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# The Protection of Consumers in the Israeli Energy Market

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Absract:
The legal architecture of the Israeli energy sector promises to deliver electricity to consumers while advancing a competitive and efficient market design. The promise of competition and efficiency is supposed to protect Israeli electricity consumers from the significant monopoly power of the state-owned Israeli Electricity Company. At the same time, the price of electricity is governed by a tariff-setting authority and is based on the cost principle. During the last decades, the Israeli government introduced several reforms intended to increase competition and efficiency in the electricity sector. Nevertheless, since the discovery of natural gas fields in the Mediterranean Sea off the coast of Israel, the government has politicized the electricity authority and passed reforms in which opaque nonmarket considerations, such as nationl security and foreign relations, trump consumer welfare for the benefit of dominant natural gas corporations, the monopolistic providers of gas to electricity producers.

## 1. Introduction

The first words uttered by God in the first chapter of the Bible are “Let there be light” (Book of Genesis 1:3). Considering the special meaning of the Bible to the inception and heritage of the State of Israel as a democratic and Jewish state, these words should have some impact on the importance of providing electricity to consumers.

The declared purpose of the architecture of the laws governing the production, transmission, distribution, and sale of electricity in Israel is to increase the efficiency of electricity production by introducing competition into some segments of the electricity production process. At the same time, general consumer protection laws provide electricity consumers with some assurance of adequate electricity provision

vis-à-vis the dominant monopoly provider of electricity, the Israeli Electricity Company (IEC).

Over the last two decades, Israel's electricity generation shifted from a complete reliance on imported coal to a mixture of coal- and natural gas–based production.

This chapter argues that despite the legal framework's declared objectives, its design and implementation were strongly influenced by nonmarket considerations, such as national security and foreign relations. Furthermore, due to the nature of these overriding considerations, the participatory and deliberative nature of democratic legislation has been significantly watered down in the process of setting up the current Israeli electricity market and, most notably, the regulation of the natural gas companies and their dominant market power. This market outcome is typical of sectors with dominant economic players that have the ability to channel economic power into political influence (Admati, 2021; Baum & Lachman Messer, 2022).

This reality has left consumers of electricity almost defenseless against the unmatched power of electricity and natural gas monopolies. Electricity consumers are practically powerless against the most important component of the service of electricity—its price. Even the attempt to regulate prices ex post through collective private litigation against the main actors in the market generated resistance by the state.

This chapter is structured as follows. Part 2 describes the architecture of the Israeli electricity market; the establishment and history of the primary regulator of the sector, the Authority for Public Utilities – Electricity; and the major legislative reforms of 1996, 2015, and 2018. Part 3 discusses the general consumer protection laws and other legal measures designed to protect consumers in the Israeli energy market. This part also addresses the development of a constitutional right to access electricity in the case law of the Israeli *High Court of Justice* (HCJ). Part 4 offers a critical evaluation of the government's role in the regulation of the electricity sector, showing that the structure of the regulation tends to favor nonmarket interests over the interests of consumers and that the government consistently undermined private enforcement attempts aimed at challenging excessive electricity prices. Part 5 concludes this chapter.

## 2. The Israeli Electricity Market

## 2.1.The Legal Architecture of the Electricity Sector

The primary source for the regulation of the Israeli electricity market is the *Electricity Sector Law, 1996*.[1] This law is the legislative product of the work of two committees of experts formed in the 1990s to design the regulatory framework for the Israeli electricity market, as the seventy-year-old concession for electricity production given to the IEC by the British Mandate before the establishment of the independent State of Israel was coming to its end. The original concession was given to the founder of what later became the national IEC, Pinhas Rutenberg, in the *Electricity Concessions Ordinance, 1927* (Official Gazette of the Government of Palestine, 1927). With the establishment of the State of Israel in 1948, the electricity company became a national government company in accordance with section 46 of the *Electricity Concessions Ordinance*.

The original concession granted the company a vertical monopoly over the production, distribution, provision, and sale of electricity, and the *Electricity Sector Law, 1996*, extended this monopoly but reformed the regulatory governance of the electricity sector.

The committees of experts that preceded the 1996 legislation recommended that the efficiency of the market for electricity and its future competitiveness would be enhanced by shifting the regulatory regime from a concession-based regime to a license-based regime. That was probably the most significant regulatory innovation of the legal reform of 1996. The licensing regime mennt that the electricity sector could be divided into segments. Hence, the licensing regime can be seen as the first step in promoting the introduction of private electricity producers to the production segment of the market.

Another significant aspect of the 1996 reform was the depoliticization of electricity prices. Before the reform, electricity prices were subject to oversight by the Minister of the Treasury and the Minister of National Infrastructures. To guarantee the professional, apolitical, and independent oversight of the prices of electricity, section 30 of the *Electricity Sector Law, 1996* established the "Authority for Public Services –

[1] Section 1 of this law states, "The purpose of this law is to regulate activity in the electricity sector for the benefit of the public, while ensuring reliability, availability, quality, efficiency, and all while creating the conditions for competition and minimizing costs."

Electricity" ("Electricity Authority"). Later in this chapter, I discuss how the Electricity Authority was again politicized in 2015.

Following the reform in 1996, there were more than two decades of attempts by the Israeli government to generate competition in the electricity sector and increase efficiency to improve service and electricity prices to end consumers. These attempts failed. The reason for the failures was, at least to an extent, strong opposition to competitive reforms by the highly organized, unionized, and well-entrenched workforce of the IEC (Katz, 2021).

In 1999, the Israeli Competition Authority formally declared that the IEC is a monopoly in the production, transportation, distribution, supply, and service of electricity to consumers.[2]

Introducing competition to the electricity production was an uphill battle, with strong opposition from the unionized employees of the IEC. It took several years for private electricity producers to build up a significant production capacity and start providing electricity to large industrial clients. Then, only in 2018, after the government agreed to spend more than 7 billion Israeli shekels (approximately 2 billion U.S. dollars) to cover demands by the IEC's workforce, was the government able to pass a second significant reform, which introduced a structural change into the electricity sector. The *Electricity Sector Law (amendment no. 16) (Interim Order), 2018*, also known as "Amendment 16," introduced competition into the electricity generation segment of the electricity sector. However, the IEC remained a monopoly in the distribution and sale of electricity to end consumers, particularly private (as opposed to industrial) customers.

