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Managing antitrust risks amid COVID-19

FW discusses managing antitrust risks amid COVID-19 with Jorge Padilla, David Sevy, Lorenzo Coppi, Rameet Sangha and Urs Haegler at Compass Lexecon.

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Dr David Sevy is an executive vice president at Compass Lexecon and heads its Paris office. He has advised clients and provided written and oral testimony in competition matters before the European Commission, national competition authorities and appeal courts. He also has extensive experience in providing expert testimony in damage litigation and arbitration. His experience covers a range of competition issues – including merger control, abuse of dominance, cartels and vertical agreements – and spans diverse sectors.

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Lorenzo Coppi is an executive vice president based in Compass Lexecon's London and Brussels offices, with more than 20 years' experience in the application of economics to competition law cases and regulation. Having spent a number of years practicing in London, Brussels and Washington, DC, Mr Coppi has worked on a variety of EU, US and UK mergers, as well as on cases involving various allegations of anticompetitive practices under EU, US and UK competition law, in litigation and regulatory settings. He has also testified in several international arbitrations.

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Urs Haegler is a senior vice president at Compass Lexecon, based in London. He has worked on antitrust investigations, mergers and state aid cases across several industries, including telecommunications, media, financial services, mining, manufacturing, construction, energy and transport. He has gathered extensive experience in the aviation sector, in particular conducting economic analyses of efficiencies resulting from revenue-sharing agreements between airlines on transatlantic or transpacific routes.

FW: How would you characterise the impact that coronavirus (COVID-19) is having on businesses across the globe? Do you believe that antitrust has a role to play in the response to the crisis?

Sangha: Coronavirus (COVID-19) is having a varied impact by sector and by type of business. While some sectors are experiencing surges in demand for their products or services, including online groceries and certain medical supplies, others, such as brick and mortar retail and leisure industries, have had demand and revenues collapse. Disruptions to supply chains and operations have, in addition, created financial challenges for many firms. Antitrust definitely has a role to play in the response to the crisis, and authorities have responded with guidance on topics such as cooperation between competitors, and warnings about excessive pricing and exploitation of consumers.

Sevy: COVID-19 has caused a simultaneous supply and demand shock in most countries around the world and in many sectors. This is unique compared to several past crises which mainly affected the financial sector, in specific countries and geographical areas. COVID-19 can be expected to trigger changes in the way businesses operate which will profoundly affect market equilibria, locally and globally, and it is difficult to predict how the recovery will unfold. Firstly, it will probably be more costly to do business, due to long-term restrictions on trade and an increase in the costs of providing goods and services. Secondly, digital means of doing business will grow more quickly and induce deep sectoral transformations, in the retail and services sector particularly, but also in manufacturing. When these transformations affect concentrated sectors, competition authorities will have a natural role to play – but this role itself might be affected by those ongoing transformations. Current antitrust tools have proven well-suited to deal with stable market environments but possibly less so in dealing with fast-evolving ones. The significance placed on past case law and the emphasis on maintaining consistency across cases make it challenging to deal with quick and radical changes, as illustrated by the ongoing debate on whether traditional competition tools are fit for dealing with 'big tech'. This questioning may now extend to additional sectors undergoing dramatic changes due to the COVID-19 crisis, namely those experiencing a fast-growing shift to digital with transformational business models. The antitrust framework may have to adapt to deal with new dominance levers and new forms of abusive conduct, while facing challenges in assessing how much these explain or contribute to industry shakeouts that will follow the crisis.

FW: Given the gravity of the COVID-19 crisis, how far might competition/antitrust authorities allow conduct which, under normal circumstances, would normally be anticompetitive? How likely are we to see a kind of moratorium on enforcement in the short term?

Coppi: The extent to which competition authorities will allow conduct which would normally be considered as potentially anticompetitive will vary, both by type of business practice and by sector. All business practices that are seen to be driven by a desire to profit from market disruption – such as price increases due to increased demand or reduced supply – will likely be judged even more severely. On the other hand, coordination between competitors which is essential to ensuring an orderly supply of goods and services will probably be considered more leniently, as long as it does not amount to coordination on prices or other 'hardcore' collusive practices. The sectors of the economy that are more likely to benefit from a more lenient approach to coordination will comprise the sectors that have been hit hardest by COVID-19 – including transport, and especially airlines, and the events industry – as well as those industries that are seen to provide essential products or services, such as health and life sciences, medical equipment, food production, distribution and retail, and internet services.

Sangha: Numerous competition authorities have signalled that they recognise exceptional circumstances, and the need for firms to coordinate and cooperate to ensure that consumers and essential services, such as healthcare, are supplied with essential products. However, this does not mean that anticompetitive conduct is allowed, or that there is a 'moratorium on enforcement'. The authorities have signalled that enforcement is continuing.

Sevy: In past crisis periods, competition authorities have proven reluctant to fully give up on their traditional enforcement logic. Rather than a blanket moratorium in respect of some conduct – which would raise difficult questions on which conduct should qualify, in what circumstances and until when – authorities may go for a more 'opportunistic' approach, using margins of appreciation within the current framework whenever possible. Exceptions may arise for sectors in which the benefits of an unconstrained cooperation may obviously dwarf their drawbacks, such as around the development of a vaccine or where critical supply chains are severely damaged – but these may primarily concern conduct that would not be judged most severely in normal circumstances, such as certain types of information exchange.

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> RAMEET SANGHA
> Compass Lexecon

FW: With governments calling for a coordinated response to the crisis, what steps should be taken to ensure that that competition/antitrust risks do not arise when competitors meet to discuss industry responses?

