ALERT MEMORANDUM

"Exploitative" Abuse of Dominance and "Price Gouging" in Times of Crisis

March 31, 2020

The COVID-19 pandemic is leading to extreme demand and price volatility for certain products, as well as fluctuations in firms' costs. As firms struggle to manage these changes, agencies are aggressively seeking to show they are preventing consumer exploitation—for example, as a result of "excessive" prices—during the crisis. Governments are already investigating based on a variety of different instruments, including competition rules, consumer protection law, and "price gouging" prohibitions. Commissioner Vestager, for example, has stated that the EU Commission "*will stay even more vigilant than in normal times if there is a risk of virus-profiteering.*"

This memorandum seeks to help businesses navigate the rapidly-evolving challenges of the months ahead. It first summarizes the rules on "exploitative" abuse of dominance in Europe and price gouging in the U.S. Second, it describes the enforcement steps that agencies are taking during the pandemic. Third, it concludes with some practical considerations. In particular, it advises that firms in sensitive sectors should rigorously document the reasons for, and background to, any price increases.

This is the first part of a series on antitrust topics that we expect to be particularly relevant at this time. It supplements the materials available on our Resource Center, including our previous COVID antitrust update, and our agency status tracker.

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors

George Cary
+1 202 974 1920
gcary@cgsh.com

Maurits Dolmans
+44 20 7614 2343
mdolmans@cgsh.com

Bruce Hoffman
+1 202 974 1784
bhoffman@cgsh.com

Thomas Graf
+32 2287 2003
tgraf@cgsh.com

Leah Brannon
+1 202 974 1508
lbrannon@cgsh.com

Rich Pepper
+32 2287 2181
rpepper@cgsh.com

Henry Mostyn
+44 20 7614 2241
hmostyn@cgsh.com

Alexis Lazda
+1 202 974 1512
alazda@cgsh.com

Savannah Haynes
+1 202 974 1711
shaynes@cgsh.com

Kristi Georgieva
+32 2287 2281
kgeorgieva@cgsh.com

Jan Przerwa
+32 2287 2157
jprzerwa@cgsh.com

Exploitative abuses and price gouging prohibitions

Charging "excessive" prices constitutes an abuse of dominance in many countries, including almost all OECD members. In the U.S., excessive prices are not in and of themselves a matter for competition enforcement at the federal level, but many states have laws that prohibit "price gouging" and President Trump recently signed an executive order designed to prevent hoarding and price gouging.

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Exploitative abuses under EU competition law

Under EU competition law, agencies can sanction dominant firms for using their market power to exploit consumers directly. In particular, Article 102 TFEU provides that an abuse may consist of "*directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions*," for example, through excessively high prices.

Historically, the EU Commission (**EC**) and other agencies have been reluctant to challenge companies' pricing, recognizing the important role that pricing plays in clearing markets and stimulating entry and innovation.[1] Exploitative abuse cases have therefore been rare. Even before the COVID-19 crisis, however, EU agencies were increasingly pursuing exploitation theories. In 2016, Commissioner Vestager stressed that the EC would seek to "*intervene directly to correct excessively high prices.*" So far, most recent exploitation cases have been in the pharmaceutical sector (*e.g.*, the *Aspen* cases in Europe, Italy, and Spain, and *Pfizer/Flynn* in the UK). The EC has also taken action against excessive prices in the gas sector (*Gazprom*).

It is not illegal to hold a dominant position. Because the natural consequence of dominance is to price above the competitive level, supra-competitive prices also are not automatically prohibited. Otherwise, treating prices above the competitive level as abusive treats the dominant position as illegal.

Prohibitions on exploitative conduct in Europe apply only to dominant firms. No doubt during the crisis, agencies may try to stretch the definition of dominance in a number of ways, including by: (i) defining narrow markets to enable them more easily to reach dominance findings; (ii) finding companies temporarily dominant, as in the *ABG Oil* case;[2] (iii) relying on the concept of collective dominance to find that several companies are dominant together; or (iv) using the fact that a firm can charge substantially above the competitive level as an indicator of dominance in itself.[3]

European competition law identifies excessive prices based on a two-stage test from the *United Brands* judgment:[4] First, is the price excessive? Second, is the price unfair in itself or when compared to competing products? Ultimately, the judgment concludes that a price is exploitative if "*it has no reasonable relation to economic value of the product supplied.*" The judgment, however, also states that "*other ways may be devised*" for identifying excessive prices, leaving open the possibility for agencies to develop alternative methods.