Hence, even after a series of reforms in the electricity sector, it would be fair to say that the legal architecture of the Israeli electricity sector still suffers from significant anticompetitive structural inefficiencies.

[2] Declaration Regarding the Existence of a Monopoly: Israeli Electric Company Ltd. (Competition Authority, No. 3001749, 01 May 1999) (Heb.), https://www.gov.il/he/Departments/legalInfo/monopolyelectric (decided under section 26(a) of the Competition Law, 1988).

## 2.2.The Electricity Authority

### 2.2.1. The Role of the Electricity Authority

The Electricity Authority is authorized to license the participants in the various segments of the power production and supply chain,[3] and it is entrusted with the power to determine and approve the electricity tariffs.[4] The Electricity Authority also sets out the standards for the quality of services provided by providers of essential services.[5]

The tariff for consumers is based on three main elements: fixed costs (customer services, collections costs, etc.), capacity payments (reflecting the different costs involved in infrastructure for higher-capacity clients), and kilowatt hours (kWh) (reflecting actual consumption). Hence, the tariff is comprised of both fixed and variable costs.

The average annual consumption of an Israeli household is 8000 kWh.[6] Despite the declared intent of the various regulatory reforms to increase the efficiency and competitiveness of the electricity market, there is no indication of a stable reduction in the price of kWh for private consumers since 2018. In fact, the kWh tariff for private households in 2022 was thirty percent higher than the tariff in the previous year. However, this increase can be explained by the global rise in coal prices (still approximately 30 percent of the production) and by the increased use of renewable energy, which is relatively costly.

Sections 30 and 31 of the *Electricity Sector Law* stipulate that the cost principle will serve as the basis for the Electricity Authority's determination of electricity tariffs. The cost principle implies that electricity tariffs should reflect the overall cost of the entire service. The Electricity Authority reviews electricity tariffs on a regular basis. Although the Minister in charge of the Electricity Authority does not have the authority to

[3] Sections 8 and 31(a) of the *Electricity Sector Law, 1996*.

[4] Sections 30 and 31 of the *Electricity Sector Law, 1996*. "Tariffs" are defined in section 2 of the *Electricity Sector Law, 1996*, as "all types of payments made by the consumer, private electricity producer, or holder of an own production license to the holder of an essential service provider's license, including payments for the provision of infrastructure services and backup services as well as all types of payments, excluding any payment determined in a tender published by the State, and paid by the holder of a transmission license to a license holder.".

[5] Sction 17 of the *Electricity Sector Law, 1996*.

[6] *Energy consumption cost calculator* [online] Available from: https://iec-info.co.il/calculator (Accessed 06 November 2022) [Accessed: 31 August 2023].

intervene in setting tariffs for electricity, the Minister does have the authority to develop policy guidelines, and these may be reflected in the tariffs.

Despite the original intent of the legislation and the original recommendations of the various committees of experts that recommended the separation of the authority from the political echelon, this changed in 2015.

In a blitz of legislation, the government repositioned the Electricity Authority such that the chairperson of the authority is now appointed by the Minister of National Infrastructures and subject to the Minister's guidance.[7] I discuss this reform in the next chapter.

### 2.2.2. Politicizing the Supervision of the Electricity Sector (2015 Reform)

In 2015, the Israeli government initiated a reform, passed in a legislative blitz, uniting the Electricity Authority with the electricity administration in the Ministry of Energy such that the EA became subject to the Minister of Energy.

The reform meant that appointment of the chairperson of the EA was – only for the particularinstance of appointing the chairperson after the reform – now in the political hands of the Minister of Energy rather than in those of a committee that guaranteed the professional experience and moreover the independence of the person assuming the role. Most unusually, the reform brought the term of the presiding chair of the EA to an abrupt end, thus allowing the Minister of Energy to immediately appoint a person of the Minister's choosing to the position.

The aggressive steps taken by the Israeli government in 2015 to diminish the independence of the EA can be seen as an indication of the significant power wielded by natural gas providers over the Israeli government, which they presumably used to guarantee a regulatory design favorable to the small group of companies in the natural gas market. This is further discussed in part 4.

The Israeli Supreme Court entertained a petition to nullify the legal reform.[8] Among other claims, the petitioners argued that the reform was meant to silence independent

[7] Sections 30 and 38(a) of the *Electricity Sector Law, 1996*.

[8] HCJ 8612/15 *The Movement for the Equality of Government in Israel v. The Knesset* (17 August 2016) (Isr.).

voices in the EA that contradicted government policy. The Supreme Court rejected the petition, although it criticized the blitz of legislation by which the reform had been enacted.[9]

Another indication of the problematic nature of the 2015 reform was that it was in stark contradiction to the OECD's recommendation to strengthen the independence of the energy market and separate it from politics.[10]

Although independent regulators are also prone to regulatory capture (Baum & Lachman Messer, 2022), the Israeli committee that examined the regulation of the electricity market noted that regulators who are independent often promote a more competitive market and support the entrance of new competitors into the market, unlike politically appointed regulators.[11]

According to section 31(b) of the *Electricity Sector Law* after the 2015 reform, the EA is authorized to inspect the costs of licensees to determine tariffs and may disregard costs that it deems unnecessary for the production of electricity, but it must include costs that are derived from the Minister of Energy's policy. Hence, tariffs may be increased as a result of ministerial and political considerations.

