Legislative Memorandum

A. Proposed Name of Bill

Antitrust Bill (Amendment 9), 5765-2005

B. Main Provisions of the Bill

The definition of a "restrictive arrangement" in the [Antitrust] Law shall be amended, in both of its parts. In the first part, only arrangements that are liable to harm competition in the market at large shall be included henceforth; the second part of the definition, based on an absolute presumption that certain arrangements are restrictive, shall be limited to arrangements that pertain to, or that have the outcome of, coordinating competitors' behavior in respect of prices, quantities, market allocation, and refraining from supplying, buying, or tendering a bid. This limitation is implemented in order to limit the incidence of the presumption, insofar as possible, to cartel arrangements and "naked" arrangements, those that concern the mitigation or preclusion of competition in their essence.

C. Purpose and Necessity of the Bill

The bill constitutes the first part in the work of the Committee for Reexamination of the Antitrust Law, appointed by the Minister of Industry, Trade, and Labor in March 2005. The first part of the committee's work focused on reviewing the definition of a "restrictive arrangement" in Section 2 of the Law. The committee's conclusion is that there is a clear and immediate need to amend this definition. Since certainty is important for economic and commercial life in this respect, it was decided that it is preferable to undertake a separate and special legislative proceeding, amend the definition of a "restrictive arrangement," and establish an explicit provision in regard to it, even before the committee finishes its work in respect of other matters that are regulated by the Law.

Essence of the Bill – General Remarks

According to the customary method in Israel, entering into restrictive arrangements is prohibited unless the contract pertaining to said arrangement is allowed by a special judicial instance (the Antitrust Tribunal) or by an administrative authority charged with regulating this area of activity (the General Director of the Israel Antitrust Authority). The review of applications for the various permits (approval by the Tribunal or granting of immunity by the General Director) makes it possible preclude *ab initio* arrangements that may harm competition and allow arrangements that are found to pose insignificant probable harm to competition or less possible harm to competition than the advantages that the arrangement would confer on the public.

Given the nature of this method, it is clear that the definition of the restrictive arrangement includes arrangements that may be approved. Accordingly, the definition was designed in a broad format that includes any arrangement that has a potential anti-competitive effect. The wording of the current definition in Section 2 of the Law follows:

> **2. (a) A restrictive arrangement is an arrangement entered into by persons conducting business, according to which at least one of the**

parties restricts itself in a manner liable to eliminate or reduce the business competition between it and the other parties to the arrangement, or any of them, or between it and a person not party to the arrangement.

(b) Without derogating from the generality of the provisions of Subsection (a), an arrangement involving a restraint relating to one of the following issues shall be deemed to be a restrictive arrangement:

(1) The price to be demanded, offered or paid;

(2) The profit to be obtained;

(3) 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;

(4) The quantity, quality or type of assets or services in the business.

Since active enforcement of the Antitrust Law began, it has become clear that the definition of a restrictive arrangement in Section 2 of the Law is excessively broad and that, if interpreted to the letter, it may have the undesired outcomes of over-incidence in certain cases and under-incidence in other cases in which, contrarily, the need for its incidence is clear.

The courts recognized these difficulties in the phrasing of Section 2 and noted with emphasis the problems that they generate. Thus, in regard to the first part of the definition as incorporated into Section 2(a) of the Law, the Antitrust Tribunal in Antitrust 2/97, *Amit Mizrahi* v. *General Director,* explained: "The difficulty that Section 2(a) presents in the context at hand is that, as worded, it covers any arrangement that may harm competition even when it has no effect on the market and the harm to competition exists between the parties to the arrangement only." Difficulties have also arisen in regard to the incidence of Section 2(b) and escalated into a dispute among decisors in the Supreme Court. The difficulties originate mainly from demands by parties that this section, with its broad incidence, be applied literally and automatically even in cases where the courts realize that the intent of the law does not require this. The main root of the difficulty is that any arrangement that falls under Section 2(b) carries the absolute presumption of being restrictive, precipitating undesired results due to the broad phrasing of this section, which does not distinguish between arrangements between competitors ("horizontal") and those between parties that are in no way competitors ("vertical" or "conglomerate").

In some cases, the courts invoked the principle of *de minimis* to resolve the difficulty, but plainly this principle cannot resolve the difficulty that originates in the overly broad phrasing of this Section as interpreted by the courts.

