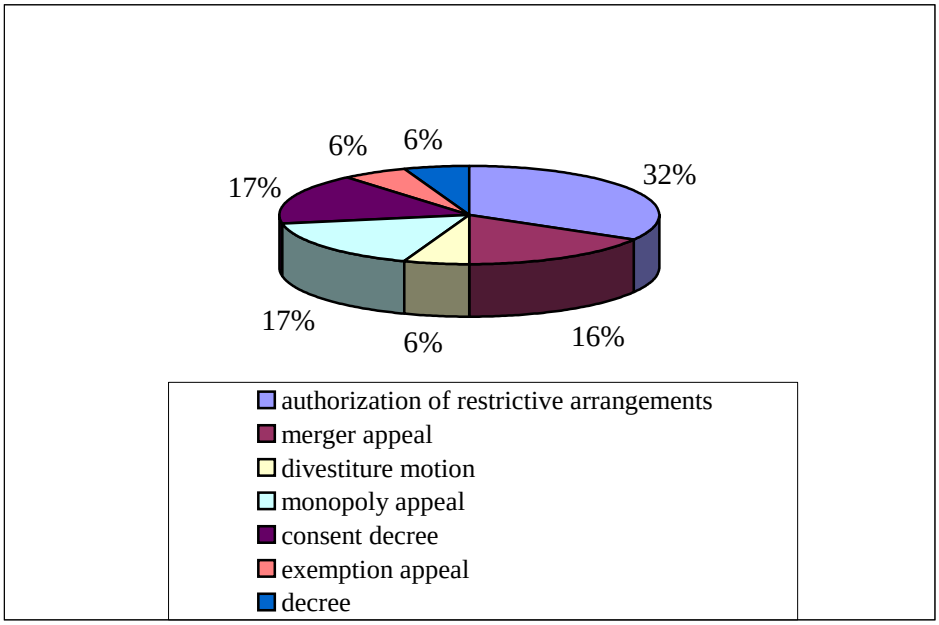
12. During the reviewed period, the IAA opened four new criminal investigations, concluded seven investigations and filed three indictments in the Jerusalem District Court. The IAA was involved in five criminal litigation proceedings before the Supreme Court and seven proceedings before the Jerusalem District Court.

2.1.2 Civil Remedies

13. The civil and administrative remedies for infringements of the Antitrust Law include consent decrees, injunctions and court orders granted by the Antitrust Tribunal. The General Director has the power to declare an activity as prima facie illegal and the power to issue rules of conduct to monopolies.

14. During the review period the IAA was involved in 18 civil litigation proceedings before the Antitrust Tribunal.

Table: Civil Litigation Proceedings



15. In addition, during 2003, the IAA opened forty-nine administrative inquiries, following public complaints. The IAA found these complaints worthy of further investigation, since they seemed to raise sincere competitive concerns. The complaints referred to a wide range of anti-competitive practices in the realms of restrictive arrangements and abuse of a dominant position.

2.2 Restrictive Arrangements

A "**restrictive arrangement**" is defined as an arrangement made between two or more persons conducting business that limits at least one party to the arrangement in a manner that may prevent or reduce competition.

In addition, the Antitrust Law provides for a number of specific restraints, the existence of which constitute an irrefutable presumption that damage to competition exists.

Accordingly, an arrangement involving a restraint relating to one of the following issues shall be deemed to be a restrictive arrangement: the price to be demanded, offered or paid; the profit to be obtained; division of all or part of the market, in accordance with the location of the business or in accordance with the persons or type of persons with whom business is to be conducted; the quantity, quality or type of assets or services in the business.

16. Entry into a restrictive arrangement without the authorization of the Antitrust Tribunal (or without a temporary authorization) is forbidden, unless the arrangement was exempted specifically by the General Director or is exempted according to one or more of the block exemptions. During **2003**, the General Director handled exemption requests as following:

Total number of decisions	Exemptions granted	Exemptions granted under conditions	Objections
61	26	29	6

17. The following are examples of significant restrictive agreements cases, which demonstrate the wide range of issues addressed by the IAA involving both criminal and civil enforcement activities.

2.2.1 The Antitrust Tribunal Approved the General Director Motion to Divest Poultry Slaughterhouses

18. In November 2003, the Antitrust Tribunal decided to divest three of the poultry slaughterhouses that marketed their produce through Tnuva Central Cooperative for the Marketing of Agricultural Produce in Israel Ltd ("Tnuva"), according to the General Director's motion that was submitted to the Antitrust Tribunal.

19. For many years, Tnuva, one of the largest food conglomerates in Israel, sold its own poultry produce and also exclusively marketed the produce of the four other competing slaughterhouses to the retail market. As a result, Tnuva held a dominant market share of the poultry market. This arrangement prevented competition between Tnuva and the slaughterhouses.

20. According to the aforementioned arrangement, Tnuva coordinated with the four slaughterhouses quotas of the poultry that would be produced by each slaughterhouse, in weekly joint meetings.

21. In April 2003, the General Director asked the Antitrust Tribunal to instruct the parties to cease from the arrangement, since he found that this arrangement infringed on the Antitrust Law.

22. Following the General Director's initiative, some of the slaughterhouses withdrew from the arrangement. Accordingly, the General Director and the defendants reached an agreement according to which the slaughterhouses undertook not to market their produce through Tnuva and to cease their joint meetings. The parties approached the Antitrust Tribunal jointly, asking it to ratify the agreement as a court decision and it did so.

23. This agreement concluded a forty-year stagnation in the poultry market and enabled the opening up of this important market to competition. Indeed, we witness that one of the independent slaughterhouses has already posed aggressive competition to Tnuva.

2.2.2 The General Director Determined that the Activity of ACUM (A Copyright Collective Society) Involves Restrictive Arrangements and that ACUM is a Monopoly

24. In March 2004, the General Director determined that the establishment and activity of ACUM, a copyright collective society, involves restrictive arrangements for which neither an approval of the Antitrust Tribunal nor a specific exemption from the General Director were sought. The restrictive arrangements provided ACUM a dominant position in the markets of administration of copyrights and the granting of licenses for users.

25. ACUM, which was established in 1936, is a collective society encompassing approximately 4600 creators, authors, composers, lyricists, poets and music publishers. In addition, ACUM is engaged in arrangements with 160 overseas associations and companies, which pursue goals similar to those of ACUM (hereinafter: foreign associations). These arrangements enable ACUM to administer in Israel, mostly exclusively, the copyrights that are held by the foreign associations. Consequently, ACUM, de facto, possesses the rights to almost every work that was ever written.

26. In practice, ACUM's members assign their rights for all of their existing and future work to ACUM exclusively, and ACUM exploits those rights by granting licenses, including blanket licenses, to users, collecting royalties, distributing the royalties among the members and enforcing their rights in case of infringement.

27. Since the copyright owners of most of the work in Israel are members of ACUM, the influence of the restrictive arrangement is substantial; ACUM's activity leaves no competitive alternative for the users. ACUM's activity involves the establishment and maintenance of uniform rates of royalty and other conditions in relation to the exploitation of the copyrights, thereby eliminating price competition. ACUM reduces competition between the various copyright owners, between the owners and ACUM, between ACUM and potential competitors in Israel and between ACUM and the foreign associations. In addition, it was found that ACUM's control of such a vast repertoire of work granted it a dominant position in the administration of copyrights and the granting of licenses.

28. The General Director's decision can serve as a prima facie evidence, in all legal proceedings, to ACUM's dominant position and involvement in restrictive arrangements.

2.2.3 Publication of the General Director's Position Regarding Restrictive Practices between Dominant Suppliers in the Food Industry and Three Large Retail Chains

29. In May 2003, the General Director published his position regarding commercial restrictive practices between fourteen dominant food suppliers (some of which had previously been declared monopolies by the General Director)[2] and the three large retail chains.

30. The publication of this position followed an extensive investigation initiated in 2000 and concluded at the end of 2002. It entailed an extensive examination by the IAA's Legal and Economic Departments aimed at evaluating the competitive impact of the different practices that were revealed and the measures that should be taken.

31. In his position, the General Director indicated that evidence of violation of the Antitrust Law were found, such as:

- Dominant suppliers demanded the retail chains, in some of their commercial agreements, to refrain from admitting competing "private labels". In addition, a dominant supplier agreed

to pay one of the large retail chains for the removal of all but one of the competing products from their shelves.

- Dominant suppliers and large retail chains agreed that the shelf space allotted to their products would be significantly larger than half of the shelf space allotted to similar products sold by the chain. In addition, a dominant supplier made an arrangement with a retail chain that the latter would receive payment in return for its guarantee that it would strive to maintain or increase the market share of the supplier's products in several categories where the supplier has a market share significantly above fifty percent.

- A large retail chain and a dominant supplier agreed to appoint the supplier to be a category manager, in order to enable him to increase the market share of its products in the relevant category.

32. The General Director presented his conclusions and guiding rules, prior to taking any legal actions, in order to prevent any continuance of the problematic practices exposed during the investigation, and in order to set the normative framework.

33. The General Director's position was published for the public's comments. The comments that were submitted by August 2003 were carefully examined by the Legal and Economic Departments, and the General Director's final position and guiding rules will be published soon.

34. The publication of the General Director's position received widespread attention in the Israeli food industry. Many of the suppliers already expressed their agreement to comply with the rules recommended in the General Director's position.

2.2.4 A Consent Decree Prohibits Lease Contracts of Gas Stations Extending beyond Seven Years

35. In November 2003, the Antitrust Tribunal ratified an agreement reached between the IAA and "Delek The Israel Fuel Corp. LTD.", one of the three largest fuel companies in Israel, as a consent decree.

36. The Israeli fuel market is highly concentrated; three longstanding fuel companies, which hold approximately eighty percent of the market, control it. The market is also characterized by high barriers to entry, mainly due to regulatory barriers on the opening of new gas stations and due to long-term exclusive supply contracts between the fuel companies and the gas stations.

37. In 1995, the General Director and the three leading fuel companies reached a settlement designed to put an end to exclusive supply agreements between the fuel companies and the gas stations. This settlement was aimed at opening the market to competition and enabling two newly established fuel companies to compete.

38. Following the abovementioned settlement, the fuel companies began to lease the gas stations and to operate them by themselves, thus circumventing the settlement by preventing gas stations from purchasing fuel from other competitors.

39. The IAA and "Delek" agreed that every lease agreement, according to which "Delek" leased a gas station for a period exceeding seven years, would be considered a merger that has to obtain the General Director's approval before consummation.

2.3 Cartels

40. The IAA devoted extensive efforts and sources to fighting cartel activity in a wide range of industries. The following are summaries of major cases that were tried during the past year.

2.3.1 The Pesticides Case: Managers' Liability in Cartel Cases

41. In January 2004, the Supreme Court denied an appeal of a director of a pesticides distribution company on the District Court's decision, which found him liable according to the "Managers Liability" provision of the Antitrust Law.

42. The company was convicted for price fixing and market allocation under a plea bargain. The director refused to take part in the plea bargain and therefore decided to proceed with the court litigation.

43. The District Court established that the accused did not prove any of the two elements of the defence available under the "Managers Liability" Provision: he did not prove that he had not known of the felonies nor did he prove that he had taken reasonable measures in order to ensure obedience to the Antitrust Law provisions. For the first time, the Court determined that in order to convict an official, under the said provision, there is no need for the prosecution to prove the existence of *mens rea*.

44. The Supreme Court concluded that even though the appellant was new in his job, he was obliged to take measures to guarantee that the Antitrust Law was not violated by his employees, even if this required an adjustment of his managerial priorities.

2.3.2 The Supreme Court Denied the Appeal of Three Convicted Cartel Offenders in the Field of Electric Pipes

45. In November 2003, the Supreme Court denied the appeal of two executives and one company that were part of a cartel that operated in 1994 in the field of electric pipes. The cartel's activity led to a rise of 120 percent in electric pipe pricing.

46. Four electric pipe companies and eleven executives were convicted and sentenced. The Jerusalem District Court was convinced that the defendants decided to reduce competition in the electric pipe field and to raise prices, after identifying a price decline in the market. Most of the parties agreed to market their products through a newly established joint company. The other parties, preferring not to market their products through the joint company, chose to coordinate their prices with it.

47. In the District Court's conviction, the judge pointed out the potential of a joint marketing company to harm competition between producers and to serve as an instrument for price fixing and allocation of production. The companies' executives were sentenced to imprisonment to be served in public service and the companies were sentenced with fines of up to 600,000 NIS.

48. Two executives and one company appealed the decision. The Supreme Court denied the appeals after determining that even a short-term cartel can substantially harm the market by raising prices and therefore **the appropriate sentencing for cartel offenders is imprisonment in jail (<u>not to be served in public service</u>)**. The courts stressed that in this specific case, nevertheless, the imprisonment would be served in public service since the cartel operated in the period in which the Antitrust Law was not widely enforced.