Given that the only source of income for the IEC is the electricity tariffs determined by the EA and that the IEC is generally in a bad financial state (Katz, 2021), increasing political control over the determination of electricity tariffs generates a conflict of interest for the ministerial echelon. If electricity tariffs are not increased, it will be the state that must bail out the IEC from its financial distress. Note however that during 2022, as electricity production costs soared, the government preferred to dampen the IEC's request to increase electricity prices, and effectively had the IEC subsidize the costs to end consumers. In 2021, the IEC had an estimated debt of 28 billion shekels (Katz, 2021:223) but this debt was a significant reduction compared to a 72 billion

[9] *Id.*

[10] Compare with the expression of the importance of independent bodies to guarantee consumer protection in section 36 of the preamble to the Directive (EU) 2019/944 of The European Parliament and of the Council of 5 June 2019 on *Common Rules for the Internal Market for Electricity*. Available from: https://www.legislation.gov.uk/eudr/2019/944 [Accessed: 31 August 2023].

[11] Report of the Committee for Improving Regulation and Examining the Interfaces Between the Various Regulators in the Economy, p. 47-48 (2013).

shekels debt a decade earlier. Some of the reduction an be attributed to revenues from the sale of production plants to private producers.

### 2.3. Competition in Electricity Production (2018 Reform)

Over the last two decades Israel transitioned from a government-dominated economy to a liberal market economy and this included a fast process of privatizations of government companies (Ben Bassat, ed., 2002; Baum & Lachman Messer, 2022). Although the IEC was never privatized, the idea of promoting private competition in the electricity sector was on the table. At the same time it was clear that private companies in the electricity and energy sector will likely have significant economy-wide political power. Accordingly, decisions about the allocation of rights to produce electricity needed to keep this economic power in check (Baum and Lachman Messer, 2022).

In 2018, the Israeli government once again introduced a major reform of the energy sector. The purpose of the 2018 reform was to increase the efficiency of electricity production and to increase competitiveness in the energy sector (Katz, 2021). To achieve these goals, the 2018 reform implemented a structural breakup of the IEC aimed at increasing competition in the electricity production segment of the electricity sector. As part of the reform, the IEC was required to sell off five natural gas–operated power generation facilities. These power facilities represent approximately a third of the total electricity generation capacity of the IEC. As of 2022, only three of the five facilities were privatized, and private electricity producers supplied forty percent of electricity production.[12] Hence, the IEC still controlled a share of production exceeding fifty percent of the market.

To facilitate a market for electricity production, the management of the grid was also extracted from the IEC, and the government established a government company called Noga – Electricity System Management Ltd.[13] Noga's purpose was to act as the acquirer of electricity from the various producers.

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[12] Electricity Authority Annual Report 2021 (Heb.), p. 22. Available from: https://www.gov.il/BlobFolder/reports/doch_meshek_hachashmal_2021/he/Files_Hadashot_press_doch_2021_n.pdf [Accessed: 31 August 2023].

[13] See the company's website at https://www.noga-iso.co.il [Accessed: 31 August 2023].

Due to the inherent monopoly characteristics of the electricity grid, the reform did not change the IEC's monopoly in the distribution of electricity to consumers.

The reform also enabled the opening to competition of the final segment in the supply chain of electricity—supply to end consumers. In 2021, only thirty-three registered licensees were buying electricity from the IEC and supplying it to consumers. This part of the reform has almost no impact on private consumers, since private suppliers usually profit by garnering the difference between the price charged by the IEC and the final price charged to end consumers.

Even if the 2018 reform is entirely successful, in the end, the IEC still will hold more than a forty percent share of the market in electricity production. Its private rivals may not control more than twenty percent of production each because of limitations set in place by the *Anti Concentration Law, 2013*, a unique piece of legislation passed in Israel to disperse the power of companies controlling activities that wield economy-wide influence (Baum & Lachman Messer, 2022). The history of the electricity sector in the United States, particularly during the 1920s, indicates that concentrating the sector in the hands of a few actors leads to significant inefficiencies and hampers growth (Bryce, 2018).

Thus, the IEC remains a highly dominant player in the market. Essentially this market structure guarantees a long-term grandfather-style protection of the IEC's dominant position in the electricity market even after the reform.

There is no indication that the reform in 2018 had an impact on electricity prices (Katz, 2021).

## 3. Consumer Protection in the Electricity Market

The need for consumer protection in energy markets stems from the inflexible demand for electricity. The demand for electricity is relatively insensitive to price changes (Tischler and Woo, 2010). Regulation and case law regarding the protection of consumers in the electricity market can be divided into two levels. The first level deals with the protection of consumers with respect to contracting, information, quality of service, and pricing. Underlying this level of classic consumer protection, on a more fundamental level, the basic provision of electricity is addressed by a guarantee of

electricity provision to consumers who are unable to pay for the service, in particular financially distressed consumers. I discuss both levels.

### 3.1.Consumer Protection Legislation

Generally, Israeli consumer protection laws are designed to address situations involving asymmetry of information and power between the consumer and the product or service provider. Consumer protection laws are also designed to guarantee consumer welfare and to mitigate unfair competition and unfair commercial practices.[14]

Consumer protection laws are general in the sense that they apply to all markets that lack specific consumer protection regulation. Thus, these laws apply to the market for the provision of electricity, which is therefore governed by both the *Consumer Protection Law, 1981*, and the *Economic Competition Law, 1988*.

The *Consumer Protection Law, 1981*, protects consumers in three stages of a transaction: first, the earliest stage, before the transaction; second, the transaction itself; and third, the post-transaction stage. In the post-transaction stage, especially in the relationship between individual consumers and corporate giants such as electricity companies, the consumer is the weaker party, often bound by specific investments, unable to exit, lacking an incentive to invest resources in additional negotiations with the service provider, and lacking the resources or incentives to engage in litigation to stand up for their rights.

The EA's tariff-setting role replaces the role of consumers whose weak negotiation power could not otherwise properly police the price of electricity. This principle is guaranteed by the EA's adherence to the cost principle, according to which electricity tariffs may reflect only the costs of electricity production, distribution and the various related services.

However, the costs of electricity production, transmission, distribution, and sale are not only opaque to consumers, they are also imperfectly supervised by the EA. There is at least anecdotal evidence that the Electricity Authority suffers from information asymmetry vis-à-vis the IEC.

[14] Explanatory Note to the Consumer Protection Bill, 1980, Knesset Bills 302.

