

# Excessive pricing in the hard cheese (Tnuva) case

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# The case

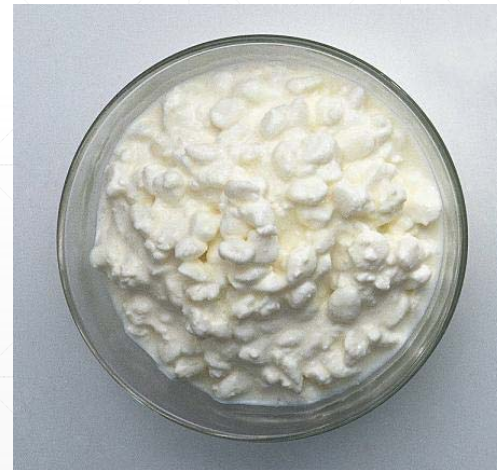
- In 2007 two things happened:
  - Tnuva was acquired by a British private equity firm
  - The price of several types of packaged hard cheese was deregulated and prices rose fast
- Tnuva had over 90% market share (serious competition only from mid 2013)
- The Israeli state comptroller heavily criticized the decision to deregulate the price saying that the decision was made without any factual basis or good explanation and without studying the likely implications and was not reconsidered after prices have increased
- Israel's consumer council has filed a class action lawsuit against Tnuva, claiming that the price of 5 different packaged hard cheeses is excessive
- The case addresses a regulatory failure

# Prologue

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# Cottage cheese

- Cottage cheese is a staple food in Israel
- Its price was under government price control until June 2006



# The evolution of cottage prices



# The cottage cheese boycott

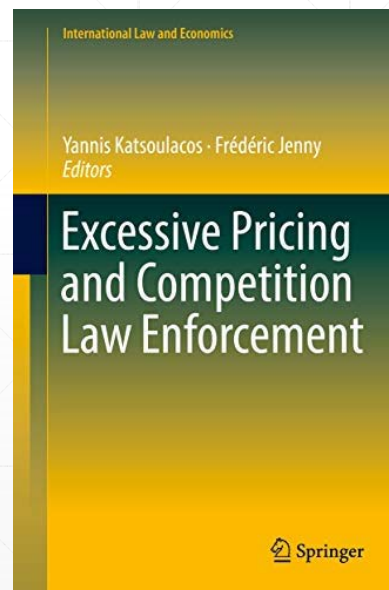
- May 31, 2011: news articles describe the surge in food prices in Israel
- June 14, 2011: the Facebook event is created:
  - 30K join on June 14, 70K by June 16, 105K by June 30
- June 27, 2011: the government appoints a committee to review the level of competition and prices in food and consumption markets
- Mid July 2011: The Committee recommends reforms in the dairy market
- July 2011: the "tents protest" starts on Facebook; thousands of protestors set up tents in Tel Aviv to protest the rising cost of living and demanding social justice
- September 25, 2011: The antitrust authority raids Tnuva's offices
  - Among other things, seizes a 2008 McKinsey report which advised Tnuva to raise prices by at least 15% since the demand for cheese is inelastic)
- October 2, 2011: Tnuva's chairman resigns from the board. Tnuva announces a price cut of up to 15% on dozens of products

# The legal background

- In 2011 David Gilo becomes the IAA's Director General and in April 2014 publishes Guidelines 1/14: *“Preventing harm to consumers and the inefficiency in the allocation of resources as a result of excessive pricing is at the heart of the antitrust laws.”*
- The IAA never brought an excessive price case to court but we now have over 30 pending class actions:
  - Dairy products, margarine, soft drinks, frozen vegetables, instant coffee, green tea, Israeli cuscus
  - Natural gas, fertilizers
  - Burial services, postal services, phone calls, flights
- So far three cases were certified: cottage cheese, hard cheese, and coca cola 1.5 liter; the supreme court is yet to rule on the matter

## “Excessive Pricing and Competition Law Enforcement,” Katsoulacos and Jenny (Eds.), 2018

- More considerations, as well as the legal treatment in various countries, including a review of the Israeli experience, appears in the following book (<https://www.springer.com/us/book/9783319928302>)





# **General considerations**

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# The legal background

- Article 102 of the TFEU prohibits
  - “directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions; ...”
- The Israeli law was more or less copied from the European law
- Does the law apply to high prices or only to predatory prices?
- The district court said yes in at least four cases (three cases were certified and in another the court approved a settlement)
- The supreme court in Israel is yet to decide on the matter