2.3.3 Gas Suppliers Cartel: An Indictment Was Filed in Court

49. In April 2004, the IAA filed an indictment against the four largest gas companies in Israel and their executives. According to the indictment, the four gas companies conspired to cartelize the gas market by agreeing not to compete with each other for their existing customers. The impetus for this arrangement was the entrance of a new competitor into the market.

50. In addition to non-competition for existing consumers, the companies agreed to divide the new customers among themselves according to an agreed quantitative key and to avoid granting benefits to customers. In order to incorporate the new entrant and a number of small domestic companies in the cartel, the companies promised them a larger share of the new customers than their pre-agreement shares warranted.

51. The investigation, conducted by the Investigation Department of the IAA, was extensive. In the course of the investigation, the investigators questioned more then 170 suspects and witnesses and seized tens of thousands of documents.

52. The Legal Department's decision, based on the evidence it had reviewed, concluded that there was prima facie evidence that the Law was violated. It therefore decided to hand down the indictment to the Jerusalem District Court.

2.3.4 Paper Envelopes Bid-rigging Cartel: The Conclusion of the Investigation and a Draft Indictment

53. The IAA notified four envelope producers and their managers that the handling attorneys recommended handing down an indictment against them.

54. According to the draft of the indictment, the companies conspired in a cartel, from 1995 and until the opening of the investigation in October 2002. The cartel members conspired to divide the customers and the tenders utilizing a quantitative key. The companies' managers met occasionally and had frequent phone calls in order to coordinate and ensure the continuance of the cartel. In addition, the parties to the cartel paid an importer to stop importing envelopes into Israel.

55. The envelopes market is evaluated at 100 million NIS a year and the major consumers are government authorities and agencies, large businesses and printing houses.

56. It was found that as a result of the investigation, envelope prices in tenders for public organizations decreased by tens of percents.

57. With the conclusion of the hearing proceedings the Legal Department will decide whether to file the indictment in the Jerusalem District Court.

2.4 Monopolies and Abuse of Dominant Position

The concentration of more than half of the total supply or acquisition of an asset, or more than half of the total provision or acquisition of a service, in the hands of one person shall be deemed to be a **Monopoly**.

2.4.1 The General Director Declared Elite a Monopoly in the Roasted Coffee Market

58. In December 2003, the General Director declared Elite Industries Ltd. a monopoly in the roasted coffee market. Strauss-Elite Ltd., the third largest food concern in Israel, controls Elite.

59. The declaration follows prior monopoly declarations on Elite in the chocolate tablets market, instant coffee and cocoa powder. Strauss, which is part of the Strauss-Elite group, is a declared monopoly as well, in the milk delicacies market.

60. Elite has been controlling the roasted coffee market for many years. It holds more than 70 percent market share despite the fact that a number of players tried and are still trying to enter the market.

61. The Economic Department's examination concluded that roasted coffee is a distinct market and is different from other kinds of coffee, e.g.; instant coffee and espresso. This conclusion was drawn following an extensive analysis of the production and consumption characteristics of the different kinds of coffee and after studying the opinions of the market participants.

62. Since the declaration can serve as a prima facie evidence for Elite's dominant position in any legal proceeding, it has meaningful and practical importance for the purpose of private enforcement. Elite has recently appealed the General Director's decision to the Antitrust Tribunal.

2.4.2 The IAA Completed an Investigation of Elite for Driving an Entrant – Cadbury - Out of the Chocolate Market

63. The Legal Department of the IAA is currently considering whether to hand down an indictment against Elite Industries Ltd. for abusing its dominant position in the chocolate market. The investigation, concluded a few months ago by the Investigation Department, focused on Elite's efforts to block the entrance of a new competitor – Cadbury - by engaging in restrictive practices with various retailers.

64. As mentioned before, Elite produces, markets and distributes a wide range of food products: chocolate, sweets, coffee, snacks and pastries. Elite possesses a dominant position in several of the markets in which it is active. Cadbury, one of the largest chocolate producers in the world, began to penetrate the market through a local representative at the end of 2002.

65. The chocolate tablets market is estimated at one billion NIS annually. Elite possesses more than 70 percent of the market and thus was declared a monopoly in 1988. Following his declaration, the General Director instructed Elite not to engage in exclusivity arrangements with retailers and not to condition the supply of its dominant products on the purchase of other products from it.

66. Allegedly, Elite's efforts to block Cadbury included granting discounts and benefits to retailers in return for excluding Cadbury from the market in order to preserve Elite's dominant position.

2.3 Mergers and Acquisitions

2.3.1 In General: Statutory Framework and Statistics

67. Analysis of merger and acquisitions constitutes an important part of the IAA's work.

Mergers that cross certain **thresholds** must obtain the approval of the General Director before consummation of the transaction. Merging parties must submit a merger notification if one of the following conditions exists:
(a) As a result of the merger, the share of the merging companies in the overall manufacture, sales, marketing or acquisition of a particular asset and a similar asset or provision of a particular service or a similar service is in excess of fifty percent;
(b) The joint sales volume of the merging companies according to their balance sheets for the year preceding the merger, is in excess of 150 million New Shekels; the sales volume of at least two of the merging companies is in excess of 10 million new Shekels each and the combined sales volume of all the merging parties is in excess of 150 million new Shekels.]
(c) One of the companies is a monopoly.

68. The Antitrust Law sets a review period of thirty days, during which the General Director has to reach a decision. This period can be extended by the Antitrust Tribunal or by the consent of the merging parties. If the IAA fails to reach a decision within the prescribed time period, the merger is deemed compatible with the Law.

The Antitrust Law defines a "**merger**" as including one or more of the following:
a) the acquisition of the essential assets of a company by another company;
b) the acquisition of shares in a company by another company that confers on the purchasing company more than one quarter of the nominal value of the share capital issued at that time, or of the voting rights;
c) the right to appoint more than one quarter of the board of directors;
d) the right to participate in more than one quarter of the profits of the company.

The above applies whether the acquisition is direct or indirect or by means of contractual rights and applies on transactions with similar results.
The IAA interprets the definition broadly as to include all transactions that are likely to establish an affinity or to significantly reinforce an affinity between the mechanisms for taking business decisions of two or more bodies.

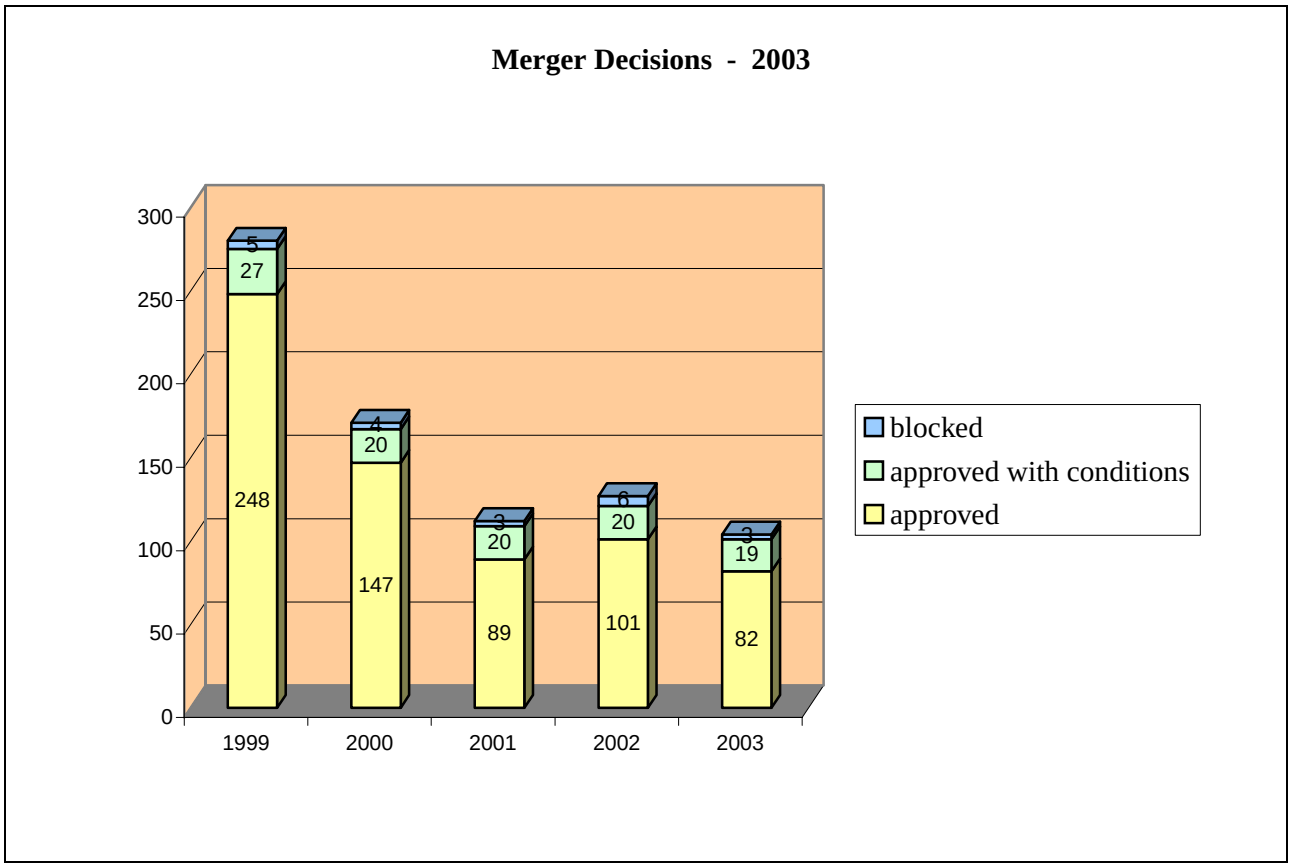
69. The General Director is authorized to block a merger if the merger raises a reasonable suspicion of material injury to competition or the public. He can clear the transaction or approve it under conditions. The General Director's decision is open to an appeal to the Antitrust Tribunal.

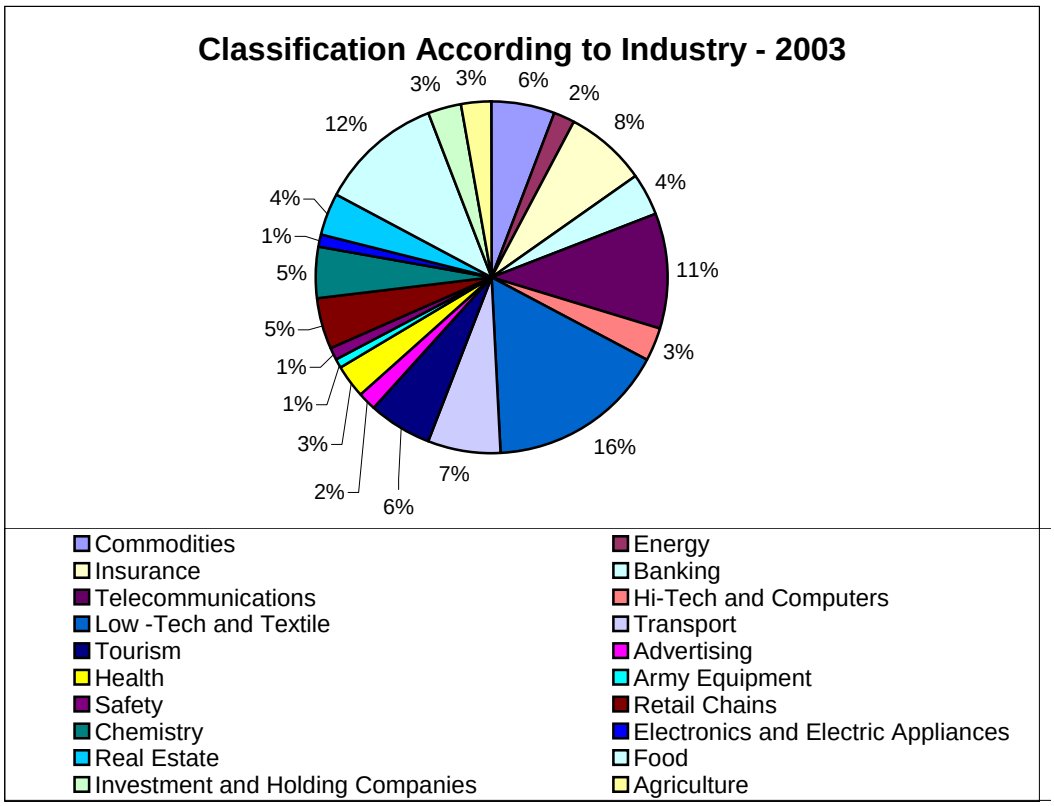
70. During 2003, the IAA considered a hundred and forty-five merger notifications (including transactions that were notified in 2002). Of these, one hundred and four were, in fact, mergers. To the best of our knowledge, five of these mergers were also reviewed by foreign competition agencies and had international implications. Three percent of the IAA's decisions resulted in the blocking of a merger; eighteen percent resulted in the approval of a merger with conditions; and seventy-nine percent resulted in the unconditional approval of the merger. In addition, the IAA reached eight decisions concerning the amendment of conditions that were imposed in the past.