Helpfully, given the limitations to the *United Brands* tests, the recent *Latvian copyright society* judgment provides additional guidance for determining whether a price is excessive: (1) comparisons with prices in other Member States may be appropriate if reference countries are selected "*in accordance with objective, appropriate, and verifiable criteria*"; and (2) excessive prices need to be "*significantly*" and "*persistently*" above the competitive level. At the same time, however, Advocate General Wahl noted that exploitative abuse cases should be rare and exceptional, emphasizing that agencies should be "*extremely reluctant*" to pursue them, especially in markets without legal barriers to entry.

Because a product's price is the typical measure of its economic value, the *United Brands* test can be difficult to apply. This is illustrated by the fact that the record fine imposed by the UK Competition and Market Authority (**CMA**) in *Pfizer / Flynn* was quashed in June 2018 by the Competition Appeal

1 Even in Fair, Reasonable and Non-Discriminatory licensing (**FRAND**) cases, the EC has in the past been reluctant to intervene, and has instead left price determination to negotiation, mediation, arbitration, or litigation.

2 In *ABG Oil*, the EC found that oil companies during an oil shortage were temporarily dominant, because their customers were "*completely dependent*" on them for scarce products, and, given the general shortage, the companies were unable to compete with each other by supplying a rival's customers. This definition is in tension with the case law defining dominance as the ability to price independent of competitors over a substantial length of time.

3 The Article 102 Guidance Paper notes that a company is dominant if it is able to raise (or maintain) prices on that market above the competitive level for a significant period of time.

4 In *United Brands*, the Court of Justice annulled the EC's finding of excessive prices. It held that the EC had not analyzed United Brands' costs to determine whether they were excessive. Instead, it wrongly relied on the observation that prices in some EU countries were higher than in Ireland, without assessing the profitability of pricing in Ireland and United Brands' costs.

Tribunal (**CAT**).[5] The CMA had considered that an overnight price increase of 2,600% after the de-branding of the relevant drug to be excessive. The CAT, however, found that the CMA had applied the wrong legal test, in particular because it failed to give sufficient weight to the economic value that patients placed on the drug. This criticism was upheld by the Court of Appeal (although it found for the CMA on other points).

Despite the difficulty of applying the *United Brands* test, several common themes emerge from recent excessive prices cases in Europe: First, a dominant company implements a drastic and sudden price increase for an old product, long after the product was originally launched. Second, the sudden increase is not caused by an increase in the dominant company's costs or some other market development. Third, the products are particularly important for consumers, with high demand inelasticity. And fourth, there are legal or other near-insurmountable barriers to entry that prevent the market from self-correcting.

Finally, as well as excessive prices, exploitative abuses can cover non-price terms. A non-price term may be deemed exploitative if a dominant company uses its market power to extract an "unfair" benefit from its trading partner. For example, in *Tetra Pak II*, Tetra Pak exploited its customers by imposing long-term exclusivity obligations (*e.g.*, giving Tetra Pak the exclusive right to maintain and repair the equipment, the exclusive right to supply spare parts, and requirements to obtain Tetra Pak's permission for the transfer of ownership or use of equipment). Dominant firms should, therefore, be aware that they can be sanctioned for changing non-price terms, if an agency later determines that those terms of trade extract disproportionate benefits from the counterparty.

"Price gouging" prohibitions in the U.S.

Neither U.S. antitrust law nor any other federal law makes charging high prices unlawful. To the contrary, agency officials have robustly spoken against competition law intervening to correct high prices. In 2016, for example, former FTC Commissioner Ohlhausen noted that "*simply condemning a high price… is not antitrust. It is a regulatory action meant to reengineer market outcomes to reflect enforcers' preferences*." Similarly, the Supreme Court in *Trinko* has stated that high, or even monopoly, prices are an expected outcome of the competitive process, and serve to stimulate further innovation and entry.

Many states, including Washington, New York, and California, have laws that target price increases in certain situations, such as a declared state of emergency. Generally, these laws are extremely vague, defining "price gouging" as increasing price to a level higher than what is considered "reasonable" or "fair." Unlike provisions in European competition law, these statutes apply to any firm, regardless of market power.

There is, though, no uniform threshold for what constitutes an unreasonable or unfair price. Many states, such as New Jersey and Oklahoma, use a 10% increase from previous prices as the relevant threshold. Others states, like Florida, rely on more vague qualitative language, such as prices that "*grossly*" exceed the average. State laws also vary with regard to what products and services are covered. All states that have statutes cover goods necessary for public health and welfare, such as medical supplies and fuel, while some states also cover consumer goods more generally or allow the scope of protections to change with the situation.