The *Schleider* decision of the Supreme Court is a case in point.[15] According to the plaintiff in this class action, Israeli electricity consumers were overcharged for electricity because the tariffs authorized by the EA were based on inaccurate financial reports provided to EA by the IEC. The IEC's financial reports misstated and exaggerated the company's obligations regarding employee pension funds. The misinformation affected the tariffs, which are cost-based, so the final price to consumers was inflated. The court eventually rejected the allegation that the IEC misledconsumers. The court determined that regardless of whether the financial information revealed to consumers was correct, it was illegal for the company to increase its costs in the way it had, so the illegality of the action (rather than the financial misstatement) was the correct cause of action.[16]

The *Schleider* case demonstrates not only that an asymmetry of information exists between the IEC and its primary regulatory supervisor but also that consumers are significantly disadvantaged in attepts to exercise effective private legal oversight against inflated production costs and pricing and tariff-setting mistakes.

The *Schleider* case reflects another fundamental problem. The cost principle underlying electricity tariffs means that the IEC has weak incentives to reduce costs because the residual beneficiaries of any efficiency improvements are consumers, not the company or its corporate officers (Anderson et al., 2017; Kovvali & Macey, forthcoming). Indeed, decision-makers within the IEC have an interest in inflating or manipulating corporate actions in a way that inflates costs if they can pocket the returns.

An anecdotal example of the problem described here can be seen in the *Visoli* case, which involved the fact that the fixed amount the IEC charges consumers includes the cost of employing workers who register household electricity meters. Meter reading is done periodically, and occasionally the IEC skips a reading. Sometimes skipping the meter checking is intentional, but sometimes it occurs because the meters are in a place inaccessible to the IEC meter-reading workers. In the latter case, the IEC may charge consumers for the visit. It is impossible for the individual consumer to supervise this charge. Indeed, a class action that was filed against the IEC revealed that the IEC

[15] CivA 3456/13 *Israel Electricity Company v. Yonatam Schleider* (29 August 2017) (Isr.).
[16] *Id.* (section 53 of Justice Rubinstein's opinion). The court was convinced by reports provided by the Electricity Authority that end consumers did not suffer pecuniary losses due to the misstatements.

systematically charged consumers for inaccessible meter–reading visits when those visits were in fact skipped by IEC workers intentionally.[17]

Obviously, the price of electricity is only a small part of the whole service. The Electricity Authority developed what seems to be a comprehensive service standards manual, which is a binding document. Indeed, the Electricity Authority's primary function, well before it was granted a licensing power, was to supervise the standards, nature and quality of the service provided by essential utilities.[18] Over the years, the EA developed standards that were incorporated to its "Book of Standards".[19] The Book of Standards includes standards regarding the measurement of individual household consumption, meter reading frequency, accuracy of the readings, pre-paid meters,[20] billing, disconnecting and reconnecting of consumers, etc. The Book of Standards also stipultes the obligation to set up a process for receiving and handling consumer complaints. To ensure compliance, a service provider that did not comply with a standard that protects a consumer must pay a monetary sanction to the consumer within 60 days.[21]

### 3.2.Access to Electricity

There is a litany of judgments in Israel regarding the right of consumers who fail to pay their electricity bills to continued access to the service. Given the vital role of electricity in maintaining basic daily routines in an advanced society, the Supreme Court has made it very difficult for the IEC to refrain from providing service even to nonpaying consumers.

In the *Rozenzweig* case, the Supreme Court recognized the right to access to electricity as a derivative basic right.[22]

This is a unique and notable decision because Israel does not have a formal constitution, nor does it have a bill of rights. Israel does have a set of basic laws defending some

[17] CivA 8080/21 *Visoli v. Weisbrod* (27 November 2022) (Isr.).
[18] Sections 17(d), 30(2) and 33 of the *Electricity Sector Law, 1996*.
[19] Electricity Authority, Book of Standards (2022). The latest version of the book from July 2022 includes more than 700 pages.
[20] Pre-paid counters are often used in the case of consumers that are insolvent and have fallen behind in previous payments.
[21] Electricity Authority, Book of Standards (2022), p. 32.
[22] HCJ 4988/19 *Sigalit Rozenzweig v. Public Utilities Authority – Electricity* (20 January 2022) (Isr.).

fundamental individual rights, including the rights to privacy, property, and human dignity. However, economic and social rights, such as the rights to access health or education, are not formally protected by these Basic Laws. It was therefore an unusual move for the court to recognize the right to access electricity.

The *Rozenzweig* case concerned the right of the IEC to withhold the provision of electricity to consumers who were unable to pay for the service as a result of financial hardship and who needed electricity for medical or other reasons. The Court laid out three alternative approaches to recognizing the right to access to electricity. Under one extreme approach, electricity would be considered a natural resource, and there would be a natural individual right to access the provision of electricity. On the other end of the spectrum, the provision of electricity would be considered a commercial service and therefore would be available only to those who could pay for the service. The court eventually preferred an intermediate approach, according to which consumers have a legal right to access electricity, but this right will be protected only insofar as electricity is required to protect other fundamental individual rights, such as the right to life or the right to health. For example, a consumer's access to electricity is protected if electricity is vital for preserving life-saving medicine in conditions of refrigeration.[23]

The right to access electricity therefore builds on the earlier recognition of the right to a minimal standard of living. *Basic Law: Human Dignity and Liberty* was interpreted by the Supreme Court as protecting the human right to a minimal standard of living. The Court held that access to electricity is one of the basic components of this minimal standard and noted that children's right to education is dependent on the provision of electricity.[24]

Some legislative texts also reflect the importance of preserving a basic level of access to electricity. For example, the law regarding personal insolvency stipulates that one may not seize the electrical appliances of an insolvent debtor because they are part of the minimal standards of living.[25]

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[23] *Id.*

[24] HCJ 366/03 *The Commitment to Social Justice and Peace Association v. The Minister of the treasury*, 50(3) PD 464 (2006) (Isr.).

[25] The *Insolvency Law, 2018*, section 217, and the Second Addendum to the Law.

Following the decision of the court in *Rozenzweig*, the EA updated its guidelines and curtailed the ability of electricity providers to disconnect electricity service to nonpaying consumers under conditions of poverty or financial distress.