# The main issues

- How high a price should be (relative to a benchmark) to be deemed “excessive”?
    - Marginal/average cost
    - The price of the same product in the past (following a price increase) or the future (following a price cut)
    - The price of the same product in another market (geographical or other customers)
    - The price of competing products
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# Problems with price benchmarks

- Cost is hard to measure
  - How do we compute marginal cost?
  - Computing average cost is easier but how do you allocate common costs?
  - How do you factor in risk?
  - How do you factor the cost of capital?
  - In regulated industries, determining cost takes months and done in an interactive procedure
- Perfect competition does not always exist (so MC is not a relevant benchmark)
  - In the presence of moral hazard price must be above cost (quality premium)
  - Vertical differentiation

# Problems with price benchmarks

- Price comparisons are valid only if “all else is equal” (but for the abuse of dominance)
- Comparisons over time require a control group (a diff-in-diff approach)
- Comparisons across markets need to ensure that costs are the same
- Comparisons with competing products are dangerous:
  - Other products are not dominant – why? Are they truly the same?
  - Research shows that firms in the same industry may have radically different costs

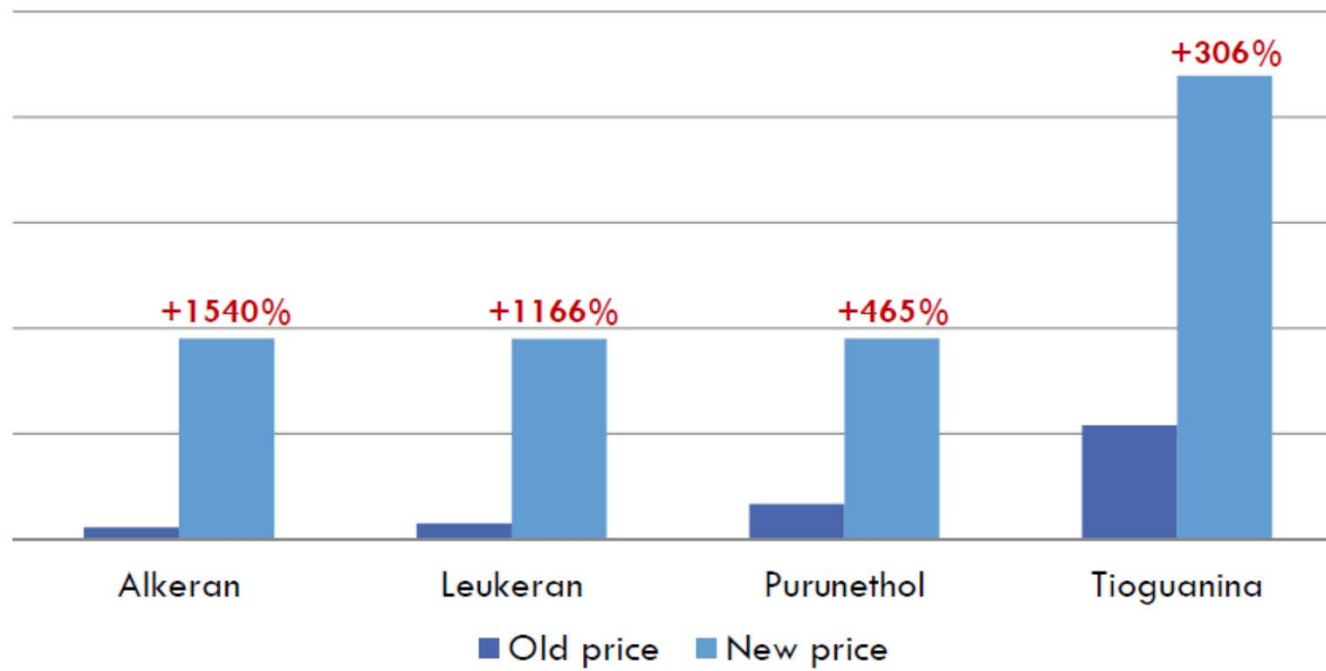
## Arguments against a ban on excessive prices

- High prices are “self correcting” – entry will bring prices down
- If a dominant firm charges high prices, regulate it!
  - Ex ante and forward looking regulation creates certainty
  - Regulators have the expertise to set price while antitrust agencies and courts do not typically know how to set prices and cannot continue to follow the price over time and update it when needed
  - Regulation involves a bargaining process while antitrust enforcement is adversary
- A ban on high prices has a chilling effect on investment
- An adversarial process is inappropriate to determine the right level of prices and courts lack the expertise to do it
  - The Israeli experience shows that this is a serious argument