Some states' laws either take effect only when a state of emergency is declared or expand their scope in those circumstances. This includes California (which implements additional restrictions on top of its usual price gouging laws), Connecticut, Florida, and Kentucky, as well as the District of Columbia. In light of COVID-19 many of these states have already declared states of emergency, so these laws are now in force.[6]

5 For additional background, *see* our alert memo on the CAT's decision.

6 At the time of writing, this includes: Alabama, Arkansas, California, Connecticut, Delaware, Florida, Georgia, Hawaii, Idaho, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Massachusetts, Mississippi, Missouri, New Jersey, New York, North Carolina, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, and the District of Columbia.

Federal enforcement agencies have long emphasized the downsides of these types of prohibitions—shortages of critical products. In fact, the FTC has criticized proposals designed to address price gouging, explaining that—particularly in the case of natural disasters—price increases are a natural response to product shortages and can help to draw resources to the affected market. For example, following an investigation into gas price increases after Hurricane Katrina, the FTC determined that the "*post-hurricane gasoline price increases at the national and regional levels were approximately what would be predicted by the standard supply-and-demand model of a market performing competitively*." The FTC concluded that "*if natural price signals are distorted by price controls, consumers ultimately might be worse off, as gasoline shortages could result*." Then-FTC Chairwoman Deborah Majoras echoed this sentiment more generally, noting that "*price gouging laws that have the effect of controlling prices likely will do consumers more harm than good*."

Enforcement developments during the COVID-19 crisis

The COVID-19 outbreak is leading to sudden and significant hikes in demand for certain products, such as face masks, hand sanitizers, and paracetamol. These price changes are an understandable consequence of a rapid increase in demand faster than supply can respond. However, enforcement agencies are looking to demonstrate their vigilance to the public in this climate and so are watching for sudden and significant price hikes.

Developments in Europe

On March 23 the European Competition Network, comprising the EC and Member States' national competition authorities, issued a joint statement on the application of antitrust law during the COVID-19 outbreak. The statement identifies excessive pricing as a particular area of concern, stressing that: "*it is of utmost importance to ensure that products considered essential to protect the health of consumers in the current situation (e.g. face masks and sanitising gel) remain available at competitive prices.*" In a similar vein, on March 27, Commissioner Vestager explained that "*a crisis is not a shield against competition law enforcement*" and that the EC "*will stay even more vigilant than in normal times if there is a risk of virus-profiteering.*"

Several national authorities have opened investigations or created task forces during the pandemic:

— **UK**. The CMA has launched a COVID task force, and set up a form for consumers to report unfair business practices during the outbreak. On March 25, the CMA stressed that its focus over the next few months is "*to protect UK consumers from the adverse consequences of the COVID-19 pandemic*." It is committed to ensuring that the prices of products deemed "*essential*" to protect consumers' health are "*not artificially inflated by unscrupulous businesses seeking to take advantage of the current situation.*" Relatedly, the Prime Minister announced on March 25 that "*profiteering*" during the crisis may be addressed via legislation, and the CMA has made clear that it will "*advise the Government on emergency legislation if there are negative impacts for people which cannot be addressed through existing powers.*"

— **France**. On March 5, the French Ministry for the Economy introduced temporary price controls on sanitizing gels. On March 16, the French competition authority announced that it is closely monitoring the prices charged for certain types of products, such as sanitizing gels and protective masks, in particular on e-commerce and delivery platforms.

— **Italy**. On February 27, the Italian competition authority sent requests for information to major retailers and merchant platforms, including Amazon and eBay, investigating price increases and misleading claims concerning face masks and hand sanitizer on their sites. Two investigations against Amazon and eBay were formally opened on March 12.

— **Netherlands**. On March 18, the Dutch competition authority issued a statement that it will closely monitor whether dominant companies raise prices excessively during the crisis.

— **Spain**. On March 12, the Spanish competition authority announced that it is closely monitoring any potential abuses that could hinder the supply or raise the prices of products needed to protect citizens in light of the COVID-19 emergency. It also called for public cooperation to detect these practices.

— **Poland**. On March 20, the Polish competition authority set up a task force to investigate the rise in the prices of food and hygiene products. The agency is also investigating two face mask wholesalers for allegedly cancelling existing contracts to re-sign them at higher prices.

Agencies have also indicated that they intend to apply antitrust law in parallel with consumer protection laws or rules concerning unfair commercial practices. The UK CMA, for example, has indicated that it will apply both competition law and consumer protection rules if firms fail to respond to its warnings.

