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THERE IS ALWAYS A WAY

The Supreme Court Sets a Very High Bar for Enforcing the Prohibition on Excessive Monopolistic Pricing

On March 20, 2023, the Supreme Court issued a ruling on the appeal filed by Tnuva against the decision of the Lod-Central District Court, which determined that Tnuva had charged an excessive price for its cottage cheese products - in relation for which it constitutes a monopoly - thereby abusing its monopolistic position contrary to the provisions of Section 29A (b) (1) of the Competition Law. The Supreme Court accepted Tnuva's appeal (in all its parts), vacated the district court's decision, and ruled that it was not sufficiently proven that Tnuva had charged an excessive and unfair price for its cottage cheese products.

At the same time, the Supreme Court established basic principles and guidelines regarding the prohibition on excessive monopolistic pricing which sets a very high bar for its application, particularly in class action proceedings. The Supreme Court emphasized that this prohibition should be applied as a last resort in exceptional and extreme cases which "sting the eye and are clear to all," and even warned that "the courts must take a particularly cautious and restrained approach when deciding a class action lawsuit which asserts a claim of high and unfair price. This is essentially due to significant difficulties involved in examining such a claim, and due to the possibility that accepting the class action in this context will ultimately harm competition and the public."

In this client update, we would like to overview the Supreme Court’s judgment in the Tnuva case and the important aspects underlying it.

Background to the proceedings in the Tnuva case

The proceedings against Tnuva began with the social outcry and protest that came to be known as the "cottage cheese protest". The protests, which took place during the summer of 2011, eventually led to a reduction in the price of Tnuva's cottage products. Following this protest, a class action lawsuit was filed against Tnuva, asserting that it had abused its dominant position between the years 2008-2011 by way of charging an excessive and unfair price for its cottage cheese products.

This claim was affirmed by the District Court, which based its ruling that Tnuva had charged an excessive price on the following facts: (1) In the relevant period, Tnuva's operating profit rate derived from the cottage cheese products was 22% at its peak, which was 3.5% higher than the competitive benchmark adopted by the District Court – 18.5% (an index based on the average operating profit rate of Kraft, a comparable foreign food company, from the sale of a variety of products); (2) A comparison between the average retail price of all cottage cheese products available in the Israeli market between the years 2008-2011 and the price charged by the other manufacturers after that period, presented a gap, that altogether led the District Court to conclude that Tnuva's cottage cheese prices were excessive in the relevant period. By virtue of the District Court's decision, Tnuva was obligated to pay approximately NIS 16 million in compensation to the consumers that purchased the products in the relevant period.

The Legal Tests for Assessing whether a Price Should be Deemed Excessive and Unfair

The Supreme Court decided to reiterate its previous ruling in the Gafniel case (dated July 26, 2022), which dealt with the fairness of the prices of Cola drinks supplied by the Central Bottling Company, by ruling that the legal test for assessing whether the price charged by the monopoly should be deemed excessive and unfair is a two-stage test.

The first stage requires proof that the monopolist has set a price which is significantly higher than the price that it would have hypothetically set had there been effective competition in the market. With regard to class action suits, the plaintiff bears the burden of proving the first stage of the above-mentioned test.

The second stage focuses on the fairness of the price set by the monopolist. Provided that the plaintiff has succeeded in the first stage of the test, the defendant bears the burden of proving that the price it set were fair, albeit excessive.

The Supreme Court applied the two-stage test in the Tnuva case and concluded that Tnuva had not charged an excessive and unfair price. In its ruling, the court made a number of important and significant determinations which set a very high legal and economic bar for the enforcement of the prohibition on excessive and unfair monopolistic pricing, both by the Israeli Competition Authority (ICA) and also in the framework of private lawsuits and class action suits.

The first stage of the test – examining the excessiveness of the price

As stated above, the Supreme Court clarified that, in the first stage of the examination, it must be shown that the price charged by the monopolist is significantly higher than the price that would have been hypothetically charged by it under competitive conditions. In other words, it is not sufficient to show that the price is merely high in relation to the competitive benchmark, but it is mandatory to show that it is excessive in relation to the benchmark. The Supreme Court ruled that, in relation to the competitive benchmark determined by the District Court (i.e., an operating profit rate of 18.5%), Tnuva's operating profit rate slightly exceeded the benchmark rate by only a small margin of 3.5%. According to the Supreme Court's ruling, this margin does not allow for a conclusion that the price charged by Tnuva is significantly higher than the price it would have charged in a more competitive market. Simply put, the price that Tnuva charged for its products was not particularly jarring, and did not – so to speak, "sting the eye" – according to the Supreme Court's ruling.