# When are prices excessive?

- We still know little about the consequences of intervention, and there's a large grey area so it's better to move cautiously and go after clear cases
- The only theory paper on excessive pricing, Gilo and Spiegel (IJIO 2018), shows that a ban on excessive pricing can restrain monopolists but may also induce them to keep prices high post entry
- Judge Potter Stewart: "I shall not today attempt further to define the kinds of material I understand to be ... ["hard-core pornography"], and perhaps I could never succeed in intelligibly doing so. But *I know it when I see it*"
- Finkel (2001): Defining what's fair is tricky but "Most often there is agreement over unfairness, and most cases are not hard cases" (albeit there are outliers)
- Kahneman, Knetsch, and Thaler (AER, 1986):
  - 82% of subjects think its unfair to raise the price of shovels after a snow storm
  - 91% think its unfair to raise rent after learning that the renter got a job near the apt. and is less likely to leave

# The Aspen case



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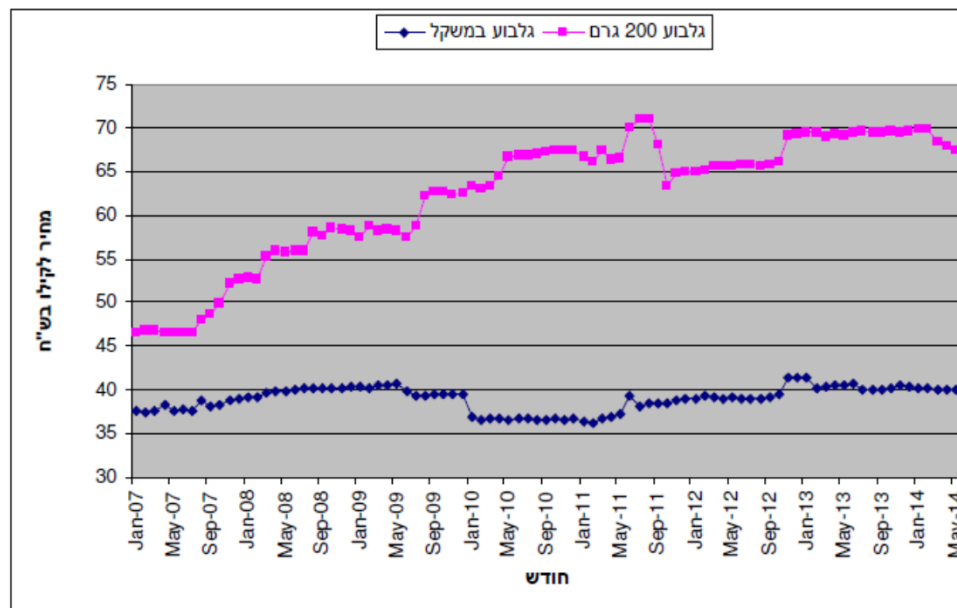


# The hard cheese case

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# The price of Gilboa (“Dutch” style) 200g vs. Gilboa by weight

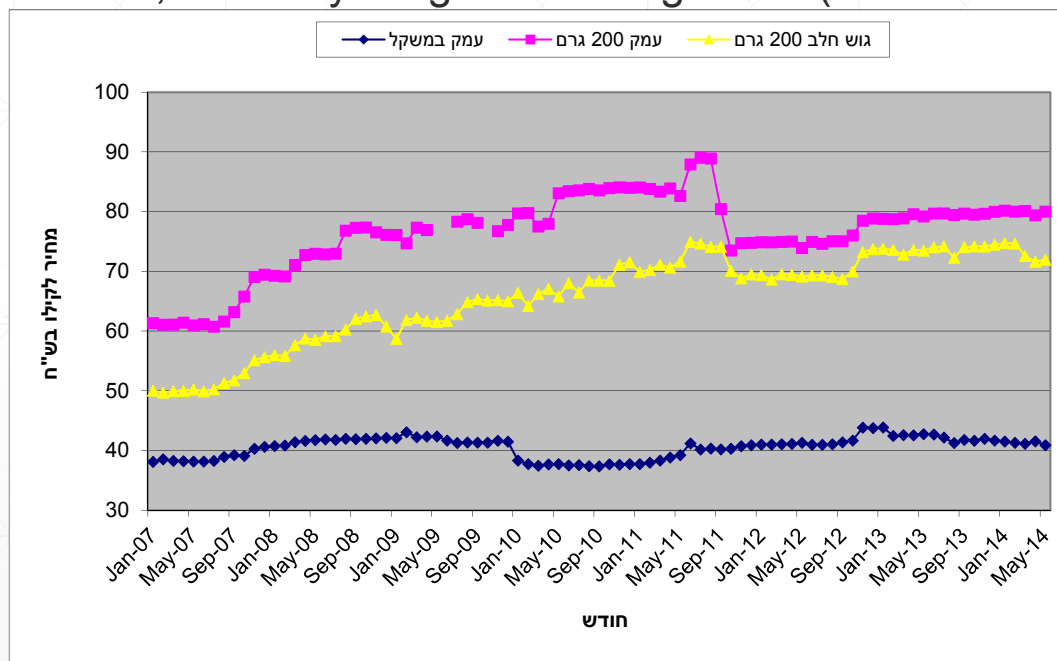
- Packaged Gilboa was deregulated in August 2007; Gilboa by weight is still regulated