Note that the protection of impoverished or financially distressed consumers does not address the issue of electricity prices. In fact, recognition of the right of impoverished consumers to continued access to electricity may have a detrimental effect on the price of the service paid by other consumers. That is because the cost of providing electricity to nonpaying consumers will, most likely, be dispersed among paying consumers. Alternatively, if tariffs determined by the EA are not increased as a result of the introduction of a strict prohibition against cutting off electric service to nonpaying consumers, the financial situation of the IEC will be worse off as a result of the decision of the Supreme Court in *Rozenzweig*. It may result in a government bailout of the IEC at the expense of all taxpayers. Since, according to the current tariff-setting system, tariffs may not be updated to allow cross-subsidizing of this sort, the *Rozenzweig* case is indeed mentioned as another potential cause for financial distress of the IEC.

## 4. The Government's Policy Impact on Competition

Designing regulation to enhance competitve markets is challenging in small states and the case of Israel is even more challenging given its geopolitical limitations (Baum, 2016). Israel has a history of emulating regulatory solutions from developed jurisdictions (Baum, 2015; Baum & Solomon, 2021; Baum & Solomon, 2022). Where regulation moves away from globally recognized best practices, without proper justification, there is cause for concern.

A series of government, regulatory, and judicial decisions regarding the energy market (especially the production of natural gas) from 2015 onward indicate that regulation of the competitive characteristics of the energy sector has been compromised. At the very least, in what seems like a classic process of regulatory capture (Stigler, 1971; Posner, 1971; Peltzman, 1976; Becker, 1983; Dal Bo, 2006), the transparency of supervision has been weakened and regulatory supervisors intimidated. The pricing of electricity to private consumers has been subjected to opaque overriding considerations, such as national security and foreign relations, without sufficient public scrutiny. Moreover, the

government made a systematic effort to curtail ex post private litigation scrutinizing unfair monopolistic pricing of electricity to consumers.

### 4.1.Ex Ante Entrenchment of the Interests of Natural Gas Suppliers

Until the beginning of the third millennium, Israel was relatively poor in oil and natural gas resources. Since 1999, a series of offshore natural gas discoveries turned Israel from an importer of energy resources to an exporter.[26]

Before the major discoveries, the government made efforts to increase competition in the sector. One example is the *Samedan* case from 2001, in which natural gas companies argued that the concession granted to them to extract natural gas included the right to construct a gas pipeline from the gas field to the electricity production site of the IEC.[27] The High Court of Justice ruled that natural gas is a national resource and that the Oil Law, 1952 gives the government the authority to regulate the exploration and extraction of the gas. The court affirmed that the principle of economic competition was a legitimate government consideration. Thus, the court rejected the petition of the companies and affirmed that the government has the authority to decide that the pipeline will be constructed by a party other than the gas field operator and that the pipeline operator will be selected by a bid.[28]

Given the significant natural gas discoveries and the importance of these resources for the production of electricity by the IEC and by private electricity producers, it would have made sense for the Israeli government to regulate natural gas production and the natural gas market in a way that would guarantee both efficient production and competitive natural gas prices. Instead, in the last decade, there has been some anecdotal evidence that the Israeli government preferred the interests of the natural gas companies over the interest of more efficient competition and over the interests of

[26] In 1999, the first deep sea natural gas discovery was made off the coast of Israel. Later, in 2009, the significant discovery of the Tamar deep sea field occurred, followed by the discovery of several additional natural gas fields, including the largest one, appropriately named "Leviathan," and two smaller fields, Karish (the Hebrew word for "shark") and Tanin (Hebrew for "crocodile"). The size of the major discoveries is estimated to be between 650 and 1000 billion cubic meters (BCM). After the development of these fields, these discoveries have turned Israel from an importer of natural gas to an exporter of natural gas to neighboring countries. The legal rights to extract, sell, and export the natural gas were held initially by a partnership consisting of several companies but mostly dominated by two major companies, Delek Group (controlled by Israeli billionaire Yitzchak Tshuva) and Noble Energy, a U.S.-based publicly traded oil and gas company acquired in 2020 by U.S. energy giant Chevron.

[27] HCJ 5812/00 *Samedan Mediterranean Sea v. Commissioner for Oil in the Ministry of National Infrastructures* 55(4) PD 312 (2001) (Isr.).

[28] *Id.*

electricity consumers. often, government oofficials explained the policy by stressing the need to enable the fast development of the natural gas findings from mere discobveries to the stage of extraction and distribution to electricity producers. The latter process is particularly costly in the case of deep sea discoveries (Steinitz, 2020). Although some of the government's actions were scrutinized and sometimes criticized by the Supreme Court and lower courts, they were eventually allowed to pass.

Immediately after the first major gas discoveries, the government realized that the tax and royalty regime regarding the profits from natural gas is outdated. In 2010, the government established a committee to review the regime. A well known professor of economics, Eytan Sheshinski, agreed to serve as the head of the committee. The committee's work stirred up strong opposition from the natural gas companies and an aggressive public reaction. Eventually, the committee recommended to increase the share of the "Government Take" from the natural gas profits from 20 percent to approximately 60 percent of profits, but also that the high taxation will kick in only after the natural gas companies will cover the costs of developing the natural gas fields. The committee's recommendation were later enacted in the *Law on the Taxation of Natural Resources, 2011*. Following extensive public debate and lobbying efforts (Sachs & Boersma, 2015), the final taxation in the law was somewhat lower than the committee's final recommendations, but still significantly higher than the previous and archaic regime.