71. In 2003, the IAA completed the review of seventy-nine percent of the mergers within the 30 day time period determined in the law, opposed to seventy-two percent in 2002; twenty-one percent of the mergers required extensions by court order or the parties' consent, in comparison with twenty-eight percent in 2003.

Table: Decisions in Merger Applications[3]

	Notified	Decisions	Approved	Conditioned	Blocked
1999	316	280	88%	10%	2%
2000	230	171	86%	12%	2%
2001 updated	160	112	79%	18%	3%
2002	158	127	80%	16%	4%
2003	**122**	**104**	**79%**	**18%**	**3%**




Classification According to Industry - 2003
3%
3%
6%
2%
8%
4%
11%
3%
16%
7%
6%
2%
3%
1%
1%
5%
5%
1%
4%
12%
Commodities
Energy
Insurance
Banking
Telecommunications
Hi-Tech and Computers
Low -Tech and Textile
Transport
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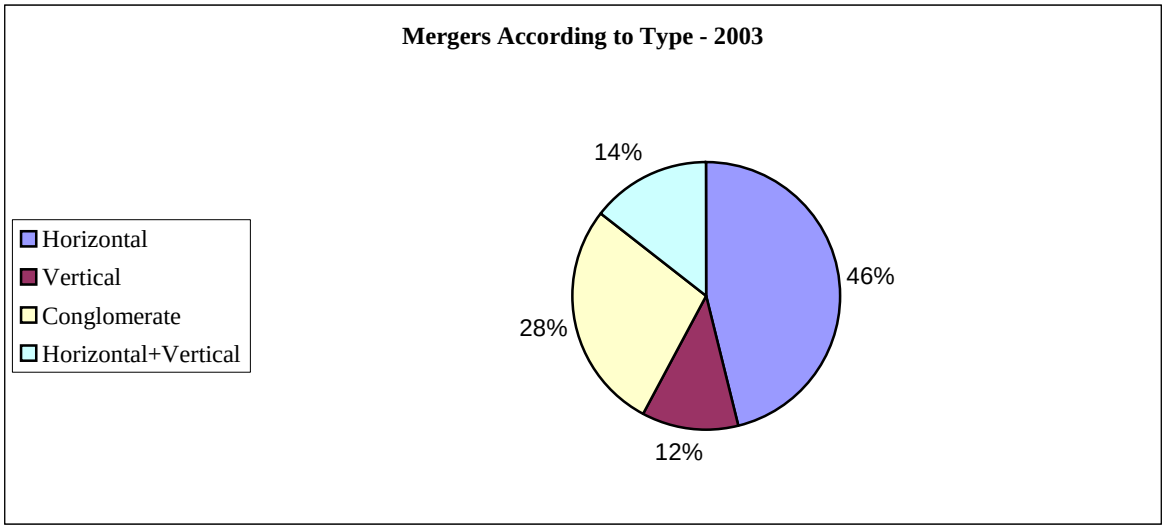
Advertising
Health
Army Equipment
Safety
Retail Chains
Chemistry
Electronics and Electric Appliances
Real Estate
Food
Investment and Holding Companies
Agriculture


Mergers According to Type - 2003
Horizontal
Vertical
Conglomerate
Horizontal+Vertical
14%
46%
28%
12%

2.5.2 Summary of Significant Court Decisions

The Antitrust Tribunal Published a Guiding Decision in the Realm of Mergers in Which It Affirmed the General Director's Position

72. In May 2003, the Antitrust Tribunal turned down the appeal of Food Club Ltd. regarding the General Director's decision to conditionally approve a merger between "Tnuva Central Cooperative for the Marketing of Agricultural produce in Israel Ltd." and "Ofkal".

73. The merger between Tnuva, a declared monopoly since 1989 in milk and milk products and Ofkal, a poultry products production plant, cut off the distribution connections between Food Club and Ofkal.

74. Food Club, which in the interim started to produce poultry products independently, presented a number of objections against the approval of the merger. It claimed, inter alia, that the merger would reinforce the market power of Tnuva, raise barriers to entry and assist Tnuva in driving competitors out of the market and consequently create an oligopolistic market that would harm competition and consumers. The Antitrust Tribunal rejected all assertions.

75. The Antitrust Tribunal accepted the General Director's position that the relevant market is the poultry products market. It determined that evidence presented supported the General Director's position that the merger had brought an increase in the total amount of poultry products in the market and in their variety as well as a reduction in prices to the consumer. In addition, the number of competitors in the relevant market grew from three to four.

76. The Antitrust Tribunal emphasized that prior to the merger, the market of poultry products was monopolistic and that the entrance of a strong competitor such as Tnuva would put pressure on the monopolistic firm in the poultry products market (Off Tov (Shean) LtD.) and would improve market structure.

77. The Antitrust Tribunal also embraced the General Director's position that in order to base the assertion that Tnuva would use its power to drive it from the market, the appellate had to explain how this type of behaviour would be profitable and that Tnuva would be able to recoup its expenditures. The Antitrust Tribunal determined that the appellate did not explain how driving it out of the market would benefit Tnuva, especially in light of the fact that there is another dominant player in the market.

78. The IAA views this court decision as an important one since this is the second substantial decision handed down by the Antitrust Tribunal since merger control was established in 1988.

2.5.3 Summary of Significant Cases

2.5.3.1 The General Director Blocked a Merger Between Two Hamburger Chains

79. In August 2003, the General Director decided to block a merger between Burger King and Burger Ranch, a local player in the hamburger chains market.4 Had the merger been approved, only two players - Burger Ranch and McDonald's - would have competed in the hamburger chains market in Israel.

80. The sale of Burger King was conducted under the supervision of the Tel Aviv District Court after the franchisee of Burger King in Israel was appointed a receiver. Aside for Burger Ranch, there was another interested potential buyer that expressed his intention of continuing to activate the Burger King's

branches under the trademark of "Burger King". Hence, there was an alternative buyer that would enable the existence of a third player in the market.

81. The main issue in dispute concerned the product market definition. Burger Ranch claimed that the appropriate product market definition is the fast-food market, including not only hamburger chains, but also, for instance, pizza and sandwich stands. On the basis of this market definition, it asserted that there are many participants in the market and thus a merger between the two-burger chains is not expected to harm competition.

82. Burger Ranch's assertions were examined in the Israeli setting and were found erroneous. Evidence given by market participants, including internal documents, showed that the market of hamburger chains is a distinct market from the fast food market as a whole. The evidence showed that the players in the hamburger chains market examine their performance in comparison to the other two hamburger suppliers and not to other players in the fast food market.

83. In addition, the IAA empirically tested whether its suggested definition (hamburger chains) was correct, or whether to use Burger Ranch's definition. The IAA identified shopping malls (a closed, well-defined geographic area) in which there was an existing hamburger outlet, and there was entry by another hamburger chain and/or a non-hamburger chain. The IAA tested whether this entry led to a significant decrease in sales by the incumbent store. The IAA found that entry by another hamburger chain significantly reduced sales by the incumbent, while entry by a non-hamburger store did not. The IAA thus concluded that the product market appropriate for the desired merger was hamburger chains.

84. On the basis of the qualitative and quantitative indications, the General Director blocked the merger.

2.5.3.2 The General Director Blocked the Purchase of a Maverick in the Corrugated Cardboard Market

85. In May 2003, the General Director blocked a merger between Carmel Container Systems Ltd. and Best Carton Ltd., competitors in the corrugated cardboard market.

86. The corrugated cardboard market in Israel is highly concentrated. Few local producers are active in this market, imports are negligible and the import and production barriers are high. In addition, it was found that Best Carton served as a maverick, and had the merger been approved, the ability of the remaining firms to coordinate would have been greatly enhanced.

87. Approval of the merger would have left three firms in the market, two of which were partially owned by the same individuals. In addition, the industry had a history of coordination between the manufacturers in the market, and several years earlier the General Director declared that there were restrictive arrangements in the industry. This also helped convince the General Director that this merger should be blocked.

3. International Cooperation

ICN

88. The IAA joined the International Competition Network (ICN) in 2001 and was appointed as a member of its interim Steering Group. Lately, the IAA was chosen to serve as a member of the Steering Group for an additional tenure.

89. During the reviewed period, the IAA continued to head the Merger Investigation Techniques Subgroup, operating within the ICN's Merger Working Group, which focuses on the development of the

best practices for the investigation of mergers. The subgroup is in the process of drafting a comprehensive handbook discussing various aspects of investigative techniques.

90. In the 2003 ICN Annual Conference, that took place in Merida, Mexico, the subgroup presented four chapters:

- Summary report on investigative tools.
- Overview of methods for developing reliable evidence.
- Report concerning the role of the economists and economic data.
- Contact list of agencies' officials for information exchange among agencies concerning merger issues.

91. In the 2004 ICN Annual Conference that took place in Seoul, Korea the subgroup presented two additional chapters:

- An overview on developing the investigative plan.
- The private sector's perspective: the subgroup recruited NGA's from various jurisdictions who are currently engaged in formulating their own views on the merger review process and their feedback on the work the subgroup already presented.

92. The subgroup is planning to hold an investigative techniques workshop in Brussels, during October 2004, in continuation to the workshop it held in Washington in November 2002.

93. In addition, the IAA chaired the Model Advocacy Subgroup, which operated within the Advocacy Working Group. In the 2003 Annual Conference the subgroup presented a compilation of existing statutory provision in member countries that authorize general advocacy, create a role for the agency in the privatization process, and control the relationship between the agency and sectoral regulators.

4. Competition Advocacy

94. The IAA acts as a competition advocate to disseminate competition principles in government agencies and Parliament so that all government bodies acknowledge competition as a crucial factor in policy decision-making. The IAA's advocacy efforts were also directed to the general public as well as to the business and legal communities.

4.1 The IAA and the Public

95. The IAA held two successful public events. The first took place in April, 2003. It presented the IAA's work during 2002, introduced the proposed block exemptions, dealt with the linkage between R&D agreements and antitrust, tackled the definition of "restrictive arrangement" in the Law and discussed the role of antitrust in small economies.

96. The second, in cooperation with Tel Aviv University's Law Faculty, took place in October 2003. There, lawyers from the private sector, academics and government and IAA officials reviewed the new judgments that were given in the realm of "restrictive arrangements" and debated over new tools in public-economic enforcement.

97. The IAA, recognizing the growing use of electronic mail, launched a new "hotline" on the IAA's website. The hotline enables the public to turn directly to the General Director with questions and complaints. This tool was revealed as effective.

98. The IAA mailed two booklets to companies and people who engage in antitrust. The booklets summarized all the important decisions that were handed down by the Courts, the Antitrust Tribunal and the General Director.

4.2 Cooperation With Other Government Offices

99. The IAA was extensively involved with other ministries and government agencies in trying to open markets to competition and solving competition issues that significantly affect the local economy. Here are a few examples:

4.2.1 Legislation processes Concerning IP Laws

100. The IAA has submitted a number of legal memos to the Ministry of Justice relating to a number of legislative initiatives concerning intellectual property. The memos focused on the interface between IP rights and antitrust and aimed at guaranteeing that antitrust considerations will be taken into account as well.

4.2.2 Privatization and Divestiture of Israel's Main Petroleum Distillates Storage and Distribution Company

101. Pi Gliloth Petroleum Terminals & Pipelines Ltd. has 4 terminals countrywide, which are used for storage and distribution of petroleum distillates. According to the General Director's position the company's ownership structure constitutes a restrictive arrangement, which did not receive the Antitrust Tribunal's authorization or a specific exemption by the General Director.

102. In 2004, the General Director initiated negotiations with Pi Gliloth in order to reach an agreement regarding the plan for its privatization and divestiture within 2 to 3 years. The relevant ministries - the Ministry of Energy, the Ministry of Justice and the Ministry of Treasury – approved the outline of the plan. Today the IAA is working jointly with the relevant ministries to promote the final agreement.

4.2.3 Privatization and Divestiture of Oil Refineries Ltd.

103. Oil Refineries Ltd. is the sole oil refiner in Israel and is a declared monopoly in the refining segment of the Oil industry. A number of government ministries and agencies - the Ministry of Treasury, the Ministry of National Infrastructures, the Ministry of Justice, the Government's Company Authority and the IAA - have been working jointly to divest and privatize the company. To this end, the aforementioned bodies established a joint team, whose mandate is to examine and outline the optimal path towards implementation.