מקור: נתוני פאנל הצרכנים של נילסן 2007-2009, ונתוני הקופות של נילסן, 2010-2014

# The price of Emek and Gush Halav vs. Emek by weight (“Edam” style)

- Packaged Gush Halav was deregulated in August 2007; Packaged Emek was deregulated in 1997; Emek by weight is still regulated (the two are similar)

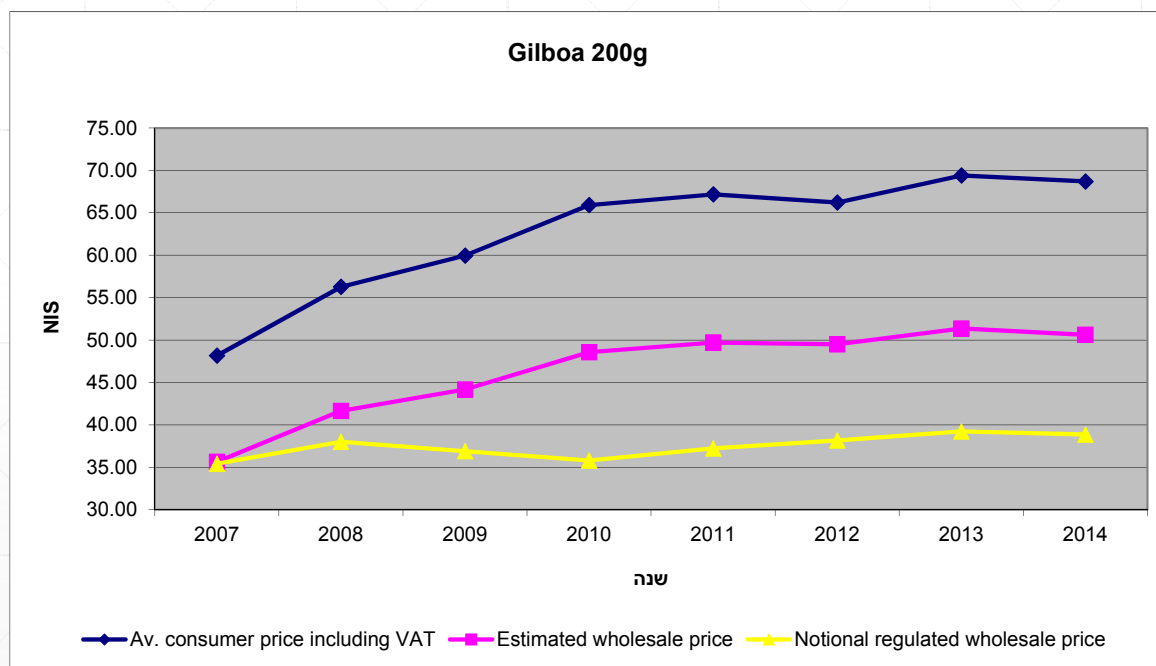


# A benchmark: the notional regulated price

- The notional regulated price is a proxy for the cost of production plus a “reasonable” rate of return
- The notional regulated price of Gilboa 200g (deregulated in July 2007) is the July 2007 price indexed to the price of Gilboa by weight (still regulated)
- Similar idea for other types of cheese
- The wholesale price (which I do not observe) is estimated as the final price minus a retail margin
  - On October 2011, following the Cottage boycott and an IAA raid on its offices, Tnuva published the wholesale price and the recommended retail price for most of its products
  - The retail margin net of VAT was 17% before October 2011 and 15% after October 2011