Finally, agencies may try to take action swiftly through interim measures. Following its recent interim measures decision in *Broadcom*, Commissioner Vestager stated that she is "*committed to making the best possible use of this important tool*" so as to enforce competition rules "*in a fast and effective manner*." National agencies in France, Germany, and the UK, have likewise pushed for greater use of interim measures.

Developments in the U.S.

The White House, State Attorneys General (**AGs**), Federal Trade Commission (**FTC**), and Department of Justice (**DOJ**) have also made announcements about potential price gouging issues in response to the COVID-19 pandemic. We expect this to be a growing area of attention and enforcement, going beyond the following recent activity:

— **White House.** On March 23, President Trump announced signing an Executive Order to "*prohibit the hoarding of vital medical equipment and supplies*" and to "*prevent price gouging*" under the Defense Production Act (analyzed in more detail here). As part of these efforts, the DOJ announced it will prioritize detection, investigation, and prosecution of price gouging and other fraudulent activity related to medical resources.

— **DOJ/FTC.** Both DOJ and FTC currently focus on combating COVID-19 related fraud. In particular, on March 9, the DOJ issued a statement cautioning businesses against violating antitrust laws in the public health product industry in light of COVID-19. Though the statement does not explicitly mention price gouging, it is expected that DOJ's action in this space would be covered under the mandate to detect, investigate, and prosecute "*all criminal conduct related to the current pandemic*."

— **Senate.** Senators Klobuchar, Blumenthal, Hirono, and Cortez Masto announced plans to introduce a federal bill prohibiting price gouging during states of emergency. A number of senators also penned a letter to the FTC urging it to take action against price gouging for consumer health products under Section 5 of the FTC Act.

— **State level.** Many State AGs have already opened investigations. The Missouri State AG announced that it issued eight civil investigative demands to third-party Amazon sellers to combat price gouging. The Michigan State AG took her first enforcement action against an individual selling high-priced products through eBay. The Washington State AG and Illinois State AG also announced investigations into price gouging relating to COVID-19, though neither has identified the targets of these investigations. Other states have ramped up efforts via tasks forces, press releases, and complaint reporting mechanisms.

Based on agencies' statements and action to date, the focus is currently on protective equipment and medical supplies deemed essential to consumer health (broadly consistent with the pre-crisis focus on excessive pricing for pharmaceutical products with inelastic demand). If the crisis continues, however, attention could extend to food and basic consumer goods, or even other sectors that have witnessed supply shortages, such as home office supplies or consumer electronics.

Concluding remarks

Firms in sectors under pressure due to the pandemic should be alert to the risk of agency interest in their pricing policies, particularly significant changes to pre-crisis prices in response to increased demand for particular goods or sudden changes in their costs. Below, we set out some considerations for firms over the coming weeks and months.

First, excessive pricing cases typically involve substantial and sudden increases for established products, with high demand inelasticity, where barriers prevent rival entry. The concept, by contrast, has generally not been applied to new products or situations where rivals can quickly enter a market. Given, however, the unprecedented nature of this crisis, firms should bear in mind that agencies may not consider themselves shackled by previous case. It may also be easier to defend gradual price movements that reflect underlying market conditions, than sudden increases.

Second, nearly all of these prohibitions exempt changes in price that reflect increased costs—*e.g.*, increases in input costs due to supply chain disruption, or increases in costs due to expanding capacity at short notice. Companies raising prices in the current circumstances should document that any price increases reflect real changes in costs, to protect against enforcement action. Although an increase in direct input cost is the explanation most likely to be accepted, some prices rises may be necessary to allow companies to continue to operate or to expand production rapidly to meet increased demand; documenting these costs is better than having no documentation at all.

Third, firms that apply substantially different prices between different EU Member States may attract scrutiny. The difference in price could be used as evidence that the price in the higher-priced country is excessive, as in the *Latvian copyright society* case discussed above. Such conduct might also infringe rules on abusive discrimination under Article 102(c) TFEU, similar to the *Football World Cup* case.[7] Clearly, not all price differences between Member States will lead to enforcement action. However, it may be prudent for companies to align prices where possible between Members States and document reasons for any material differences, as unexplained deviations could attract scrutiny.