4.2.4 Light Rail Tenders

104. In 2003 the government published two tenders for the construction of two light rails (in Tel Aviv and in Jerusalem). The IAA's concerns in this connection related to the possibility that competitors would submit a joint proposal and to the possibility that dominant players in the bus transportation market would enter the light rails market. The IAA brought to the relevant ministries' attention the abovementioned concerns in order to ensure that the tender process will be competitive. Since then the relevant ministries consult with the IAA on a regular basis.

4.2.5 Seminar for Public Servants

105. The IAA organized a comprehensive seminar on Antitrust for attorneys in public service. This seminar was required for two main reasons: (a) the detection of cases in which offers in public tenders were coordinated by the participants; and (b) the IAA's feeling that bodies of the state sometimes unintentionally create conditions that make it easier for competitors to cartelize markets.

106. The workshop aimed at deepening the acquaintance of public servants with the Antitrust Law and the IAA's work. The IAA attached high importance to this occasion; the venue enabled the IAA to enhance the awareness of Antitrust principles and the understanding of the relevance of these to the various ministries' day-to day work.

5. Resources of the IAA

5.1 Annual Budget

107. Funding of 21,324,000 NIS (which is approximately 4.6 million USD) was provided to the IAA in the 2003 budget. The annual budget had not changed significantly in comparison to the previous year's budget. A major portion of the budget, 60%, was allocated to salaries.

Table: Annual Budgets- 2003 (thousands)

	2003	**2002**	**2001**	**2000**
NIS	21, 324	21,412	20,689	20,250
USD	4,688	4,520	4,922	4,965

5.2 Number of Employees - 2003

Economic Department	13 economists
Legal Department	16 lawyers and 7 legal interns
Criminal Investigations Department	17 investigators (lawyers, economists and other professionals)
Support Staff and Administrative Services	23
The General Director's Office	2 lawyers
All staff combined	**78 employees**

NOTES

[1] Replacing the Restrictive Trade Practices Regulations (Registration, Notice of Merger, Notice of the General Director to the Public and Determination of the Sales Volume in a Merger of Companies), 5749 – 1989.

[2] The declaration serves as prima facie evidence for the firms' monopolistic position in any legal proceeding.

[3] "Notified Transactions" refers to the number of applications that were submitted during the calendar year, and "Merger Decisions" refers to the number of decisions made in the calendar year. All other numbers relate to the number of decisions.

The recession experienced in Israel since 2000 has resulted in a structural change in merger applications. While the number of applications has fallen drastically since 1999, the number of troublesome applications is on the rise, as firms attempt mergers that would not have been contemplated in better times.

[4] The General Director is authorized to block a merger if the merger raises a reasonable suspicion of material injury to competition or the public.

ANNEX

Note: The English version is a slightly modified version of the original document. Only the Hebrew Version is Official.

The Position of the General Director of the Antitrust Authority Regarding Commercial Practices Between Dominant Suppliers in the Food Industry and Large Retail Chains

1. Introduction

The primary role of the General Director of the Antitrust Authority is to protect competition in the various product markets of the economy – those markets in which the consumers make their purchases. "Protecting competition" is not just a slogan. In the view of the General Director, it's meaning is pure and simple: to prevent a person (or a group of people) from dominating the supply of a certain product to consumers. Such dominance is primarily achieved through a significant increase in market concentration among the suppliers of the specific product (and its close substitutes). Such a result can be realized through various mechanisms: the removal of competition, by excluding competitors or blocking them, coordinating with them (explicitly or implicitly) or acquiring some measure of control over them (mergers).

A combination of such enhanced concentration with existing entry barriers, are widely recognized. They result in the placing of market power in the hands of an individual or team, which, in turn, permits them to deprive the public of the benefits of competition; they can then raise prices, reduce production, lower the standard of service and the quality of the product, neglect investments in product improvement, and take actions geared at maintaining their existing market power in product distribution.

Among the General Director's efforts to protect competition, the food staples markets stands in "center stage". These are products consumed by nearly all-Israeli consumers: e.g., bread, milk, meat, dry foods, and beverages. The centrality of these markets is witnessed by both the quantity of products purchased and the percentage of disposable income spent on them. Any harm to competition in these markets results directly in a likely increase in prices paid by the Israeli public, as well as in a likely decrease in the variety of products facing the consumer. This explains why the Israel Antitrust Authority (hereafter: "IAA") has defined the protection of competition in these markets as its top priority.

For many years, dominant suppliers have controlled the food staples markets in Israel: the supply of milk and other dairy products, meat and its bi-products, various beverages (cola, other carbonated beverages, beer, etc.), coffee, chocolate and cocoa, pasta, salty snacks, ice cream and wines serve as examples of markets in which there exists, and has for many years, a clear dominance of a lone supplier. In several of these markets competition to the incumbent dominant suppliers appears to have developed, yet in others, for varying reasons, the incumbent suppliers preserved their dominance entirely. In a large percentage of these cases the competition that developed was low intensity oligopolistic competition, often with a discreet market division.

As early as 1994, only few years after its establishment, the IAA began to focus on the supply of food staples to the Israeli consumers. The supply chain can be divided into two main tiers: the suppliers - manufacturers, importers and wholesale marketers of these products (henceforth: "the suppliers") - and the consumer sales platforms - retail chains and supermarkets, and local grocery stores. A marked increase in concentration in either of these may deeply harm consumers, be it by paying a monopoly rent to the suppliers, or by paying the retail chains (supermarket). The bottom line is that the consumer is forced to pay more for fewer goods. This is the "monopoly tax" the consumer bears, often without even being aware of doing so. Independent of its origin, its consequences are clear - severe harm to the consumers relative to the outcome under competition between suppliers and competition between sales platforms[1].

From this negative scenario, the IAA draws its main objectives regarding these markets:

- To defend competition between suppliers - competition on consumers patronage at the various sales platforms; and
- To defend competition between sales platforms (in their different markets) - competition that enables the lowering of prices and improvement of service, to the benefit of the consumers.

As these are food staples, the stifling of competition and a dramatic increase in concentration in one of the tiers (suppliers or sales platforms) will harm consumers to such a magnitude that the extent and long-term effect on the economy will be immense. Particularly in times of hardship, when a majority of consumers have fallen into financial difficulties and many have little or no change in their pockets, we must protect competition with extra diligence, since the primary benefactor from such competition is the general public (and not any specific sector). Hence, the grave importance of removing competition barriers on the supply and sales tiers of the food staples sold to the Israeli general public.

2. From the General Picture to Specifics

Early on, it was realized that dominant Israeli suppliers have a tendency to "enlist" the help of large sales platforms for the sake of excluding competitors, and, at a later stage, for the sake of creating and increasing barriers to direct competition against them. The IAA has dealt with this problem, resulting in part from the structure of the markets involved, on several levels:

2.1. The Suppliers Perspective: Issuing Directives to the Monopolists

Based on Section 30 of the Restrictive Trade Practices Law (Hereafter: Antitrust Law), directives were issued in 1997-8 to the primary monopolists providing food staples to the country: **Tnuva**[2], **Elite**[3], **The Coca Cola Company**[4], **Tempo**[5], **Jafora-Tabori**[6] and **Strauss**[7]. This use of the General Directors power (often linked to monopoly declarations or related to them) included directives designated, among other things, to cancel exclusivity agreements with different points of sale made by the aforementioned monopolists, and to prevent such agreements from being made in the future. In some instances, it was forbidden to promise financial benefits to a point of sales in return for their guarantee to purchase the majority of a certain type of product from the monopolists. The principal bans imposed in these directives forbade the following: exclusivity agreements regarding sales platforms, "target discounts", "aggregate target discounts", "linked agreements" and various stipulations concerning the supply of products or the bestowal of benefits centered around not marketing competing products and other such agreements that secure the dominance of the dominant suppliers without regard to the quality or price of their product. Their dominance is maintained largely through agreements made with sales platforms, which predetermine the results of the competition and the shares of the dominant supplier, with no regard whatsoever to the preferences of the consumers. These agreements provide the "secure" dominant suppliers with power over the consumers and immunity from competition on the merits, which is the type of competition the Antitrust Law was written to protect.
In order to prevent circumvention of these instructions through semantic changes to the previously existing agreements, a clause was added to the directives that result in all the listed restrictions being applied to the "taking of all measures to the same effect" as well[8]. The validity of several of these directives has recently expired. As they are in need of revision, I have refrained from renewing them as currently worded. Indeed, in light of what is to be described in the following pages, it would seem the directives set by my predecessor no longer suffice, and there is a pressing need for a more thorough and extensive regulation of the practices in markets that contain dominant firms.

2.2 The Chains' Perspective: Objecting to Mergers and Preventing Consolidation

At the same time, there appears to have been a clear and considerable rise in the market power of the key retail chains. At first, this trend was viewed as beneficial to the consumer, as it has been widely held that the buying power of a large retail chain translates into the ability to purchase products from suppliers (including dominant suppliers) at reduced prices. Under full and direct competition between several separate and independent retail chains, this could have led to a substantial reduction in prices to consumers, as well as a decrease in the monopoly rent of the dominant suppliers. An empirical and veritable weakness in this argument became clear to the Authority when it discerned that there exist independent supermarkets, far smaller than the leading retail chains, which sell food staples to consumers at lower prices than do the major retail chains.

In the beginning of 2001, I decided to conduct a thorough examination of the matter for the purpose of receiving an accurate, up to date, picture of competition in this market. The results of my research were presented in my decision to block the acquisition of **Haviv** by **Blue Square.**[9] The gists of the relevant findings are:

A. In recent years there has been a sharp increase in the extent of grocery sales in the retail chains, far exceeding the increase in food consumption in the country. The power of the retail chains has therefore increased sharply and steadily[10].
B. The power of the retail chains is double-edged: Consumers have become more and more dependent on the services provided by the retail chains and supermarkets, and suppliers cannot afford to have their products missing from the shelves of the retail chains.[11] The power of the retail chains over the suppliers is concrete and substantial.[12]
C. In recent years we have witnessed a growth in the retailers' margins from grocery sales, i.e. the gap between the prices at which the retailers purchase food products from the suppliers (which largely

resembles the increase in the C.P.I.) and the prices at which products are sold to consumers (which have increased at a higher rate than the C.P.I.).[13]

D. This margin, which has increased throughout the years, is a further indication of the market power existent in the hands of the retail chains.[14]

As a direct result of these findings, in **October 2001** I decided to object to the merger, and prevented the acquisition of "Haviv" (a large independent cheap supermarket) by the "Blue Square" chain. In this manner, we posted a clear signal regarding any further increases in concentration through mergers and acquisitions, while maintaining the required discretion to test each and every case based on the relevant circumstances and context.

Additional inspection showed that in 2001 the power of the retail chains was maintained, while 2002 brought a moderate decrease in the retailer's growth margin. Indeed, it appears that ever since the IAA began acting in the matter and investigating the chains, there has been a slight improvement in competition in certain segments, though undoubtedly, the retail margin is still substantial. It is clear that now in particular, while the public is price sensitive, there is great importance in the removal of the many competition barriers that still exist, as described below.

2.3 Investigation of the Retail Chains and Suppliers - Key Suspicions

In April 2000, my predecessor ordered an investigation to be carried out based on the following suspicions: the existence of restrictive Agreements between dominant suppliers and large retail chains, the abuse of dominant positions, and the violation of directives issued to monopolists several years earlier. [15] Several complaints and the subsequent examination of numerous agreements between dominant suppliers and large retail chains, gave rise to the suspicion that the Antitrust Law was being violated.

The principal suspicion upon which the investigation was founded was that the dominant suppliers in Israel had found means to decrease competition between themselves and competing suppliers in the product categories in which they were dominant. This was allegedly achieved with the assistance of the large retail chains, which often cooperated with suppliers in imposing competition barriers in return for sufficient payment. The Authority investigated whether rebates or improved purchasing terms given by dominant suppliers to the large retail chains were attributable to any of the following: a reduction in the number of competing suppliers, additional growth in their market share at the expense of their competitors, preventing parallel import, preventing the entry of a competing private label, displaying their products on off-shelf displays while blocking these displays to their competitors during peak times (holidays and such), or similar actions meant to result in a reduction of "on shelf" competition between product suppliers. Various practices were thoroughly investigated by the IAA.

The practice whereby suppliers prevented, with the cooperation of the retail chains, a reduction in prices of their products, and thereby reduced price competition between different sales platforms, was investigated as well.

IAA investigators found evidence and factual confirmations for an extensive portion of the unacceptable practices listed above. The investigation showed that **trade in the those goods sold through large retail chains suffers from substantial competition barriers**, some via explicit agreements designed to bar competition, and some ingrained in deep-rooted customs.

The investigation revealed various trade practices that are liable to impair free trade in retail chains and the competition between grocery suppliers. It has been shown that various agreements between dominant suppliers and large retail chains utilize the market power of the retail chains for the purpose of blocking potential competition in the suppliers' markets. Similarly, agreements through which the suppliers actively suppress competition, specifically price competition between retail chains, have been exposed. The Antitrust Law directs me to detect and map out these practices, and neutralize their harmful effects. This is what I intend to do.