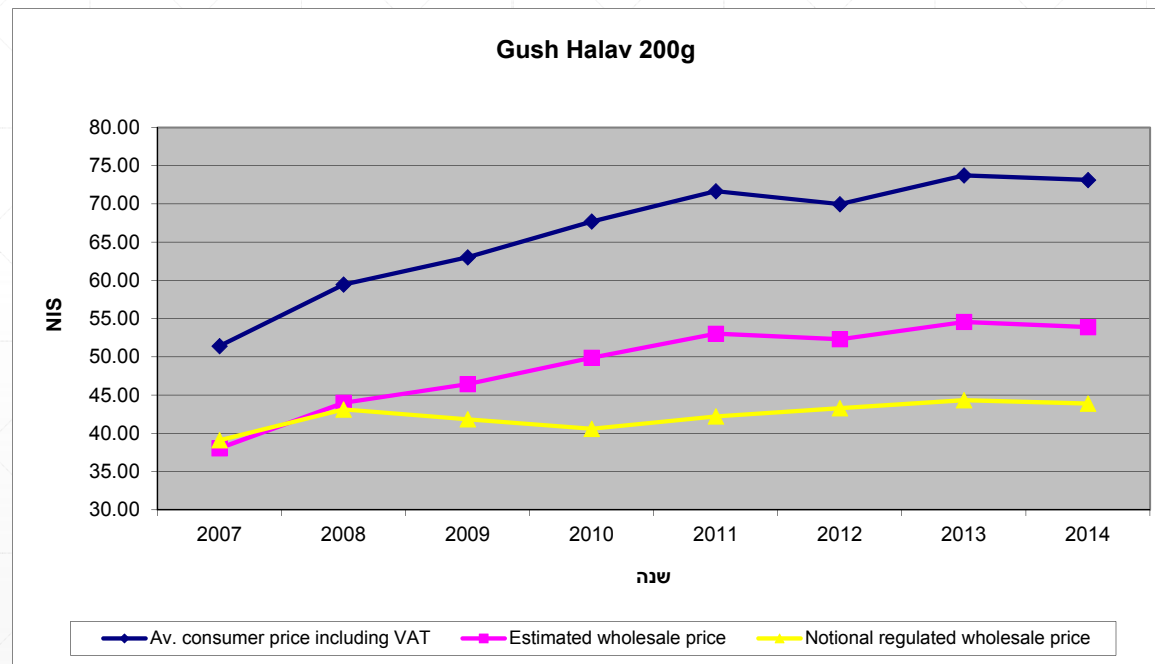
# Gilboa 200g

- The av. excess for 2010-2014 is 32%



# Gush Halav 200g

- The av. excess for 2010-2014 is 23%



# The takeaway

- No doubt that prices have increased after deregulation due to the exercise of market power
- We have a very reasonable benchmark due to ongoing regulation of cheese by weight
- The standard complaints about legal intervention do not have a bite:
  - Entry is unlikely, so the problem is not “self-correcting”
  - No chilling effect: we are talking about hard cheese...
  - Regulatory failure
- The main question: is 30% above the benchmark excessive?

# Appendix

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## The notional regulated price

- Gilboa 200g was deregulated in July 2007; Gilboa by weight is still regulated
  - The notional regulated price of Gilboa 200g is the July 2007 price indexed to the price of Gilboa by weight
- Gush Halav 200g was deregulated in July 2007; Emek by weight (almost identical to Gush Halav) is still regulated
  - The notional regulated price of Gush Halav 200g is the July 2007 price indexed to the price of Emek by weight
- Emek 200g was deregulated in 1996; Emek by weight is still regulated
  - The notional regulated price of Emek 200g and 400g is the price of Emek by weight, plus 24.6% (the difference between Gilboa 200g and Gilboa by weight as of July 2007)
- Tal HaEmek 200g was deregulated in 1996; Tal HaEmek by weight was deregulated in June 2009
  - The notional regulated price of Tal HaEmek 200g is the price of Tal HaEmek by weight in 2007, plus 28% (the difference between Tal HaEmek 200g and Tal HaEmek by weight in 1985-1996), indexed to the price of Emek by weight