The proposed phrasing of the Section has two mutually balancing parts: a general part, incorporated into Subsection (a), that captures any arrangement that may mitigate or preclude competition in the market and is based on the test of the economic effect of the arrangement on competition in the market; and a specific part in Subsection (b), which applies only to the specific types of arrangements that are listed therein, that have always been presumed to be harmful to competition irrespective of the need for any economic test whatsoever. The first part is meant to replace the existing Section 2(a) and narrows its incidence to arrangements that may

mitigate or preclude competition in the market at large (irrespective of their effect on competition among the parties themselves). The second part replaces the existing Section 2(b) and limits the incidence of the absolute presumptions in Subsection (b) to arrangements among competitors only.

a. Section 2(a)

The wording of Subsection (a) relates to the adverse effects of an arrangement on competition among specific parties: any arrangement in which one party restrains itself in a manner that "is liable to eliminate or reduce the business competition between it and the other parties to the arrangement, or any of them, or between it and a person not party to the arrangement." Even though the legislator's intent in legislating this section was to establish a general test that focuses on the possible implications of the arrangement for competition at large, the section was phrased in such a way that to fall within its bounds, an arrangement need only be liable to mitigate competition between one party to the arrangement and another party, irrespective of its effect on competition in the market.

The proposed phrasing is meant to correct this state of affairs by deleting the segment of Subsection (a) that relates to the possible effects on competition among the parties and by no longer requiring the existence of a party to an arrangement that "restricts itself." The proposed new phrasing of Subsection (a) defines a restrictive arrangement as:

> **An arrangement entered into by persons conducting business that is liable to preclude or mitigate business competition.**

This phrasing focuses on testing the economic implications of the arrangement for competition in the market, a test that competition laws have long invoked in order to assess the economic impact of various activities on the level of competition in markets. This test is based on a factual economic assessment of the definition of the product or service market, the size and position in the market of the parties to the arrangement, and the expected effects of the arrangement on competition in view of the totality of market circumstances, including the existing and expected level of market competitiveness, barriers to entry and expansion, and the nature of the arrangement and its pertinence to market competition. This test shall be performed both by the courts that adjudicate civil claims – be it in the enforcement of contracts in which the existence of the restrictive arrangement is alleged, or within the framework of damage claims on the part of those who argue that they sustained damage due to the existence of a restrictive arrangement – and by the Antitrust Tribunal and the Antitrust Authority in the proceedings that pertain to their respective purviews.

By focusing on the outcome and effect of the arrangement, [the new phrasing] will close the loophole that was created by interpreting the nature of the restraint so that the Section would apply only if a party restricts itself. While some courts regarded any contractual arrangement as satisfying the requirement of restraint, other courts adopted a test in which only a restraint that negates freedom of action that the party to the arrangement had *ab initio* falls within the bounds of the incidence of this Ssection ("the diminished rights test") (*Shimoni* v. *Lechaim Hall, Ltd.,* Ruling 25(1) 824). Due to the use of the "the diminished rights test," many arrangements lend themselves

(artificially) to shaping in the form of a diminished right, thereby totally evading the incidence of the Law even though they raise concern about anti-competitive effect.

For an arrangement to be considered restrictive under Section 2(a), concern about harm to "business competition," i.e., in the specific market that is affected by the arrangement, will be needed. If the arrangement is among parties whose aggregate market share is not large, or if its pertinence for competition in the market is marginal, the elements of probable harm to business competition shall not exist. The amendment brings Section 2(a) into closer alignment with a test that U.S. courts have been using to examine the existence of a restrictive arrangement in accordance with the Rule of Reason, which, generally speaking, focuses on analysis of the probable economic effects of the arrangement on competition in the market at large.