2.4. Principal Findings of the Investigation

The principal practices uncovered during the investigation influence the competition between the dominant suppliers and their competitors, and the competition between the large retail chains and the smaller retail chains and supermarkets. At times this has a **direct** effect on the competition (prevention of price reductions, restraining price competition, "punishing" price competition, reducing the variety of products facing the consumer). Other times the effect is **indirect** (impairing the ability of the dominant supplier's competitors to sell their products due to the direct battle they must wage against the dominant supplier. This may result from a requirement by the supplier to decrease the number of suppliers competing against him. Or, indirectly, to the advance guarantee of significant shelf space and large market shares, the bestowal of generous benefits in return for increased market shares, granting exclusivity in preferred displays, preventing discount sales from competitors, and the exchange of information resulting in a price equilibrium harmful to competition). **The overall results of these practices are unacceptable.**

It is noteworthy that several of these agreements do not necessarily cause severe damage to competition when the retailers in question are small and insignificant sales platforms. For instance, the law does not forbid exclusivity agreements when the share being foreclosed to the competing products is minor, as long as said exclusivity is not obtained by a monopoly.[16] However, the cases investigated include several dominant suppliers, who, for the most part, are monopolists (some have even been declared as such), and several extremely large retail chains consisting of hundreds of branches spread throughout the country. The damage caused by these agreements is substantial. It must be stopped. The Antitrust Law gives the power and legal authority to prevent precisely this kind of injury.

Typical Findings

A. A dominant supplier agreed to pay one of the large retail chains for the removal of all but one of the competing products from their shelves. A different retail chain offered a supplier to, for the right price, reduce the number of competitors present in the store. Yet another dominant supplier bestowed benefits (rebates) upon one of the retail chains in return for a reduction in the number of suppliers competing with him for shelf space.

B. Several of the dominant suppliers demanded of the retail chains, as a prerequisite for an agreement that included benefits for the chains, that they guarantee not to admit to their "variety" of products a competing private label. A different dominant supplier, a monopolist, offered the retail chain certain commercial terms with the stipulation that the chain will refrain from selling identical products from parallel importers.

C. A dominant supplier made an agreement with a retail chain that the chain would receive payment in return for its guarantee to take steps to maintain the supplier's product's market share in several categories, categories in which the supplier controlled a percentage significantly above

50%. Another dominant supplier agreed to give the retail chain a generous rebate, on a yearly basis (for two consecutive years), for increasing his relative market share by 10%.

D. Dominant suppliers made agreements with large retail chains that the shelf space allotted to their products would be significantly more than half the shelf space allotted to that category of products sold in the chain.

E. Dominant suppliers arranged with retail chains exclusivity for "off-shelf displays". These are special displays placed in highly visible areas, and the selling power of the products displayed in these is significantly higher than on the "regular" shelves.

F. A large retail chain and a dominant supplier agreed that the supplier would serve as a category captain, so he would take the opportunity offered to increase the market share of his products sold to the retail chain in that category.

G. A practice has developed between dominant suppliers and large retail chains pertaining to the occasions during which the suppliers offer special discounts to consumers. During these periods, the chain does not allow competing suppliers to make similar offers, and the supplier promises not to hold similar sales at competing chains. This exclusivity agreement blatantly prevents competition: preventing a competing supplier from reducing prices in reaction to a sale held by the dominant supplier.

H. A dominant supplier approached a retail chain and requested equalizing the retail price of a competing product with the retail price of his own products. In a different case, a supplier arranged to have the prices of his products linked to the prices of competing products. These and similar agreements prevent price competition and result in unified prices for competing products.

I. Many suppliers demand that retail chains not reduce the retail price of their products, even if such a discount would not create losses for the chain. In such a fashion the suppliers detract from the price competition between retail chains - competition from which the consumer benefits. In fact, a rather large portion of these agreements are made at the demand of competing retail chains, or in response to threats made by these retail chains, that if their competitors prices are not raised, they will compensate be subtracting similar sums from the regular payments made to the suppliers.

J. Dominant suppliers publish a price-list with recommended retail prices for the range of their products. In addition, there is an understanding between the suppliers and the retail chains regarding a "profit margin", and the recommended price is the sum of the buying price and the profit margin. In most cases, the retail chains almost automatically adopt the recommended price as the retail price.

2.5 Concrete Implications and Conclusions

The findings of the investigation are clear. The majority of these practices are restrictive trade agreements, and some of them are bluntly so. Several of these practices are viewed as abuse of the dominant position, while others appear to be violations of directives issued to monopolists.

The possibility of taking of legal measures against those involved is under serious consideration. Toward this end, we are examining, one by one, the actual effects these reprehensible practices had on competition and the state of competition in the relevant markets in general. Clearly, the impact on the competition

differs from practice to practice, just as the severity of a practice executed and enforced differs from that of one not executed and/or not enforced. Evidently, several of the practices detected could not withstand the pressures of competition, and were therefore not carried out. The damage caused by these practices and agreements bears no relevance to their legality, but may have a bearing on additional legal actions to be taken. In any case, this matter, to which I attribute grave importance, will now be expanded upon.

Pending a final decision regarding what legal actions will be taken and against whom, I deem it necessary to outline the boundaries of the permissible and the extent of the prohibited in regards to the agreements and practices exposed and investigated. The rationale behind this is clear: prior to any legal confrontation and the taking of legal actions dealing with past events, it is essential that we act to prevent future continuance of such harmful behaviour by the retail chains and suppliers involved. It is our obligation to remove such damaging practices, and return proper competition to the markets. Therefore, dominant suppliers and large retail chains must view these words as a **clear and definite warning signal** against the continuation of their anti-competitive practices.

At the same time, I deem it appropriate to recommend a proper normative course that may be taken by those involved. This course will be laid out by means of directives depicting the policy of the IAA regarding the permissible and the prohibited in matters concerning these agreements and practices. These instructions will be made public for a period of 45 days from today. At the conclusion of this period I plan to enforce them in accordance with the Antitrust Law. Separately, but concurrently, I will be considering the legal actions to be taken in this matter.

Following are the directives necessary to obey the law and remove the threat to competition.

3. Directives for the Retail Chains and Suppliers on How to Comply with the Antitrust Law

3.1 Explanations on the Behavioural Directives

The common strand between the various directives is the removal of the dominant suppliers ability to increase or secure their strength by means of agreements with large retail chains that block or reduce the access of competing suppliers to shelf space in the retail chains. In addition, the directives are aimed to put an end to supplier's exploitation of market power that results in a reduction of price competition between the retail chains. The logic is simple: the large retail chain purchases products from the suppliers for the purpose of selling them to their clients, the consumers. The retail chain may determine the lay-out of the products, yet is not entitled to charge a dominant supplier for a reduction of competition through agreements that concern the number, identity, size, location or size of shelf-space allotted to the supplier's competitors. Clearly, the retail chain is forbidden from achieving the same result indirectly, e.g., through an assurance or an "understanding" with the dominant supplier that secures the supplier a "promised market share" of the retail chain' sales.[17]

These agreements are illegal. Their outcome is especially harsh in a reality in which the large retail chains possess an overwhelming portion of the sales in any relevant category. In light of this reality, we must view with great gravity a situation in which obtaining two to three agreements with leading retail chains, secures for a dominant supplier his dominant standing in the market for the next year. The directives issued, which reflect the spirit of the Antitrust Law in the specific circumstances before us, are intended to do away with such situations. The directives are based upon the findings of the investigation, and focus on the relationship between large retail chains and dominant grocery suppliers. However, similar rules may apply to the relations between grocery suppliers and other retailers as well. To remove any doubt, let me clarify that these directives do not diminish in the least from what is stated in the Antitrust Laws regarding these relationships.

3.2. Paragraphs 1&2: Commitment to Reduce the Number of Suppliers and Refrain from Dealing with Competing Products

In agreements made between large retail chains and dominant suppliers, the retail chains guaranteed to reduce the **number of competing suppliers** on the shelves, in return for payment. In other instances, the suppliers attempted to influence the **identity** of the suppliers whose products would compete with theirs at the retail chain. These agreements constitute harsh restrictive practices, and severely harm the competition and the public on several levels:

First, these agreements block many competing suppliers (existing and potential) from interacting with a large percentage of the consumers. These agreements also contain within them the potential for preserving the market power in the hands of the blocking supplier, of dulling the competition by excluding competitors from the retail chains, and of raising the entry barriers to the market. Second, reducing the number of supplier increases the ability and the probability of coordinated behaviour in the supplier's markets and in the retail chain's market, as it decreases the costs of coordination, and thus makes the coordination of prices between competitors easier to achieve. This scenario is particularly likely when the dominant supplier is paying the retail chains to remove a "maverick" from the shelves. Finally, reducing the number of suppliers directly impairs the **variety of products** facing the consumer, and thus constitutes a reduction of production in the market. It is noteworthy that the retail chains that desire the additional pay given in return for the removal of competitors often initiate these agreements.

Preventing the entry of a competing Private Label: In certain cases, retail chains receive payment from suppliers in return for their guarantee not to permit the entry of a competing private label. This is but one example of supplier involvement in the determination of the number and identity of competitors within the chain.

A private label is a product marketed under a label owned by the retail chain. The retail chain generally control the parameters related to its production. In fact, as the owner of a private label, the retail chain is an additional competitor in the market. The private label good is sold, generally, for a lower price than that of the better - known brands. The high profitability of the private label can be expected to lead to an increase in the incentive of retail chains to compete with each other. A promise by retail chains to refrain from competing with a private label in return for payment by the supplier impairs all of the aforementioned processes. The private label usually takes up approximately 25% of the shelf space in the large retail chains. Many suppliers have argued before me that these practices by the retail chains threaten the smaller suppliers, who are excluded from the shelves. However, we have yet to discern whether there is a market failure in this matter that merits involvement. It seems that the presence of the private labels in the retail chains does not exceed the typical level found in other countries. Furthermore, a manufacturer who has no other way of getting his product to consumers through the retail chains often creates the private label. In such instances, the private label may be of assistance to the small manufacturers, enabling them to reach minimum efficient scale, and so prevent a substantial percentage of the production from falling into the hands of the dominant suppliers. Hence, an agreement that includes payment to the retail chains in return for their blocking the private label is "buying competition", and is prohibited.

Preventing parallel importing - the investigation of the retail chains revealed an attempt by a dominant supplier to reward a retail chain for their guarantee not to import the suppliers' products by parallel import or to make acquisitions from a parallel products importer. This too is a Restrictive agreement.

Parallel importing is the importing of goods that are subject to intellectual property rights and have been lawfully purchased from the legal owner, though their trade in Israel is not carried out with the permission of the legal owner. Generally speaking, the Laws of Competition approve of parallel importing. The reasoning is that in many cases the profitability of parallel importing derives from the existence of market power in the hands of one exclusive importer in a specific category. Parallel importing assists in reducing this power, thus benefiting the consumer.[18] Preventing the retail chains from such importing is a violation of the law.

The retail chains and food suppliers must be made aware that no one is entitled to negatively impact competition by means of an agreement with sales platforms regarding the identity, number, and characteristics of his competitors. This kind of agreements is classified as a "hard-core" restrictive practice, inter alia according to sections 2(B)(3)-(4) of the Law.

The directives issued in this matter:

1. Decisions regarding the quantity and identity of suppliers whose products are to be displayed for sale in large retail chains, and the number of products purchased by said retail chains, are to be reached independently by the retail chains, with no intervention of the suppliers. Without detracting from the aforementioned:

   1.1 Large retail chains shall not receive any payment, discount, or other benefit whose pretext, purpose or result is the reduction of the number of suppliers competing within the retail chains, minimizing the display area allotted to their competitors within the retail chains and exchanging the identity of the competing suppliers. A large retail chain shall not be a party to any agreement of said context or consequence.

   1.2 A supplier shall not offer or grant a large retail chain any payment, discount or other benefit for the removal of a competing suppliers' product from the chain or from a specific display within the chain, for reducing the display area of a competing supplier or for displaying it to the consumers in inferior locations or conditions.

   1.3 Large retail chains shall not commit to a supplier and shall not be party to an agreement with a supplier regarding the quantity or identity of competing suppliers with whom the retail chain will have contact, the retail chains supply and trade terms with competing suppliers, or the volume of the retail chains sales with these suppliers. All this shall be upheld regardless of any consideration.

2. Large retail chains shall reach decisions regarding the selling of products under a private label, including the reduction or discontinue of selling said product, independently, without any involvement of suppliers. This includes, among others, the following:

   2.1 Large retail chains shall not receive from a supplier any payment, discount, or other benefit regarding a reduction or discontinue in the sales of private label products, or for preventing the entry of a private label.