In the aftermath of the Sheshinski committee's process there are three interesting observations. First, the Sheshinski committee was the last time in which the government appointed an external expert to head to chair a committee on issues regulating the natural gas regime. Second, it was also the last time in which the government reformed or made significant regulation in thenatural gas regime through a legislative process. Finally, it should also be noted that the reglation of the Government Take has a counterbailing effect on end-consymers. Increasing the tax on natural gas profits means that the price of natural gas to electricity producers will increase and thus the price of electricity was expected to increase accordingly. On the other hand, increasing the government take means that the government share in the profits will be larger, at the

expense of energy consumers. In other words, the governnemt stands to profit from monopoly pricing of natural gas.[29]

Regulating the government take in the gas profits was only the first step in a series of matters that needed to be resolved. The next major issue was the competitive structure of the natural gas sector. Due to the high costs of natural gas exploration, the rights to explore natural gas was given by the Minisstry of Energy to a small number of companies. However, as it happened, the two largest natural gas findings were discovered by a collaboration of companies that did not seek the approval of the Israeli Competition Authority prior to their collaboration. As a result of that, the Israeli Competition Authority intervened and started a process of regulating the monopoly created by the natural gas companies. This process came to a halt as a result of public criticism and the development of the natural gas fields came to a stop (Steinitz 2020; State Comptroller Report, 2021: 498).

The formative regulatory event in the natural gas sector occurred in 2015, when the government decided to promulgate a comprehensive regulatory regime to promote fast development of the natural gas fields. Despite public demand for regulation of the huge discoveries by a transparent, democratic process of deliberative legislation, the government preferred to set up an intragovernmental committee of experts, which negotiated with the gas producing companies a long term, national, *Natural Gas Plan* (NGP).[30]

The NGP proposed a comprehensive regulatory regime for the extraction and development of natural gas fields from the four main gas fields. The NGP dealt with eight main issues: (1) restructuring and breakup of the holding in the natural gas fields;

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[29] In reality, the projected government share in the profits is still far from materialization. The state established a sovereign wealth fundd to manage the revenues. The fund was established by the *Fund for the Citizens of Israel Law, 2014*. According to the Bank of Israel, the fund should have accumulated 3.9 billion U.S. Dollars by 2022, but at the end of 2021 it only had only 6 percent of the projected amount (State Comptroller Report, 2021: 486).

[30] Government Resolution 426 (2015), *Framework for Increasing the Quantity of Natural Gas Produced from the Tamar Natural Gas Field and Rapid Development of the Leviathan, Karish and Tanin Natural Gas Fields and Others*. https://www.energy-sea.gov.il/English-Site/Pages/Regulation/Gas%20Outline%20and%20Appendices%20and%20Explanatory%20Remarks%2016%20August%202015%20-English%20ver.%20with%20dislaimer.pdf. Government Resolution 1465 (2016), *Amendment to the Outline for Increasing the Quantity of Natural Gas Produced from the "Tamar" Natural Gas Field and the Rapid Development of the "Leviathan", "Karish" and "Tanin" Natural Gas Fields and Additional Natural Gas Fields*. https://www.energy-sea.gov.il/English-Site/Pages/Regulation/Decision%201465%20English%20translation%20with%20disclaimer.pdf. I refer to the resolutions together as the National Gas Plan ("NGP"). *See* also: Azran, E. & Shpigel, N. (6 December 2015) *Thousands protest natural gas plan across Israel*. [online] Available from: https://www.haaretz.com/israel-news/business/2015-12-06/ty-article/.premium/thousands-protest-natural-gas-plan-across-israel/0000017f-f525-d460-afff-ff6745ec0000 [All accessed: 31 August 2023].

(2) rapid development of Leviathan field; (3) pricing of the natural gas; (4) taxation; (5) export caps; (6) guaranteeing the stability of gas supply; (7) maintaining regulatory status quo; (8) exemption of the natural gas companies from the purview of the *Economic Competition Law*.

The most striking achievement of the NGP was the partial structural breakup of the holdings in the gas fields. Delek and Noble agreed to sell off their holdings in the two smaller fields, Karish and Tanin within a given time frame (they were sold the Greek energy company Energian) and Delek had to sell off its holdings in Tamar within six years). Noble had to reduce its stake in Tamar to 25 percent but remained as the operator of this field. In addition, the NGP included various price mechanisms for future short term gas supply contracts, thereby intervening with the pricing of new contracts at least until the level of concentration in the market will – so it was expected – be reduced. Finally, the most controversial clause of the NGP stipulated a government guarantee that the regulatory status quo of the NGP would not be changed either by regulators or legislation for ten years.[31]

The stated purpose of the NGP was to promote rapid development of the natural gas fields and guarantee that international companies will be interested in future natural gas exploration. It is therefore no surprise that the NGP did not breakup the holding of the U.S.-based company Noble Energy in the two main gas fields, Tamar and Leviathan. It is also important to note that the NGP did not intervene in pre-existing long term contracts between the natural gas companies and the IEC. In these contracts, that were inspected and ratified by the Electricity Authority, the IEC agreed to pay a relatively high price for natural gas. The reason for the long term commitment to high prices was the need to finance the development of the natural gas fields. These long term contracts are one explanation for discrepancies between the comparatively low natural gas prices in Israel and the electricity prices.

On balance, the NGP did not give sufficient weight to short- and medium-term competition considerations in the market for natural gas but rather assumed that guaranteeing the profits of the natural gas companies and the regulatory status quo will incentivate more exploration and eventually yield more fields and more suppliers (State Comptroller's Report, 2021). This is a projection that has not yet materialized.

[31] HCJ 4374/15 *The Movement for the Quality of Government in Israel v. The Prime Minister* (27 March 2016) (Isr.).