By eliminating the test of the effect on competition **between parties,** [the new wording] also solves another problem that has arisen in case law. As currently phrased, Subsection (a) ostensibly applies only if the restraint may mitigate competition specifically by the party that restrains itself. Some courts have interpreted the current phrasing of Subsection (a) in a way that excludes from the incidence of the Law arrangements in which the party restrains itself in a way that mitigates competition between the other party to the arrangement – the benefactee of the restraint – and a third party. (See Civil Case (TA) *Golan Heights Wineries* v. *Peter Stern* (District Court Rulings 33(5), and Civil Case (TA) 1160/03, *Shikovta* v. *Lev Ashdod,* Ltd. (TK-48 2003(1) 12552)). According to this interpretation, many vertical arrangements that specifically preclude competition between a party that assumes no restraint but rather imposes a restraint on the other party to the arrangement, and a third party, have been excluded from the definition of a restrictive arrangement. It is true that in other cases the section has been interpreted differently and in a manner compatible with the intent of the Section. According to the latter interpretation, a restraint of trade between the benefactee of the restraint and its competitor also falls within the bounds of the Section (Antitrust 469/98, *Delek Israel Fuel Co., Ltd., et al.,* v. *General Director,* and Criminal Proceeding 1724/01, *Superpharm (Israel), Ltd.,* v. *Adummim Mall Co., Ltd.,* TK-49 2001(2) 35902). These clashing intepretations, however, have created a problem that the proposed phrasing solves.

Thus, the bill proposes to amend the wording of Section 2(a) so that proving the adverse effects of an arrangement on competition between the parties will not suffice; instead, an adverse effect of the arrangement on the market must be proved. This will also make it clear that any arrangement that may harm competition in the market – whether the implications of the restraint pertain to competition between the restrained party and some other party or whether the mitigation of competition is actually expected to take place between the benefactee of the restraint and another party – shall be considered a restrictive arrangement, all of which provided that concern about harm to business competition is present.

b. Section 2(b)

The second part of Section 2 includes a list of arrangements that carry an absolute presumption of restrictiveness wherever they exist. This section is meant to replace the existing Section 2(b) and to narrow it perceptibly, limiting it to arrangements concerning coordination of competitors' behavior and aligning it as closely as possible with arrangements that have always been known as "hard-core" antitrust violations, including price fixing, reduction-of-output agreements, and market

allocation. The purpose of the amendment is to narrow the phrasing of Subsection (b) in order to include, insofar as possible, arrangements that pertain inherently to severe anticompetitive effects. If thus far the Section also applied to pronouncedly vertical arrangements, the bill proposes that it shall apply henceforth only to horizontal ones, i.e., arrangements that establish coordination among competitors. By so doing, the bill will narrow the scope of the Section.

Section 2(b) is unique because, since it is limited to specific arrangements that are known and presumed to be harmful to competition, it obviates the need to prove that the probable competitive effect of said arrangements is adverse. In this sense, Subsection (b) is altogether different from the nature of the test invoked in Subsection (a). While the test in Subsection (a) is based on an estimation of the expected economic effect of the arrangement on competition in accordance with the circumstances of the market and the parties, the test in Subsection (b) is based on examination of the legal nature of the arrangement. The purpose of Subsection (b), like the *per se* rules that are customary in various places abroad, is to give the competition-protection authority efficient enforcement tools against a small number of specific arrangements. Practical experience in regard to these arrangements absolves the authority of the need to invoke economic tools to prove the existence of an anticompetitive effect. See Supplemental Civil Litigation 4465/98, *Tivall (1993), Ltd.* v. *Chef-Hayam (1994), Ltd., et al.,* Ruling 56(1), 56, 95, and also Motion re Permission for Civil Appeal 6233/02, *Axtel Ltd.* v. *Kalma Vi Indus., Mktg. of Aluminum, Glass, and Iron, Ltd.,* (ruling of Judge Naor).

By establishing absolute presumptions, [the bill] enhances certainty in the business community and draws clear rules about arrangements that shall always be considered illegitimate. The absolute presumptions capture a set of arrangements that may not be entered into unless they receive *ab initio* permission as set forth in the Law. Absolute presumptions are necessary due to the need to prove the existence of a prohibited restrictive arrangement in state-instigated enforcement proceedings, mainly in the criminal domain. The experience amassed in Israel, as in other countries, shows that the need to prove economic harm to competition in a judicial enforcement proceeding defeats the efficiency of enforcement, encumbers the deliberations, and drags the parties into litigation that rests on professional economic opinions. Many antitrust laws in other countries list arrangements that are totally prohibited irrespective of their economic outcome and absolve the enforcement authority of the burden of proving that they are bad for competition.