   2.2 A large retail chain shall not commit to a supplier and shall not be party to an agreement whose object or effect is a reduction or discontinue in the sales of private label products by the retail chains.

   2.3 Large retail chains shall not be party to an agreement whose object or effect is the lack of parallel importing of a similar product by the retail chains, refusal to sell products from parallel importing in the retail chains or the reduction in sales of said products.

   2.4 Suppliers shall not offer large retail chains any payment, discount or other benefit in return for the decision not to sell, to reduce sales, or to cease the sales of private label products or in return for the retail chains' guarantee not to commit parallel importing of products, not to sell products from parallel importing or to reduce their sales.

3.3 Paragraph 3: Acquisition of Retail Display Area

A plethora of consumers visit the retail chain branches and encounter the various suppliers' products in display areas and on the shelves. It is therefore understandable that every supplier wishes to assure a high level of visibility for his products. Being present and prominent in the display areas is vital to the viability of suppliers. The immense significance of the display areas has not gone unnoticed by the retail chains, who have begun to exploit them. A fierce and intense struggle has developed between the suppliers regarding the presence and prominence that each is to receive in key display areas. Seeing as the results of this struggle largely determine the fate of the entire campaign, "control over shelf space" has become an effective tool in the hands of the dominant suppliers to maintain and secure their market power. Experience teaches us that where there is the ability to harm competition and an incentive to do so - harm shall indeed be done.

The investigation of the retail chains revealed that the trade in display areas is focused on two main parameters: the scope of the display area, and the quality of the display. The most sought after display areas are the off-shelf display areas, which are highly visible and are considered outstanding for sales promotions.

The findings of the investigation show that dominant suppliers approached large retail chains with agreement provisions regarding the acquisition of a significant, quantitative and qualitative portion of the display areas allocated to the product categories they supply. In several instances, the dominant supplier was promised exclusivity on off-shelf displays whenever the supplier offered special discounts at the retail chain, or in peak periods such as the New Year or Passover holidays, during which a significant percentage of the yearly sales volume is made.

The trade in display areas allows the retail chains to extract the maximum they can from their assets, and is not prohibited of <u>its own accord</u>. However, in the existing circumstances, this trade may assist dominant suppliers in excluding existing competitors and making entry into the market by new competitors difficult. This level of concern for the well - being of competition is dependent, among other things, on the scope and type of the display area foreclosed, the standing of the foreclosing supplier, barriers to entry to the foreclosed market, and the timing of the foreclosure. Transforming these circumstances into definable applicable rules is not always a simple task, but it is clearly a necessary one for protecting competition.

It is therefore proper to instruct in advance that the allocation of display areas shall be carried out under several restrictions. First, an agreement may not grant a dominant supplier an allocation exceeding half of the overall display area designated for the product category in which he has dominance. Second, acquiring exclusivity for various off-shelf displays will be limited in time. Third, there shall be no long-term agreements regarding the acquisition of display areas, so as not to block the product market from potential suppliers who wish to compete with incumbent competitors.

<u>The directives issued in this matter:</u>

3. Large retail chains and suppliers shall not reach agreement s:
   3.1 Whose object or effect is the allocation to a dominant supplier of display areas exceeding half the total display areas designated by the retail chain to the product category over which the supplier is dominant.

   3.2 Whose object or effect is the granting of exclusivity to a dominant supplier over off-shelf displays for a cumulative period exceeding three calendar months or a period exceeding 30 consecutive days, or the granting of exclusivity to a dominant supplier over off-shelf displays during the holiday season, or a substantial portion thereof.

3.3 The validity of agreements concerning the allocation of shelf space to a supplier will not exceed one calendar year.

3.4 Paragraphs 4&5: Category Management and Suppliers' Sales Representatives

An efficient retail chain must take full advantage of the limited shelf space available. Optimal allocation requires extensive knowledge of the different categories and the ability to identify changes in market patterns as they occur. Naturally, the professional knowledge of the suppliers operating in each category is an asset the retail chains wish to rely on for effective category management. As a result, a format of cooperation between suppliers and retail chains referred to as "category management" has come into existence.

Category management deals with the planning of optimal allocation of shelf space, the relative portion to be given each product, the location of competing products, designing the display area and more. The retail chains may appoint an expert to serve as category captain, or it may appoint a supplier to serve as such. At times, the category captain's duties end with counselling the retail chains, and at times the retail chains choose to bestow the supplier with full category management responsibilities. All agree that the supplier always plays a crucial role in the shaping of the entire category, and the basic assumption behind "category management" by the supplier is that he possesses more information and knowledge than the retail chains. Therefore, there is no real relevance to whether the suppliers' recommendation as "category captain" formally obligates the retail chains.

The involvement of a dominant supplier in category management in a concentrated market raises realistic concerns for the well being of competition. First, it is feared that the dominant supplier managing the category will gradually push his competitors from the shelves of the retail chains by reducing their share in the overall display, and so secure his power. There is also the obvious apprehension that category management will be used to bypass the prohibitions listed in these directives and in the law, whose purposes are to prevent dominant suppliers from limiting the scope of exposure consumers receive to competing products, by means of agreements with large retail chains. Category management may also assist in the creation and stabilization of forbidden coordination between competing suppliers. This may occur as a by-product of cooperation regarding category management, and be encouraged due to the joint interests they have with other competitors. Indeed, entrusting category management to the hands of the suppliers, all the more so to a dominant supplier, runs a real risk of causing substantial harm to competition. [19] Such an agreement contains a built-in conflict of interests: The dominant supplier is charged with setting the stage on which the competition with those competing against him will be conducted.[20]

The high level of concentration existing in many segments of the food market necessitates taking a cautious approach towards these agreements, and inspecting each agreement individually. I do not believe a category management agreement, which greatly increases the supplier's ability to determine the results of the competition, should be granted the type of automatic permit granted to other Restrictive Agreements whose logic is clear. This is particularly true because the evidence attests to the fact that dominant suppliers view category management as a tool for increasing market share.

Furthermore, no concrete evidence was found during the investigation or during the deliberations held between the IAA, suppliers and the retail chains, that pointed to any significant efficiencies that necessitate, or even justify, the managing of categories by suppliers. On the contrary, the retail chains themselves, who are the purported beneficiaries of this "efficiency", claim that in the future they would

prefer organizing their shelf space by themselves based upon their own knowledge and expertise, and that "handing the reigns" to the suppliers was a mistake.

In comparing category management in Israel to similar practices in other countries, we found that retail chains often receive professional advice from an expert in this matter, and they often request advice from suppliers. The key difference lies in the fact that the concentration picture in Israel is completely different, with respect to both the supplier sector and the retail chain sector. In Israel, the fear that category management will be exploited for increasing the power of dominant suppliers is not purely theoretical. There is concrete and tangible evidence to this affect in the evidence collected in the framework of the retail chain investigations, while investigating other practices. For instance, the following paragraph appeared in an annual agreement between a dominant supplier and a large retail chain:

> "It is agreed that the representatives (of the dominant supplier, D.S.) Will accept the category management in all branches of the retail chain and all that is implied, and this with the aim of increasing the sales (of the dominant supplier, D.S.) within the retail chains by at least 8%, **while increasing the market share (of the dominant supplier**, D.S.) in this category." (Emphasis added).

The evidence before me shows that retail chains do not pay the dominant suppliers for the category management services provided; often the supplier pays for the ability to become category captain. The return given to the supplier for his services may be the reduction of competition against his products, meaning that consumers, through a "monopoly tax" which it is my responsibility to prevent, will eventually pay the tab. Therefore, the directives instruct that the retail chains alone, without the involvement of the suppliers, shall execute category management. This is by no means an absolute ban on all category management agreements. Those may be brought for approval, but this will enable us to carefully examine all such agreements, based upon the individual circumstances.

This is even truer of another accepted practice in the relationship between large food chains and food suppliers. Dominant suppliers send company representatives to physically arrange the shelves in the stores - thereby determining market shares in the entire category. These company representatives promote the interest of their employers over that of the competition, often against the best interests of the retail chains in the process. While the necessity of having shelf space arranged by the dominant suppliers has not been shown (the shelves serve as contact points with the consumer, and are at the heart of the retail chains' activities), it is evident that it poses a real threat to the competition between suppliers [21]. It became apparent that dominant suppliers utilize the company representatives as leverage for increasing their power at the sales locations, at the expense of other suppliers who do not have regular representatives. There is, therefore, a need to prohibit this practice in its current form, and to individually examine similar agreements, should the need arise. I would like to note that elements from within the retail chains, expressed their desire to take back control over the shelves in their own hands.

In summation, placing, or more precisely, returning the responsibility of arranging shelf space to the retail chains, will prevent the dominant suppliers, by means of their representatives, from appropriating shelf space, without the retail chains having any effective control or ability to preserve the survival of those suppliers not represented in the stores.

<u>The directives issued in this matter:</u>

4. Category management will be executed independently by the large retail chains with no intervention of the suppliers, including in determining the variety and quantity of products and suppliers, suggested market shares or shelf allocations. The aforementioned does not

to preclude submission of desired agreements relating to joint category management with suppliers to the approval of the court, or for exemption by the General Director.

5. No later than one year after the date for the submission of public comments to these directives – only employees of the retail chains, or other individuals not connected to the suppliers, shall execute the agreement of display areas in large retail chains.

3.5 Paragraphs 6&7: Discounts and Rebates in Return for Meeting Sales Targets

The array of benefits given to retailers by suppliers has become a central part of these relationships. The purpose of these benefits, or at least their likely result, is the possible foreclosure of access to the retail chains from competing suppliers, or, at a minimum, a significant narrowing of such access. In certain circumstances, the benefits bestowed by a dominant supplier for the attainment of sales targets may prevent any real openings for competing suppliers, and, consequently, cause serious damage to the competition.

One of the most important financial benefits received by retail chains from suppliers is for meeting sales goals. In most cases these are financial goals, linking remuneration with the annual volume of sales of the supplier's goods at the retail chain. Generally, the benefit is paid to the retail chains as a lump sum, usually at the end of the calendar year. Failing to meet the goals set by the supplier results in a very significant loss to the retailer.

This manner of remuneration (hereinafter "rebates") by dominant suppliers results in a reduction in competition between food suppliers, as explained briefly below:

Agreements regarding benefits presented to the retailer in return for meeting sales targets are legal manifestations of a marketing technique through which the supplier gives the retailer an incentive to increase the latter's marketing efforts of the supplier's product. This marketing technique may be legitimate, as it signifies the existence of competition that obligates such marketing efforts. However, when a powerful supplier practices this technique, there is reason to believe it attests not to the existence of competition, but rather to an attempt to decrease or abolish said competition.

The practice of granting rebates by dominant suppliers for meeting individual sales targets preserves and even intensifies the power of dominant suppliers. In fact, this system constitutes a type of target discount[22] given as a global sum, stipulated upon the retail chain's meeting a sales goal that increases the market share of the dominant supplier at the expense of his competitors (and not as a discount from the price at which the retail chains purchase the product from the supplier **- hereinafter: "**purchasing price"). **This discount, as opposed to legitimate discounts, is not based on uniform objective parameters for all retailers, but is rather tailored to the dimensions of each client and directed towards a certain portion of the individual sales volume of each retailer. [23] Clearly, therefore, competing suppliers cannot approach the retailer with counter-offers of similar value, since their sales volumes are far smaller than those of the dominant supplier. The rebates system fully exploits the existing asymmetry between dominant suppliers and others, and places the competitors in a position of inferiority, with no regard to their relative efficiency.[24]**

The rebates system enables dominant suppliers to use the pre-eminence of the retail chains to their advantage. The desire of the retail chains to obtain the benefits received by meeting the sales goals set by dominant suppliers, forces them to make use of the tools they have at their disposal. These tools include allocating preferential display areas to that supplier, intervening in product prices and the prices of competing products, and excluding competitors from the shelves. In this

fashion, by means of the rebate system, the dominant suppliers foreclose access of competitors to the retail chains. Several of the witnesses interrogated agreed that the rebates given to the retail chains infringe upon the ability of competing suppliers to enter the market. Given the current market layout, the existing rebate system can even be used to offer discreet payments for the removal of suppliers - a clear violation of the law.

However, I do not wish to unconditionally deny the giving of benefits in return for meeting sales goals. The directives were issued to plot a course in which dominant suppliers, while prohibited from giving retroactive discounts for all products purchased once a certain goal is achieved, may nevertheless offer incentives to the large retail chains for the purpose of increasing their sales volume. Such incentives, however, may not be in the guise of discounts for surpassing the sales goal that effectively cause the price paid to be lower than the costs. Under these restrictions, other suppliers will be able to compete with dominant suppliers over the price of the marginal unit. This course does not contain the obstacles of the current rebate system, obstacles that give a permanent advantage to the dominant suppliers. The directives guarantee that benefits will be given as a reduction of the purchasing price (which increases the probability of it "trickling down" to the consumer), that it shall be given only for units beyond the goal (and not be for the existing and assured sales of the dominant supplier), and it shall be given for each of these units.

