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LAW FIRM

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The Competition Authority published a guidance paper on evaluation of significant market power

Background

In January 2019, an extensive amendment to the Economic Competition Law, 5748-1988 (formerly the Anti-Trust Law) came into effect. *Inter alia,* the amendment broadened the definition of a "monopolist", which will now include "a person who holds **significant market power** regarding the supply or purchase of assets, or regarding the provision or purchase of services".

On July 21, 2019, the Competition Authority (the "**Authority**") published a guidance paper regarding the method in which it interprets the term "significant market power".

What is significant market power?

According to the Authority, significant market power pursuant to the Competition Law exists when a supplier is able to determine for a specific product conditions of supply that are significantly inferior to those that would have been set in a competitive market, for a period of time that is not temporary, for all its customers or for a specific group of customers.

This definition of significant market power requires that additional points be clarified:

<u>Firstly</u>, the very existence of significant market power, provided that it was achieved legally, does not constitute an infringement of the provisions of the Competition Law. The prohibition in the Competition Law refers to abuse of such significant market power.

<u>Secondly</u>, "conditions of supply" means price, quantity, quality, variety, availability, etc.

<u>Thirdly</u>, the purchaser of an asset may also have significant market power (and not only the supplier of an asset), and the definition of a monopolist in the Competition Law also refers to one who possesses significant market power in purchase power – i.e. a monopsony. Nevertheless, the guidance paper focuses solely on the method of evaluation of significant market power of supply (and not purchase).

How can the existence of significant market power be determined?

In general, evaluation of the existence of significant market power requires addressing the ability of the supplier to act independently of two competitive restraints: **restraint on the part of demand** (in other words, the expected reaction of customers to inferior conditions of supply) and **restraint on the part of supply** (in other words, the expected reaction of competitors − actual or potential − of the supplier). The degree of effectiveness of these restraints on the behavior of the supplier indicates the extent of the market power enjoyed by the said supplier.

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Evaluation of the expected responses of the customers and the competing suppliers focuses on a competitive market, and not necessarily on the market conditions actually existing during the examination. This is done to avoid the cellophane fallacy.[1]

In the characteristics that influence **the restraint on the part of the demand** the Authority initially references the market share in its opinion. An additional consideration is the number and status of additional competitors in the industry and the volatility in the market shares of the entity being evaluated and its competitors, as well as the degree of differentiation and substitutability between its products and those of the competitors.

A large market share indicates significant market power. However, significant market power may also be held by one who does not have a large market share, for example, where there is substantial gap between its market share and that of its competitors, or where its product is sold to retailers who attribute importance to offering its product to their customers. Although the Authority has deliberately avoided fixing a threshold for the market share, below which there shall be presumption of the absence of significant market power, it states in the guidance paper that in general it shall be rare for an entity holding a low market share to hold significant market power.

An additional important consideration is the level of differentiation between the products offered by the competitors in the market. The greater the level of differentiation between the products, the less they will be substitutable, and consequently the market power of each of their suppliers will increase.

In the characteristics that influence **the restraint on the part of the supply** the Authority shall examine the expected response of competitors (actual or potential) of the supplier to worsen the conditions of supply by it – by means of entry into the market or expansion within the market. In this matter the Authority determined that in order for such a response to be regarded as preventing it from achieving significant market power, it must be expected to occur **in a likely, timely and sufficient** manner.

To estimate the possibility that the response by the competitors will have these required characteristics, the entry and expansion barriers in the market need to be examined. The higher these entry and expansion barriers are, the lower the possibility that the response of competitors will restrain the supplier's market power. There is a lengthy list of characteristics that may indicate entry and expansion barriers, including: production capability limitations, high costs involved in entry into the market, a regulatory regime (standards, licensing requirements, etc.), limited accessibility to essential inputs, etc.

Additional evaluation that can form an indication of the existence of significant market power is the actual behavior of the entity being examined. Where a firm can force its customers to contract with it exclusively, or where it can condition the purchase of the product on the purchase of additional products – this may indicate that it holds significant market power.

The Authority states in its guidance paper that although in principle the mark-up (the difference between the economic costs of the product and its price) and the supplier's profitability may indicate its market power, this in itself cannot be relied upon. At most it may be combined with evaluation of the various considerations as set forth above.

Possible implications of the guidance paper

In our opinion the guidance paper reflects a change in the attitude of the Authority on enforcement *vis-a-vis* monopolists. The Authority will focus its efforts on entities that do in fact hold significant market power more than on entities that hold a market share of more than 50%, but do not necessarily enjoy significant market power. Although both are monopolists, it seems that the Authority will focus its efforts more against the former.

Following the publication of the guidance paper, it may be assumed that the Authority itself, and certainly private entities, will use it to enforce the prohibitions that apply to a monopolist, even against those who do not hold a market share of more than 50%.

[1] A familiar term in competition law following the extensive and erroneous definition of the relevant market in the case: U.S. v. E. I. du Pont, 351 U.S. 377, 76 S.Ct. 994, 100 L.Ed.1264. The court regarded the monopolistic price as a competitive equilibrium.

For example, it is plausible that plaintiffs in class actions will attempt to submit actions against such suppliers on the grounds of unfair prices.

Therefore, entities that enjoy a substantive status in the market, even if not 50%, would be well advised to carry out thorough examinations of both their status in markets in which they are active, and of the methods of pricing their products, and their competitive conduct, to manage properly the risks facing them.

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