Apart from the need for absolute presumptions in regard to arrangements that lead to coordination among competitors, there is a need to limit the arrangements included in Subsection (b) to those belonging to the “hard-core” of antitrust violations, focusing on cartel arrangements to the extent possible. This limitation takes place at two levels. First, the beginning of Subsection (b) determines that it shall apply only to arrangements “between competitors”; second, the section establishes that it shall apply only if the arrangement pertains to the coordination of competitors’ behavior in one of the following four collective respects:

a. **The price to be demanded, offered, or paid, including a discount to be offered or given, or the profit to be obtained.** This section replaces the existing Sections 2(b)(1) and 2(b)(2) and shall apply only if the material nature of the arrangement is price-fixing between competitors. Thus, vertical price-restraint arrangements, e.g., between a supplier and a retailer, shall be excluded from the

bounds of the absolute presumption; they shall be adjudicated under Section 2(a) and, where appropriate, under the Monopoly chapter. The narrower phrasing of the proposed Section 2(b)(1) is meant to capture, first and foremost, cartel price-fixing, including such conduct where performed within the ambit of requests for bids.

b. **An arrangement between competitors that pertains to, or has the outcome of, restraining the quantity of assets or services that a party to the arrangement shall offer, supply, or purchase, or limiting the quality or variety of said assets and services.** This section replaces the existing Section 2(b)(4). The phrasing of the proposed Section 2(b)(2) is meant to include, first and foremost, cartel arrangements that restrain production, set quotas, and restrain production, importation, or supply among competitors, including such conduct within the ambit of requests for bids. Practically speaking, restraint of quantity is but another aspect of the raising of price. Here again, vertical arrangements in which a manufacturer or a supplier wishes to impose quantity or other restraints on its marketer or retailer are excluded from the bounds of the Section. Such restraints shall be adjudicated under Subsection (a), since economic circumstances exist under which even vertical arrangements of these types may be harmful to competition.

c. **An arrangement between competitors that pertains to, or has the outcome of, allocating all or part of a market.** This section replaces the existing Section 2(b)(3) but expands the prohibition to include all other methods of market allocation, since cumulative experience shows that markets may be allocated by means of diverse techniques. The narrowed phrasing of the proposed Section 2(b)(3) seeks to capture cartelistic market-allocation arrangements including those carried out within the ambit of requests for bids. The current phrasing applies only to horizontal arrangements and excludes vertical arrangements such as exclusivity agreements, which shall be adjudicated within the framework of Subsection (a).

d. **An arrangement between competitors that concerns refraining from the delivery or purchase of an asset or service on the part of a party to the arrangement, including refraining from tendering bids for said supply or purchase.** The existing Law does not refer explicitly to boycott arrangements, which have been interpreted as falling under the broad absolute presumptions that exist today.[1] One may, however, conceive of commercial arrangements that, while involving the imposition of a boycott, do not amount to arrangements relating to price, market allocation, or restraint of production. These arrangements, which pertain to the mitigation of competition among competitors, including methods of enforcement and punishment of cartel members that wish to deviate from its provisions, are prohibited by foreign laws as well. Accordingly, [this Section] proposes the inclusion of arrangements of these types, when executed between suppliers or buyers of competing assets, as arrangements to which an absolute presumption shall apply. This Section shall also capture bid-

[1] Finding under Section 43 concerning the existence of a restrictive arrangement in activity of the Actors Agency Association, *Antitrust* (Bar Association Tel Aviv District, 1994), at p. 86 (in Hebrew).

rigging arrangements, in which parties refrain from tendering purchase or sale bids in requests for bids.

Definition of “competitor”: Since the scope of the absolute presumptions shall be narrowed considerably so that they shall apply only to coordination of behavior among “competitors,’’ i.e., horizontal arrangements, and given the certainty that is required for the incidence of Section 2(b), it is necessary to define a “competitor.”

In Section 2(b), the bill wishes to capture arrangements that are clearly expected to preclude or mitigate competition between parties that engage in actual competition over the supply or purchase of goods or services. The purpose of the proposed phrasing is to obviate, for the requirements of Section 2(b), unlike Section 2(a), the need for any market analysis or market definition in order to establish that the parties at issue are competitors. The test for the existence of competitive relations is the priori existence of actual competition between them, i.e., that they actually posed a competitive threat to each other and that the arrangement is meant to eliminate or limit it. The intent is to include in the definition players that used to compete with each other at some point in the past, with reasonable striking distance from the time the arrangement was executed, so that they should still be viewed as actual competitors. Others that shall be considered competitors are those who did not engage actual competition because they thwarted such competition via an arrangement of one of the types included in Section 2(b). The purpose of inserting the requirement of competitive relations is twofold: to exclude from the bounds of the absolute presumptions in Section 2(b) vertical arrangements to which the parties are not competitors, and to leave Section 2(b) in effect in regard to arrangements between competitors, i.e., arrangements that are materially horizontal.