The government pushed to implement the NGP by administrative and governmental decisions rather than through legislation. This was not the first time the government had tried to do this. The question of whether the natural gas market should be regulated on the administrative level or by legislation had arisen earlier with respect to the right of the government to determine the extent to which natural gas companies would be allowed to export natural gas, a national resource owned by the state. Then, as with the NGP, the government established an intragovernmental committee of experts to determine the extent of natural gas reserves that the state would require natural gas companies to refrain from exporting. The government committee, chaired by the genera director of the Ministry of Energy Shaul Zemach, recommended that a quantity that will guarantee 25 years of national consumption will be reserved and not allowed to be exported. The committee estimated this quantity at 450 BCM. In 2017, a revised estimate of the national consumption needs increased the reserve to 500 BCM (State Comptroller Report, 2021: 496). Following the government decision on the matter of the quantity that must be reserved, a petition was filed with the Supreme Court. The petitioners argued that the issue should be determined through a deliberative legislative process. The petitioners contended that regulating the natural gas market is a matter of national importance that should fall under the doctrine of "primary arrangements" and that the *Oil Law, 1952* enacted more than sixty years before could not be seen as a sufficient, or even relevant, legislative source of authority for the government to regulate the massive discoveries.[32]

The Supreme Court rejected the argument that the regulation of the natural gas findings was a "primary arrangement" that should be dealt with by parliament by way of legislation and not by a government decision. Although the *Oil Law* was drafted in the early 1950s, the majority opinion of the court delivered by Chief Justice Asher Grunis held that it was sufficient to authorizing the government to regulate the market.[33] The minority opinion delivered by the Deputy Chief Justice, Elyakim Rubinstein, warned against the interests that may influence decisions taken in opaque closed rooms. Having ruled that the Oil Law gives the government the authority to regulate the export of natural gas, the Supreme Court allowed the government to determine without

[32] HCJ 4481/13 *The Academic Center for Law and Business v. The Government of Israel* (12 July 2014) (Isr.).
[33] *Id.*

parliamentary scrutiny the share of natural gas resources that may be exported and the share that must be kept in reserve for national consumption.[34]

The legal battle over the application of the "primary arrangements" doctrine to the design of the natural gas market was the antecedent to the final legal battle over the legality of the NGP. As before, the legality of some clauses of the NGP was challenged by petitions to the Supreme Court filed by members of the parliamentary opposition and by civil society activists. The respondents included Prime Minister Benjamin Netanyahu and the companies holding the rights to the four main natural gas fields.[35]

The case attracted national and international public attention. It sparked disputes even within the government. For example, the head of the Israel Competition Authority at the time, Professor David Gilo, held the opinion that the NGP did not sufficiently guarantee a competitive market and the interests of consumer welfare were not properly served by the NGP. Gilo withdrew from the committee that drafted the NGP and eventually also resigned from the Competition Authority. His interim replacement supported the NGP in oral arguments before the Supreme Court.[36]

Similarly, as noted earlier, the 2015 reform of the EA, including the removal of its chairperson, was also a measure that quashed criticism within the government against the NGP.[37] After the swift politicization of the EA, it did not voice any further opposition to the NGP.

The lengths to which the government was willing to go to protect and defend the NGP were demonstrated by the fact that Prime Minister Netanyahu, asked to appear in person before the Supreme Court in the hearings of the petition contesting the legality of the NGP. Despite this unprecedented intervention, the Supreme Court decided to nullify the NGP, but only because of one legal drawback—its ten-year "regulatory stability" clause.[38] Indeed, one of the most controversial sections of the NGP was a government undertaking to guarantee a ten-year regulatory status quo, including a guarantee that the

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[34] *Id.*

[35] HCJ 4374/15 *The Movement for the Quality of Government in Israel v. The Prime Minister* (27 March 2016) (Isr.).

[36] Bar-Eli, A. & Coren, O. (25 May 2015) *Antitrust chief steps down amid dispute over breaking up gas cartel*. [online] Available from: https://www.haaretz.com/israel-news/business/2015-05-25/ty-article/israeli-antitrust-regulator-steps-down/0000017f-e905-df2c-a1ff-ff55e7240000 [Accessed: 31 August 2023].

[37] Bar-Eli, A. (5 November 2015) *Electricity agency loses independence*. [online] Available from: https://www.haaretz.com/israel-news/business/2015-11-05/ty-article/.premium/electricity-agency-loses-independence/0000017f-eb23-d3be-ad7f-fb2b433a0000 [Accessed: 31 August 2023].

[38] HCJ 4374/15 *The Movement for the Quality of Government in Israel v. The Prime Minister* (27 March 2016) (Isr.).

government would stave off any attempt to change the NGP in future legislation by a future government. The court held that the regulatory status quo could not be put in place by the government; such protection could be given only by legislation.[39] The Supreme Court then went on to invalidate the entire NGP because the government insisted that the NGP reflected a comprehensive and delicate balance of interests and that the invalidation of even the smallest component of it would result in its collapse.[40] Despite that claim, the government then redrafted the NGP to exclude the long-term regulatory status quo guarantee, and the NGP was approved by the government in 2016. Finally, the government exempted the natural gas companies governed by the NGP from the purview of the *Economic Competition Law*'s regulation by invoking, for the first (and only) time in the history of Israeli competition law, section 52 of the *Economic Competition Law*. Under section 52, the Minister of Economic Affairs may exempt a monopoly from the purview of the competition law for reasons of foreign affairs or national security. The Ministry of Foreign Affairs and the National Security Council (a body directly subject to the Prime Minister) provided the government with written opinions justifying the exemption of natural gas companies from the *Economic Competition Law*.

Israel's national security and foreign relations were given as justifications for setting up the regulatory regime of the natural gas sector in what was clearly a hasty, opaque process yielding a suspiciously uncompetitive design. The Israeli government argues that natural gas exports to neighboring countries serve as a diplomatic tool to enhance peace and mitigate conflicts (Even & Eran, 2014; Ashwarya, 2020; Steinitz, 2020), but it is unclear why that objective could not have been achieved within a more competitive market structure. In fact, a dispersed energy market structure is considered more stable and resilient in terms of national security because damage to one energy producer cannot paralyze the entire sector (Bryce, 2018).

To date, there are three main natural gas fields (Tamar, Leviathan and Karish-Tanin) supplying gas to Israel. The multiplicity of sources guarantees a stable supply. The reliance of Israeli electricity producers on natural gas more than tripled in less than a decade and is as of 2019, more than 60 percent of Israel's electricity production is based on natural gas. However, even after the breakup and restructuring of the rights in the

[39] *Id.*
[40] *Id.*

natural gas fields, Noble Eneergy remains a significant operator in the two largest fields and the level of concentration in natural gas production is considered high (State Comptroller's Report, 2021).