Operating profit is not a sufficient measure of proving the excessiveness of the price

In its ruling, the Supreme Court clarified, that there is an inherent difficulty in relying on operating profit rate as a measure of examining the fairness of the price charged by the monopolist. In this regard, the court stated, that the operating profit rate can increase significantly even when the price of the product does not, due to the efficiency of the monopolistic firm. That is, there may be no correlation between the rate of operating profit and the price actually charged, thus an increase in operating profit does not necessarily equal to an increase in the price of the product in the monopoly. Therefore, in accordance with the words of the Supreme Court, reliance on operating profit rate can lead to a substantial error in the application of the prohibition on excessive pricing, which in turn, might disincentive firms from becoming more efficient. Hence, it is inappropriate to enforce the prohibition on excessive pricing in cases where only the profit margin of the monopoly has increased, without a similar increase in the retail price.

The second stage of the test – an examination of the fairness of the price

Although the Supreme Court ruled that the plaintiff failed to show that the price of Tnuva's cottage cheese products was excessive, and could have thereby concluded its judgment at the first stage of the examination, the court went further and held that it has not even been established that the price charged by Tnuva was unfair. In this regard, the court relied on the tests, which will be elaborated on below.

The market dominance test

In order to examine the fairness of the price, the Supreme Court held that the prohibition is applicable only in such cases where the market share of the monopolist is consistently and over time close to a "full control of the market". When there are substitutes in the market to the monopolist's products, and the monopoly is not close to full control of the relevant market, then the tendency will be not to enforce the prohibition against the monopolist. In such cases, where there are indeed substitutes in the market to the monopolist's, it cannot be argued that the price is unfair (even if it is ostensibly high). On the other hand, an excessive price set by a monopolist that controls almost the entire relevant market –especially a monopoly that controls essential infrastructure (such as water, gas, electricity, postal services) – could be deemed unfair, in a manner that may justify enforcing the prohibition against the monopoly.

Consumer preference test

The Supreme Court ruled that even in cases that concern monopoly's products, and even an essential product, it is necessary to determine the reason consumers prefer to purchase the monopoly's products, and whether the consumers' preference is only due to lack of any alternatives. In the Tnuva case, the Supreme Court raised the possibility that consumers' choice to purchase Tnuva cottage cheese is indicative of their preferences, relating to matters of personal taste, as well as to Tnuva's success in differentiating its cottage cheese from that of its competitors. Accordingly, it was established that the less essential the product, and the more consumers' preference to purchase it specifically from the monopolist is due, essentially, to their personal taste, the tendency will be to not view the price as unfair.

The test of the existence of a Specific Sector regulator

In addition, the Supreme Court further held that it is necessary to examine whether there is a designated specific sector regulator that oversees the prices in relevant industry. Insofar as the prices in a specific industry are regulated, it is preferred that the specific sector regulator would perform the task of setting the regulated price, as it specializes in price control, and holds an advantage over the Competition Authority and the courts in this regard. Therefore, it is not appropriate for the courts to act in place of a specific sector regulator.

Regarding Tnuva, since 2006, Tnuva's cottage cheese products have indeed been under a price control regime under the Supervision of Products and Services Law, and, on this basis, as well, there was no reason to determine that this is an unfair price.

The Supreme Court's call for applying the prohibition with restraint - as a last resort only

At the end of its ruling, the Supreme Court designated a separate chapter in which it reiterated its call (warning) to apply the prohibition on excessive pricing with caution, and restraint, and **only in the most extreme and clear cases of consumer exploitation, i.e., cases that "stings the eye and are clear to all**."

The Supreme Court emphasized that high prices can encourage the entry of new competitors into the monopolist's market, thereby increasing competition. The Supreme Court further emphasized that charging a high price enables firms to "reap the fruits of their investment." When interfering with market prices retroactively (particularly by courts that lack expertise in the matter) and applying the aforementioned prohibition, they may harm the firms' incentives for efficiency, in a way that will ultimately lead to harming competition and the public.

In this context, the Supreme Court emphasized that in light of the significant probability that the courts will err in the application of prohibition, as well as the lack of a clear legal test that provides certainty, the ICA, which is a professional authority specializing in competition law, has a clear advantage in enforcing the prohibition in relation to the civil courts, which usually lack appropriate tools for examining the fairness of the price charged by the monopoly. In this regard, the Supreme Court emphasized that in the EU, the prohibition for excessive monopolistic pricing is enforced solely by the Directorate-General for Competition (DG COMP), and not in the framework of private lawsuits (such as class actions).

The expected implications of the ruling for pending class actions on excessive pricing

In practice, the Supreme Court's ruling in the Tnuva sets a very high bar, and even a substantial "obstacle", for plaintiff's who wish to file law suits asserting that the monopoly has charged excessive price. This ruling will obviously affect the dozens of class actions alleging that the defendant-monopoly has charged an excessive price which have already been filed and are currently being examines in the various district courts around Israel.

Although the Supreme Court's ruling is particularly relevant to the question of applying the cause in class actions, we believe that it is also a call to the Competition Authority to enforce the prohibition only in extreme and clear cases that are "eye-catching and clear to all," and only as a last resort.

Please feel free to contact and consult our experts with any questions that you may have

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