The experience of other legal systems and the cumulative experience in Israel both show that insofar as arrangements included in the proposed phrasing of Section 2(b) belong to the class of hard-core antitrust violations, recourse to economic definitions and market analyses is not needed. Such a necessity may seriously impair the efficiency of the enforcement of the Law and the establishment of an adequate level of deterrence. Accordingly, [the bill] proposes, in regard to the definition of “competitors” as well, that the definitions of a “market” in Section 2(b) not be inserted because they are relevant for Section 2(a) only. The practical preclusion of competition by means of the arrangements captured by Section 2(b) is a behavior that the legislator wishes to deter in any event.

An arrangement in which at least two of the parties are competitors: to satisfy the requirement that the arrangement be “between competitors,” [the bill] proposes explicit wording to the effect that not all parties to the arrangement need be competitors. Cumulative experience shows that cartel-type restrictive arrangements, although executed between competitors, often involve some other party – be it has an enforcer or a “policeman” of the restrictive arrangement or as a facilitator via which the restrictive arrangement is performed or acquires substance. Blatant cases of this kind are joint-marketing arrangements between competitors that are executed by a co-marketer and arrangements between competitors that are executed by their common supplier. These arrangements, too, insofar as they include restraints of the types listed in Subsection (b), shall be considered, even though they have a vertical or conglomerate element, arrangements between competitors that are severely adverse to competition and, accordingly, categorically prohibited. To make this clear, it is explained that an “arrangement between competitors” is one in which at least two of

the parties are competitors and the fact that one of the parties to the arrangement is not a competitor does not exclude the arrangement from the incidence of Section 2(b).

Scope of incidence of Section 2(b): in essence, Section 2(b) is meant to capture arrangements that are expected to constitute ("naked restraint of trade." Notably, however, even though the proposed wording of Section 2(b) is perceptibly narrowed, one may still encounter arrangements between competitors that, while not cartelistic in nature, will fall, due to their phrasing, within the bounds of Section 2(b) but may be approved nevertheless because they have economic advantages that justify their existence. Examples of such arrangements are joint ventures, coordination among competitors for the purpose of meeting standards, arrangements among competitors in order to create interconnectivity, and so on. These arrangements may obtain a permit in one of the ways set forth in the Law (unless they have been already excluded under the rules of class immunity).

D. Effect of the Bill on the Existing Law

Section 2 of the Law shall be amended and replaced with the proposed Section 2.

E. Effect of the Bill on the State Budget

None.

Phrasing of the Bill

Section 2 of the Law shall be repealed and replaced with the following:

2.a. A restrictive arrangement is an arrangement between persons conducting business that may preclude or mitigate business competition.

b. Without derogating from the generality of the contents of Subsection (a), an arrangement between competitors that pertains to or has the outcome of coordinating behavior in one or more of the following respects is a restrictive arrangement:

1) the price to be demanded, offered, or paid, including a discount to be offered or given, or the profit to be obtained;

2) restraining the quantity of assets or services that a party to the arrangement shall offer, supply, or purchase, or limiting the quality or variety of said assets and services;

3) the allocation of all or part of a market; in respect of "allocation": in accordance with the persons or type of persons with whom business is to be conducted, the location of the business, the time in which the business is conducted, the type of asset or service to be supplied or acquired or their quality, or in some other way;

4) refraining from the delivery or purchase of an asset or service on the part of a party to the arrangement, including refraining from tendering bids for said supply or purchase.

For the purposes of Subsection (b) herewith:

"Competitors" – parties that engaged in any form of actual competition and also parties that were precluded from said competition due to the arrangement between them; if said competition took place or was precluded, the argument

that the parties are not competitors because they do not belong to the same market according to the definition of the market in which any of the parties operate shall not be heeded.

"Arrangement between competitors" – an arrangement to which at least two parties are competitors.