The directives issued in this matter:

6. A large retail chain and a dominant supplier shall not be party to an agreement whose object or effect is the giving of benefits to the retail chain in return for meeting sales goals, unless the benefit is given as a discount off the purchasing price of units sold in above and beyond the sales goals, and restricted to these units alone.

7. In the aforementioned benefits, the prices of units surpassing the sales goals shall not be lower than the production costs of these units.

3.6 Paragraph 8: Agreements Establishing Supplier Market Share in Retail Sales

In an agreements between a large retail chain and a dominant supplier, the supplier was guaranteed that its **market share of sales in various product categories would remain above a certain percentage. This percentage was far greater than half the entire sales volume of the chain in those specific categories. In addition, the supplier also set market shares for the sales of his other products in which he was not dominant, again setting a rate relative to the sales of the chain in the specified product category. The agreement guaranteed financial retribution to the retail chain in return for meeting the goals (market shares) set. These agreements may be used as a direct tool for preserving the power of a dominant supplier and as a shield before competition: whatever the nature and measure of attractiveness of competing products before the consumer, the chain must sell the products of the dominant supplier. Even agreements determining a market share lower than 50 % of the category's sales can be a basis for the division of market shares among suppliers, enforced by the retail chains, in a manner that precludes competition. This and similar agreements are types of prohibited loyalty discounts, through which the dominant supplier assures himself a significant portion (and in the dominant category an overwhelming portion) of the total sales of the chain in the relevant categories. I have been presented with no valid justifications for these agreements, nor a justification that is able to quell the fear for the well being of the competition. These agreements also appear to be restrictive according to Section 2(b)(4), and Section 2(a) of the law.**

I therefore find it appropriate to forbid large retail chains and food suppliers from reaching agreements concerning the determination of the suppliers' market shares.

The directive issued:

8. A large retail chain and a supplier will not be party to an agreement whose object or effect is the determination of the supplier's market share (or those of competing suppliers) in the sales of the retail chain; without detracting from the aforesaid, the retail chain will not be party to an agreement whose object or effect is one of the following:
   8.1. The retail chain guarantees that the supplier's share in the chain's sales of similar products (or of a certain category) will not be lower than a certain percentage.
   8.2. To bring about that a competing supplier's share in the retail chain's sales of similar products (or in a certain category) will not be above a certain percentage

3.7. Paragraphs 9&10: Exclusive Sales

Special discounts sales offered by suppliers are clear acts of competition that benefit consumers and are to be encouraged. The assumption is that in a competitive market, discounts by one supplier can lead to a competitive reaction by his competitors - other suppliers of the same type of product. Therefore, it is clear that an agreement between the supplier giving the discount and the retail chains according to which the retail chains will not permit competing supplier to hold competing sales simultaneously, is a blatant Restrictive Agreement that prevents competition, and is therefore clearly unacceptable.

Evidently, however, it has become common practice that, in large retail chains, guarantees are given to suppliers that no similar sales by competing suppliers will be permitted for the duration of the supplier's sale. Concurrently, the supplier makes a commitment that he will not offer a similar sale to competing retailers. These are prohibited agreements. They harm the heart of the competition process and isolate the sides from such competition. Competitive reactions by competing suppliers or manufacturers to a sale held by a supplier are the embodiment of competition, and preventing such reactions by means of forbidding the retail chains to permit competing suppliers to improve the purchasing terms of his product (price, quantity or other), is strictly forbidden. It is therefore proper to explicitly forbid such practices, which are Restrictive Agreements, according to Section 2(b)(1), (3) and 2(a) of the law.

The directives issued are:

9. A large retail chain and a supplier shall not be party to an agreement whose object or effect is to limit, via the retail chain, the ability of competing suppliers to react to the dominant supplier's sales The retail chains will permit competing suppliers to hold competing sales.
10. A large retail chain and a supplier shall not be party to an agreement whose object or effect is the restriction of a competing retail chain's ability to respond to a sale held at the chain, including by having the supplier guarantee not to hold similar sales at competing retail chains.

3.8 Paragraph 11: Resale Price Maintenance

The investigation of the retail chains revealed many incidents in which suppliers approached the chains in an attempt to determine the price at which the suppliers products are to be sold to the consumer (hereafter also: "Resale Price Maintenance"). In most cases the suppliers approach the retail chains for the purpose of raising the prices of their products. This is done in response to complaints by a competing retail chain that prices at the chain approached by the supplier are too low, and the goal is to suppress local competition between the retail chains. It appears that in several

instances the basis for a suppliers' contact with the retail chain was the (justified) fear that if they did not raise the prices of their products at the cheaper retail chain, the complaining retail chain would charge them a payment known as "chargeback due to local competition". At other times the supplier approached the retail chain at his own initiative, with various motives.

Influence on retail prices by the supplier has taken on many forms: written and oral requests, use of price appraisal systems that have stabilizing effects on the retail price, use of recommended price lists including "profit margins", detailed recommendations, and more. Suppliers place a great deal of pressure on retail chains not to lower their prices, even where there is no justification for this, and even when the reduction does not lower price below the retails chain's purchasing price ("net price"). These pressures applied by the suppliers seem not to exist in a vacuum; they are based on an early understanding that deviations from list (retail) prices are not acceptable.

Resale price maintenance by suppliers contains proven negative effects on the state of competition between retails chains, and as a Restrictive Agreement is forbidden under Section 2(b)(1) and 2(a) of the law. The characteristics of the market, which in any case create incentives for, and pressures towards, coordinated behaviour, justify a harsh attitude towards this practice.

In addition, the suppliers' segment is often also characterized by high concentration and low competition. It is possible that the dictation of retail prices will harm competition between suppliers and will lead to a supra-competitive equilibrium. This becomes even more worrisome in light of the findings that in several cases, the prices set by suppliers were retail prices of competing suppliers. In one such case a supplier approached a retail chain and requested that the retail price at which his own product is sold be linked to that of the dominant competing product. In another case, the supplier asked the retail chain to change the price of a competing product to match the price at which his own product is sold.

In light of the aforementioned, the directives impose a wide ban on the intervention of suppliers in the decisions of the retail chain regarding the setting of retail prices. This ban is appropriate for the relationships between grocery suppliers and other retailers as well.

However, the directives are not meant to affect constructive practices. These include maximum retail price maintenance by suppliers (intended to reduce the retail price of their products),[25] and recommended resale prices,[26] as long as this practice is not a concealed effort to dictate the price, but rather is intended to provide the retail chain with guidance concerning the proper branding of the product upon its introduction into the market, and for a reasonable period thereafter.

The investigation revealed that retailers often automatically accept the recommended price lists distributed by several dominant suppliers. In light of the market structure laid out above, these findings are not surprising. The negative impact of recommended price lists is exacerbated by the manner in which retail prices tend to be determined: by adding a fixed, rigid retail margin to the wholesale price (a cost plus system). After considering the competitive fears raised by this practice, I have concluded that a limited permit, under the terms listed in the directives, will best promote the interests of the public, without creating a veritable threat to competition. Therefore, the directives permit suppliers to recommend prices of new products to retail chains for a period that shall not surpass nine months from the day the product was launched. When a new product enters the market the supplier has a natural desire to inform the retail chains of the optimal way in which to brand the product, including by recommending a price.

The directive issued is:

11. A supplier shall not determine the price of his products sold in a retail chain or supermarket (hereafter: "the chain"), and will not impinge, directly or indirectly, on the decisions of the chain regarding the retail prices of his, or his competitors', products. This pertains to interventions imposed by agreements, instructions, stipulations, advice, suggestions to the retail chain, or in any other fashion. Without detracting from the aforementioned:
    11.1 A supplier will not approach a retail chain and demand that it raise the retail prices of its products;
    11.2 A supplier will not approach a retail chain and demand that it equate the retail prices of the suppliers products to those of competing suppliers, or link them to one another;
    11.3 A supplier will not demand or request of a retail chain that it determine or alter the retail price of competing products;
    11.4 A supplier and a retail chain will not be party to an agreement resulting in the determination of retail prices, such as setting the pricing method, fixed profit margins, or any other method.

    11.5 Despite the aforementioned restrictions, the supplier is permitted to:
        A. Agree with the retail chain, for the purpose of promoting the sales of his products, that the retail price of his products will not exceed a certain maximum price, lower than the price previously afforded for the same product.
        B. Recommend the price of a new product for a reasonable period during which the product is introduced. For this purpose, nine months from the launching of the product will be considered a reasonable period.

3.9 Paragraph 12: "Chargeback due to Local Price Competition"

The investigation of the retail chains has shown that when a large retail chain finds that a competing chain, in close geographical proximity, is selling a certain product at a lower price, they will usually lower the price of the product in order to respond to the local competition, and will then charge the supplier for the difference (in its entirety, or close to it), and inform the supplier of the source of this chargeback. At times, the retail chain grants the supplier a limited period in which to restrain the local competition, and if the "problem" is not taken care of, they then move on to demanding chargeback. Often, the response is that the supplier assures the retailer that he will "take care of the matter" so as not to be charged. Once instigated, the chargeback normally ceases only once the retail chain has become convinced that local issue has been resolved.

Such chargeback serve as a clear incentive for the supplier to prevent price competition between retail chains. The imposition of this practice on a wide variety of suppliers impairs competition between retail chains, and can even prevent the formation of such competition. There are, of course, other ways to create the same incentives. Under these circumstances, it is proper to forbid such chargeback, since they result in increased incentives for the supplier to intervene in the setting of prices in competing chains, thus decreasing price competition.

The directive issued in this matter:

12. A large retail chain will not demand, request, suggest, or recommend to a supplier that he intervene in setting prices for any products at competing retail chains. Without detracting from the aforementioned:
    12.1 A large retail chain will not cause, directly or indirectly, the intervention of a supplier in the setting of prices at competing retail chains, including by retroactively and/or unilaterally charging the supplier for the discount given by the chain to consumers, that resulted from a reduction in the retail price by a competing store.
    12.2 The prohibitions in this paragraph apply equally whether the supplier is charged for the price reduction retroactively and/or unilaterally, or whether he agreed ahead of time to this provision.
    12.3 A supplier will not request the competitors of large retail chains to increase the retail prices of his products.

3.10. Paragraphs 13&14: Exchange of Information

The investigation has shown that the large retail chains and the dominant grocery suppliers regularly exchange information about each of the parties' competitors. Exchange of information between competitors, especially systematic exchanges including recent information, may often serve to harm competition. This suspicion was considered given the existing circumstances, and was weighed against the possible benefits for and justifications of information exchange. Some of the information exchanges resulted from the initiative of dominant suppliers who wished to persuade several of the large retail chains to increase the retail prices of their products. An additional cause for concern is that these information exchanges might cause unification among retail chains in matters essential to competition. Due to the condition of today's market, we must be very cautious. Therefore, information sharing regarding competitors (either by suppliers or by retailers) must be considered on a case-by-case basis.

The directives issued in this matter:

13. A supplier will not transfer to a retail chain, nor will a retail chain receive, information regarding the quantity of products sold or the terms under which products are sold at competing retail chains.
14. A large retail chain will not transfer to a supplier, nor will a supplier receive, information regarding the wholesale price, retail price, quantity sold or the sales terms of products supplied by other different suppliers.

3.11. General Instructions and the Definitions of Key Terms

The Antitrust Law does not always absolutely prohibit Restrictive Agreements. It necessitates their submission for approval or dismissal, under the assumption that for each request submitted for approval there is a thorough and extensive examination of the influence of these agreements upon competition. Although it is clear that the agreements mentioned above are restrictive (and often an exploitation of monopolistic power and a violation of directives issued to monopolies), there is still the question of whether to permit them, in light of possible claims of minimizing the harm to competition and beneficial effects. After consideration and examination, I have concluded that in this case it is not sufficient to declare the practices uncovered as illegal restrictive trade practices. We should also, in my opinion, point to legitimate practices, which allow garnering the benefits without suffering any real harm to competition.

The aforementioned directives constitute the position of the IAA in this matter. They are intended to restrain and curb the dangers presented by these agreements to competition in the staple goods markets and the supermarket segment. However, progress stands still for no one. New practices will rise to replace old ones. These practices may well present new threats to competition. Therefore, it must be made clear that these directives do not infringe upon the jurisdiction of the Antitrust Laws with regards to the relationship between retail chains and food suppliers.