In sum, the crucial stages of formulating the design of the Israeli energy market were conducted within the government with intensive political intervention and several meetings with industry captains (Steinitz, 2020).[41] The public was then faced with a "done deal" and courts were warned that any intervention would cause irreparable harm.

### 4.2.Ex Post Protection of Monopoly Pricing

The government's efforts to shore up the economic and financial interests of natural gas companies did not stop at the preliminary stages of the design of the market. The government also intervened in an effort to stave off collective private litigation efforts aimed at tackling excessive electricity prices resulting from the monopoly power of the natural gas companies.

In 2015, a class action was filed in the Israeli District Court against the natural gas companies and the IEC claiming that abuse of monopoly power by the natural gas companies resulted in local electricity consumers being charged excessive prices for electricity.[42]

The Attorney General's (AG) intervention in this private litigation is yet another example of the anticompetitive intervention of the government in the natural gas market and consequently in electricity prices. The position of AG is uniquely powerful in the general architecture of Israeli public law. The AG is a civil servant appointed by the government, but he is independent in the rendering of his legal opinions. The AG advises the government on all matters of law, and his legal opinion is binding on all branches of the government. In addition, the AG is the head of the General Prosecution. The AG has the authority to intervene in any litigation, including private litigation, to represent the public interest.[43] The main purpose of this authority is for there to be an entity that will represent the public interest in private litigation in which the court's

[41] The government did submit the NGP to the Knesset for a ratification vote on September 7, 2015. However, this was not a legislative process. The Knesset could not influence the content of the NGP nor change it. The outcome of the vote was merely declaratory in nature. The vote was split along party lines, 59 members of the Knesset supported the NGP and 51 objected.

[42] Class Action (DC CT) 35507-06-14 *Nizri v. Noble Energy Mediterranean Ltd.* (8 June 2021) (Isr.).

[43] The *Legal Procedure Ordinance (Standing by the Attorney General)* [New Version, section 1.]

ruling may have far-reaching consequences beyond the interests of the parties, and sometimes contradicting them.

The AG intervened in the class action regarding natural gas pricing and its impact on electricity prices in two ways.

First, the AG used the authority to intervene in civil matters that potentially implicate the public interest and asked the court to dismiss the plaintiffs' action. The AG argued that the NGP is a comprehensive and exhaustive regulation of the natural gas market that creates a bar against any intervention by the state or the court in the pricing of natural gas. The AG also argued that any potential intervention by the court in the pricing of natural gas would have a destructive effect on the fragile balance of interests reflected in the NGP and therefore might result in nationally detrimental consequences. The Supreme Court eventually rejected the efforts of the AG and the natural gas companies to quash the class action in its initial stages.

Second, on a more fundamental level of intervention, the AG and the Israeli Competition Authority have made it much more difficult for consumers to tackle monopoly power.

Class actions claiming abuse of monopoly power in the form of excessive pricing are notoriously difficult for plaintiffs because these class actions feature two major asymmetries. First, the plaintiffs are usually private litigants mounting a claim against the most powerful economic entities in the market. Second, the plaintiffs have no access to information about the cost structure of the defendant companies, which makes it almost impossible to prove the existence of excessive monopoly profits. Rather than proposing or supporting procedural solutions to balance the extreme asymmetries, the AG intervened in the excessive-pricing class action and called on the court to raise strict barriers against requests to approve class actions regarding excessive pricing by monopolies.[44] Although the latter class action was not related to the energy market, the position of the AG and the ruling of the Supreme Court on the matter had an impact on all pending excessive-pricing class actions.

It is therefore no surprise that the Israeli District Court rejected the class action regarding natural gas prices. The District Court noted that there were indications that the prices were excessive, but they were insufficient to allow the class action to survive

[44] CivA 1248/19 *The Central Company for the Production of Light Beverages v. Gafniel* (26 July 2022) (Isr.).

the preliminary stage of litigation.[45] An appeal by the plaintiffs to the Supreme Court was eventually withdrawn in 2023 after unfavorable remarks from the bench made it clear that the appeal had little chance of succeeding.

## 5. Conclusion

The production, transmission, distribution, and sale of electricity require huge economic power and therefore in most countries these activities are conducted by huge private corporations or by government-owned corporations. Often monopoly power is given to companies in all or some of the segments of the electricity supply chain. Israel is not different in these respects.

The size, complexity, and opaqueness of the supply side in the energy market create one of the most extreme market asymmetries in the relationship between energy providers in a monopolistic or highly concentrated market, and their consumers.

The general *Consumer Protection Law* is insufficient to remedy the imbalance in the electricity market. With regards to service quality, the EA aims to rectify the imbalance through a complex set of service standards, enforced through pecuniary sanctions in favor of consumers. There is anecdotal evidence that suggests that this enforcement is imperfect. Therefore, the Israeli *Electricity Sector Law, 1996* aims to protect the public interest through the promotion of competition and efficiency in the sector. Over the last three decades, the government promoted several reforms in the electricity sector with the declared intention of protecting the public interest, including competition and efficiency in this market. Although some reforms, such as the breaking up of the IEC, were able to reduce the monopoly power of the IEC, the market is still far from competitive. Furthermore, despite the declared intentions of the *Electricity Sector Law*, it seems that the reforms promoted by the government – particularly in the natural gas sector – were often designed to protect the interests of powerful corporate entities in the energy sector, and may have undermined consumer welfare.

The Israeli government seems to have prioritized nonmarket national considerations over increasing competition in the markets underlying the provision of electricity to

[45] Nizri case, supra note 42.

consumers. While it might be legitimate to prefer nonmarket interests such as foreign relations and national security, this has been done under a veil of secrecy and in ways that consistently minimize or outright disregard the democratic process of parliamentary and public checks and balances.

To the extent that the protection of consumers is left to private litigation, it would be the role of courts to resolve the asymmetric balance of power between consumers and monopolies. Given the extreme imbalance between the parties, the lack of transparency in the design of the regulation, and the overwhelming complexity of the energy market, the courts should shift the burden of proof in collective private litigation from consumer-plaintiffs to the main actors in the energy market, requiring the latter to show that their prices are not excessive.

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