Finally, e-commerce platforms that distribute third-party products may be held liable for a third party that is engaging in exploitative behavior on their platform. While such cases would appear to raise difficulties under existing exploitation rules (because the platform does not set the final price), agencies already appear to be pursuing such cases (*e.g.,* the investigation in Italy discussed above) on the basis that the platform failed to provide adequate consumer protections. These cases may be attractive targets to agencies at the current time because they allow for targeting a smaller number of entities that the agencies were already keen to investigate. E-commerce platforms, like Amazon and eBay, have announced they are taking action against price gouging (including by removing product items and blocking accounts) and are already engaging at least with the UK CMA on this issue. Finally, E-commerce firms and manufacturers/distributors of sensitive goods might monitor prices charged by downstream re-sellers, and consider the feasibility of introducing maximum resale prices or other appropriate steps to prevent price-gouging.

In conclusion, we expect "excessive pricing" and "price gouging" to be an area of agency attention over the months ahead. Firms that may be considered dominant (especially those active in sensitive sectors) may want to mitigate this risk, including by: carefully considering any significant deviations to their pricing; documenting the reasons and background to new pricing decisions; using objective criteria or processes (*e.g.*, auctions) to price scarce assets; and engaging with antitrust agencies (some of which have invited dialogue on these topics). Of course, we stand ready to help with any points of difficulty at this time.

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7 The EC imposed a fine on the organizers of the 1998 World Cup tournament for selling tickets to French consumers on more favorable terms than sold to non-French consumers.

UNITED STATES

Leah Brannon
lbrannon@cgsh.com

Brian Byrne
bbyrne@cgsh.com

Jeremy J. Calsyn
jcalsyn@cgsh.com

George S. Cary
gcary@cgsh.com

Daniel P. Culley
dculley@cgsh.com

Elaine Ewing
eewing@cgsh.com

David I. Gelfand
dgelfand@cgsh.com

D. Bruce Hoffman
bhoffman@cgsh.com

Mark Leddy
mleddy@cgsh.com

Mark W. Nelson
mnelson@cgsh.com

Kenneth Reinker
kreinker@cgsh.com

Kathleen W. Bradish
kbradish@cgsh.com

Cunzhen Huang*
chuang@cgsh.com

Steven J. Kaiser
skaiser@cgsh.com

Larry Malm
lmalm@cgsh.com

*Special Legal Consultant, qualified in the People's Republic of China

BRUSSELS

Antoine Winckler
awinckler@cgsh.com

Maurits Dolmans
mdolmans@cgsh.com

Romano Subiotto QC
rsubiotto@cgsh.com

Wolfgang Deselaers
wdeselaers@cgsh.com

Nicholas Levy
nlevy@cgsh.com

F. Enrique González-Díaz
fgonzalez-diaz@cgsh.com

Robbert Snelders
rsnelders@cgsh.com

Thomas Graf
tgraf@cgsh.com

Patrick Bock
pbock@cgsh.com

François-Charles Laprévote
fclaprevote@cgsh.com

Christopher Cook
ccook@cgsh.com

Daniel P. Culley
dculley@cgsh.com

Mario Siragusa
msiragusa@cgsh.com

Dirk Vandermeersch
dvandermeersch@cgsh.com

Stephan Barthelmess
sbarthelmess@cgsh.com

Till Müller-Ibold
tmuelleribold@cgsh.com

Niklas Maydell
nmaydell@cgsh.com

Richard Pepper
rpepper@cgsh.com

LONDON

Maurits Dolmans
mdolmans@cgsh.com

Romano Subiotto QC
rsubiotto@cgsh.com

Nicholas Levy
nlevy@cgsh.com

Paul Gilbert
pgilbert@cgsh.com

Paul Stuart
pstuart@cgsh.com

COLOGNE/FRANKFURT

Dirk Schroeder
dschroeder@cgsh.com

Wolfgang Deselaers
wdeselaers@cgsh.com

Romina Polley
rpolley@cgsh.com

Stephan Barthelmess
sbarthelmess@cgsh.com

Rüdiger Harms
rharms@cgsh.com

Katharina Apel
kapel@cgsh.com

PARIS

Antoine Winckler
awinckler@cgsh.com

François-Charles Laprévote
fclaprevote@cgsh.com

Frédéric de Bure
fdebure@cgsh.com

Sévérine Schrameck
sschrameck@cgsh.com

MOSCOW

Scott C. Senecal
ssenecal@cgsh.com

ROME/MILAN

Giuseppe Scassellati-Sforzolini
gscassellati@cgsh.com

Marco D'Ostuni
mdostuni@cgsh.com

Matteo Beretta
mberetta@cgsh.com

Mario Siragusa
msiragusa@cgsh.com

Giulio Cesare Rizza
crizza@cgsh.com

Gianluca Faella
gfaella@cgsh.com