Definition of key terms used in the directives:

"The Law**"- Restrictive Trade Practices Act, 1988;**

"Agreement **" – be it explicit or implicit, direct or indirect, written, oral, be it legally binding or not;**

"Dominant supplier**"- An individual manufacturing, importing, or conducting wholesale marketing of products, for which one of the following is true: (1) he is legally defined as a monopoly, whether or not he has been declared as such by the Director General; (2) the total sales of a product supplied by him to a large retail chain exceeds half the general products of the same type sold by the chain, in the previous calendar year;**

"Display Area"**- the commercial area where products are displayed to the consumer at a large retail chain, including shelf space and off-shelf displays;**

"Large Retail Chain"**- Super-Sol Ltd, Blue Square Israel Ltd, Klubmarket Marketing Chains Ltd., and any individual person related to any of them;**

"Off-Shelf Displays"**- any commercial area where products are displayed for sale, not on shelves, including gondolas, stages, floor space, stands, and bathtubs.**

4. Claims Made by the Suppliers

Many suppliers claimed that the large retail chains take advantage of their singular status and buying power to behave in an aggressive manner towards suppliers: changing prices after the fact, imposing new charges with no prior agreement and arbitrary behaviour which dictates one-sided terms of trade (in favour of the retail chains). The General Director is not responsible for determining terms of trade contracts, even if these are not just. I have often been requested to do so (e.g., to forbid the retail chain from imposing one-sided commissions or other such payments) and to intervene in the terms of the agreements between the two sides or in actions that are not proper, but these matters are not always within the scope of my authority. The mandate of the General Director's powers is centered on intervention for the prevention of activities sabotaging competition that benefits the consumer. When the behaviour of the retail chains contains aspects sabotaging such competition, I have intervened and shall continue to do so. An example in which I am mandated to intervene is "chargebacks due to local competition," which served the retail chains as a means of foiling price competition and coordinating an increase in price by means of applying pressure on the producer. I have already made clear the illegalities concealed within such behaviour, and if they continue, be it directly or indirectly, I shall take the legal actions necessary, as I have already warned those involved. To remove all doubt, I shall clarify that the aforesaid is not intended to usurp our right to exact legal sanctions for past conduct. This too shall be determined in time.

5. Summary

The directives reviewed implement fundamental principals of Antitrust Laws, according to which, a large percentage of the business practices uncovered by the investigation of the retail chains are improper, and may cause harm to competition. Practices based upon payment to a large retail chain in return for the reduction or nullification of competition, are illegal and should not be exempted. In light of the structure of the staple goods markets, the level of concentration that exists therein, and the size of the large retail chains, even practices concerning benefits given in return for maintaining the dominance of monopolistic suppliers do not comply with the provisions of the Antitrust Law, and must be stopped.

The position of the Antitrust Authority will be brought before the relevant suppliers and retail chains. For a period of 45 days these matters will be open to review before those concerned and before the entire public. At the conclusion of this period, I will act to set these matters using the tools laid out in the Antitrust Law, after taking into considerations the comments I will receive, if deemed to be appropriate.

The taking of legal action will be examined and decided upon separately. As mentioned above, I wish first to halt the illegal practices rampant in the market. Prior to the deciding what actions are to be taken and against whom, I wish to outline before the many players in the market a proper normative course of action. The purpose is simple: before litigation, it is necessary to prevent the continuation of such harmful practices by the suppliers and retail chains involved. The removal of such reprehensible practices and the return of the markets to their proper course are most pressing matters.

This document is intended to post a clear warning signal to the dominant suppliers and large retail chains not to proceed with such anticompetitive practices. Concurrently, we have set out balanced directives that clarify to all the position of the IAA regarding the limits of the permissible in the practices uncovered.

Dror Strum
General Director of the Antitrust Authority
Thursday, May 29th, 2003

NOTES

1 "Sales platform" is a general term for any point of sales. Clearly, there are vast differences between different types of sales points, which can be divided into several separate markets. Many foreign Competition Authorities have concluded that the retail chains and large, independent supermarkets, is a separate product market from other sales platforms with different traits: grocery stores, convenience stores, specialized stores, open markets etc. For decisions by courts and Competition Authorities in the U.S.A, Britain, the European Commission and Israel, see the discussion in the General Director's decision regarding his objection to the merger of Blue Square Israel Ltd. and Yarkon (plus 2000) Wholesale Foods Ltd., 2001, **Antitrust** 3012217 (pg. 14-18 of the decision).

2 Case number 1/96 the General Director of IAA against Tnuva Central Cooperative for the Marketing of Agricultural Produce in Israel Ltd., 1997 **Antitrust**, 3001532

3 Directives issued to the Monopolists- Elite Industries Ltd., 1998, **Antitrust** 3006297

4 Directives issued to the Monopolists- The Coca Cola Company Ltd., 1998, **Antitrust** 3006300

5 Directives issued to the Monopolists- Tempo Beer Industries Ltd., 1998, **Antitrust**, 3006301

6 Directives issued to the Monopolists- Jafora -Tabori Ltd., 1998, **Antitrust**, 3006302

7 Directives issued to the Monopolists- Strauss Holdings Ltd., 1998, **Antitrust**, 3006303

8 For example: refer to section 8 of the directives issued to the Coca-Cola Company and section 5 of the directives issued to Elite.

9 The objection of the General Director to the merger between Blue Square Israel Ltd., and Yarkon (plus 2000) Wholesale Foods Ltd., 2001, Antitrust 3012217. No appeal was filed at the Restrictive Trade Practices Court concerning this decision.

10 The decision regarding Haviv: "From the overall grocery marketing in the country, the weight of the grocery retail chains today is estimated above 50%, as opposed to an estimated third (34%) in 1994. Between 1944-1995 the extent of sales of the grocery retail chains grew by 46%, while overall private consumption grew by a mere 8.5%. Meaning, grocery marketing in the grocery retail chains increased in these years by 35% more than did the consumption of groceries."

11 The decision regarding Haviv: "The continuous increase in the power of the large retail chains is double-edged. The growth in their power over consumers is expressed by the fact that today the large retail chains sell the largest percentage of grocery sales in Israel, and by the increase in the number of their points of sale. Simultaneously, they have also increased their buying power over the suppliers of grocery products. As the volume of consumer sales of the large retail chains grows, so do suppliers become more dependent upon their services. Is such situations, the grocery suppliers cannot afford to have their products missing from the shelves of any of the large retail chains."

12 The decision regarding Haviv: "The large retail chains enjoy substantial buying power over the grocery suppliers. This power is expressed by the high payments given by the suppliers to the large retail chains for shelf space in their chains, as well as in the vast difference between the terms enjoyed by the large retail chains and those offered by the suppliers to the independent supermarkets and small retail chains. The representatives of Blue Square also mentioned, as a major advantage to the merger, that the addition of Haviv's sales volumes to those of the retail chain will greatly improve the buying power of Blue Square in

the eyes of the suppliers: " (Haviv's D.S) sales volume **will increase the chain's buying power and its status in the eyes of the suppliers**"

13 The decision regarding Haviv: "The ability of the large retail chains to avoid transferring their cost savings to the consumers became noticeable after the large devaluation of October 1998. The devaluation caused a sharp increase in wholesale prices and retail price retail prices, yet when later the wholesale prices decreased, retail price retail prices did not follow, and experienced no actual decrease. This is not the way of a competitive market….these conclusion are supported by a report prepared by the economist Dr. Ilan Maoz for the Ministry of Finance and the Antitrust Authority. He found that during the period in question (1996-2000) the consumer did not enjoy a reduction in import (wholesale) prices of grocery products.

14 The decision regarding Haviv: "A retail chain can prevent consumer from enjoying the reduction in their costs (or charge the consumer a sum larger than their cost increase) only if they need not fear the consumer switching to their competitors. This situation arises if the competition is coordinated or if the competition does not enjoy the reduced wholesale price that the chain does, and therefore cannot compete with their retail price retail prices."

15 The investigation was instigated against the following companies: Super-Sol Ltd., Blue Square Israel Ltd., Klubmarket Ltd., Elite Industries Ltd., Strauss Marketing Ltd., Tnuva Central Cooperative for the Marketing of Agricultural Produce in Israel Ltd., Osem Food Industries Ltd., Sano Brunos Enterprises Ltd., Zoglobek Naknik Naharia Kosher Ltd., Hogla-Kimberly Ltd., Tempo Beer Industries Ltd., Jafora-Tabori Ltd., The Cooperative of the Rishon Le Zion and Zichron Yaakov Wineries Ltd., Shimon Shastowitz Ltd., Pri-Galil Marketing (1949) Ltd., The Israeli Food Products Ltd., The Coca Cola Company Ltd.

16 See Antitrust Laws, Block Exemptions for Exclusive Distribution, 2001. The contents of the rules are stipulated with the existence of additional terms listed.

17 Many suppliers claim that an agreement with a large retail chain concerning promised market share causes no harm, and that it is their right to guarantee the market share they already possess (according to market surveys) in a large retail chain. It was also said that large retail chains tend to diminish the market share of dominant suppliers in the interest of other suppliers. However, reviewing the investigation findings reveals that there is not much truth to these claims. There are many reasons for this, and I shall list only the most obvious. First, when the supplier concerned is a monopolist, he has no lawful right to "secure" his monopolistic share in agreements with grocery retail chains consisting of over hundreds of branches in Israel. In so doing, the monopolist blocks competitors, be they actual or potential, and increases the barriers to entry to the market in which he is the monopolist. Second, the claim that these agreements merely protect what already exists is a circular claim in a reality where the existing market share is often the result of such long - term agreements between suppliers and large retail chains. Furthermore, if the suppliers large market share is the result of the consumers' preferences, the chain will automatically place the suppliers' products on the shelves, so why the need for the dominant supplier to pay the large retail chain for doing so? Alternatively, if these are not the preferred tastes of the consumers, the question becomes more problematic - what is the dominant supplier paying for, if not the reduction of competition? Either way, there is no room for such agreements, especially in the harsh concentrated reality existing in many product categories in the Israeli market.

18 Appointing an importer to be the sole representative of a foreign manufacturer may be justifiable (and even necessary) in order to prevent the "Free Riding" phenomenon. However, when the imported product has no substitutes in the eyes of the consumers, imparting exclusivity to a local representative embodies market power over the consumers. Under these circumstances, parallel import may be the sole medium for reducing this market power, and is therefore viewed as beneficiary by the Antitrust Law.

19 A different type of harm that may be caused to competition due to category management being aided by suppliers concerns the competition between retail chains. Appointing one entity as category manger of different retail chains concurrently may cause unification of policy in these retail chains in these categories, and ultimately lead to the unification of their trade policies in a vast portion of their activities.

20 A tangible example of the dangers lurking behind the involvement of a dominant supplier in category management can be seen in the **Conwood** decision, recently given by the Federal Court of Appeals in the USA. In this case, the dominant supplier appointed as category captain of several retail chains delivered

false data to these chains for the purpose of increasing the shelf space allocated to his products, at the expense of his competitors. The Court of Appeals determined that the conduct of the dominant supplier was incompatible with the antitrust laws. The Supreme Court overruled a request to file an appeal. See **Conwood Co., L.P. v. U.S Tobacco Co**., 290 f.3d 768, 2002 U.S App., Cert denied, 123 S. Ct 876, 2003.

21 Manifestation of the threats posed to competition by entrusting the physical agreement of display areas to dominant supplies can be found in the **Conwood** case (footnote 20). The case included systematic physical damage caused to the competing displays at the retail stores by the representatives of the dominant supplier. The court ruled that such behavior is not compatible with the interests of competition and the laws protecting it.

22 Which may even be viewed as a type of loyalty discount.

23 For a case in which a similar technique was used by a monopolist, see case number 2/96, General Director of IAA against Yedioth Ahronoth Ltd.,- verdict (2000), **Antitrust** 3008136. For an advanced review see Faull & Nikpay, **The E.C Law of Competition** (New York- Oxford University Press, 1999) at p.178-181.

24 For an extensive analysis of the phenomenon, particularly that of extending the benefit over the entire sales volume, see the document submitted by the British competition authority in the framework of a debate held in this matter by the Organization for Economic Co-operation and Development (OECD), **Roundtable on Loyalty or Fidelity Discounts and Rebates**- note by the United Kingdom, 2002.

25 **Maximum price maintenance**- when there is market power in the retail segment, suppliers may prevent the price of their products from being raised above the level of competition by setting the maximum retail price retail price. There is concern that a maximum price may assist the retail chains in charging a supra-competitive price. However, due to the beneficial aspect of this practice and the restraints issued in the directives, it is desirable to permit this practice as an exception to the ban on intervention by suppliers in the determination of retail prices.

26 **Recommended price**- a supplier may advise a retailer to charge a certain price for his product, in order to inform him of the manner in which he wishes to brand his products. In many instances, the supplier's familiarity with the product, with the consumers preferences and with the competitive environment in which he operates, gives him an advantage over the retailer in recognizing the optimal price at which the product should be sold. The use of a recommended price enables the supplier to share this information with the retailer. In addition, once a recommended price is known to consumer's public, retailers wishing to raise the price above its recommended value will find it difficult to do so.