Sangha: It may be advisable to have a lawyer present at such discussions. It would be sensible to ensure that the objectives of any cooperation are clear and in the consumer interest, and that the information exchanged, and any coordination between competitors, does not go beyond what is strictly necessary to ensure that the objective is met. It is also worth thinking about which competitors are invited to take part in such discussions and industry responses. In particular, if larger competitors do not invite or involve smaller rivals, could this have the effect of weakening smaller rivals by excluding them from important sources of industry revenues, or access to important inputs?

Coppi: The key to a coordinated response is to ensure that the objectives of any cooperation are clear and focused on delivering clear benefits to consumers. In particular, it would be important to avoid discussing prices, and especially future price intentions. Similarly, discussions about costs, volumes and output plans, or allocation of customers or geographic areas, also carry very substantial antitrust risk, even during COVID-19. On the other hand, exchanging information and forecasts on market demand, even if detailed, is more likely to be acceptable, although seeking specific legal advice is always important. It is also important that any collaboration focuses on what is strictly necessary to manage the crisis and does not stray into discussion of business plans or products unrelated to the crisis.

FW: With some companies facing a sudden increase in demand for their products, what steps might competition/antitrust authorities take to protect consumers, especially from excessive prices?

Coppi: It is clear that, as a result of the crisis, most competition authorities around Europe, and beyond, have stepped up their antitrust enforcement against price gouging and excessive pricing. Thus, any price increases are likely to attract regulatory scrutiny during the crisis – regardless of the reasons behind them – especially if those price increases are in sectors that are considered central to the management of the crisis, such as medical equipment, first need and sanitary products, pharmaceuticals, but also food and other products. While competition authorities have historically been somewhat cautious in enforcing excessive pricing provisions, it is clear that this type of enforcement will be much stricter during the crisis. It is also clear that the sudden increase in demand will not be considered by competition authorities as a valid justification for price increases, while increases in purchasing costs might be. It is therefore important that companies considering increasing their prices have a cost-based justification for doing so.

Sangha: Authorities understandably wish to protect consumers from exploitation as demand for products surges and certain suppliers may increase prices significantly. The UK Competition and Markets Authority (CMA), for example, has signalled that it will take enforcement action against firms that may have charged excessive prices, or broken consumer law by making misleading claims about their products, such as about the efficacy of protective equipment. At the same time, suppliers may be facing higher costs, which could justify price increases. Production costs could be higher than normal as firms expand production to meet demand and bring less efficient capacity onstream. Logistics and transportation costs could also be higher than normal. Suppliers that legitimately need to increase prices significantly should keep records of the reasons for such price increases, so that they can produce these in the event that a competition authority asks questions, perhaps in response to a customer complaint.

> FAILING FIRMS ARGUMENTS WILL NEED TO BE CONSIDERED VERY SERIOUSLY, AS WILL EFFICIENCY ARGUMENTS, IN SECTORS WHERE MARKET FORCES WILL STEER SIGNIFICANT RESTRUCTURING WITH ONLY A FEW FIRMS BEING ABLE TO REMAIN VIABLE.
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> DAVID SEVY
> Compass Lexecon

FW: Do you expect competition authorities to adjust their approach to merger control?

Padilla: All EU economies to a greater or lesser extent are populated by zombie firms – firms that are unable to repay their loans but are kept alive by weak banks concerned about their own financial stability. Zombie firms are not only inefficient and unable to grow, they also drive resources away from relatively more efficient firms and, therefore, slow down aggregate productivity and growth. The COVID-19 crisis risks increasing the number of these firms, which may seriously delay economic recovery. Therefore, EU countries need to facilitate the exit of these firms so that their scarce resources are reallocated from zombie firms to efficient firms. There are different ways to achieve this, with merger control one possible route. But today's merger control rules and, in particular the so-called failing firm defence, are not fit for purpose. Yet, competition agencies are unlikely to promote their change because they tend to ignore the macroeconomic implications of their decisions.

Sangha: Certain authorities, for example the CMA, have signalled clearly that their normal standards will not be relaxed during the pandemic. However, assessing the impact of a merger relative to the no-merger counterfactual – including issues relating to whether the firm would have exited absent the merger – is challenging when there is so much uncertainty around how businesses would fare in the absence of the merger, and a business's prospects can change rapidly. There are signs that a 'failing firm' merger defence will – despite the pandemic – continue to be challenging to substantiate, as shown by the CMA's recent assessment of Amazon's acquisition of a minority stake in Deliveroo – a firm whose primary activity is restaurant delivery. The CMA provisionally cleared the transaction in April 2020 on the basis that, absent the funding obtained from the investment by Amazon, Deliveroo would likely have exited the market as a result of the onset of the COVID-19 pandemic. The matter was investigated further, and the CMA has since – in June 2020 – revised its provisional findings. While the transaction has still been provisionally cleared, the CMA has found that Deliveroo's financial situation improved since April 2020 and it

was no longer likely to exit the market as a result of the pandemic.

Sevy: Merger control is inherently a forward-looking exercise. In a 'traditional' merger assessment with a three- to five-year horizon, in most sectors the early years were relatively predictable, even if the subsequent years were not. Now even the very short run has become highly uncertain, and that will pose great challenges – in many sectors, the recent past or the present will be poor predictors of the future state of competition. While the existing tools may remain valid, their implementation may call for adaptations. I would expect to see an interest in building scenarios with probabilities against them, although probabilistic reasonings would lead to errors and to challenges in courts, especially given the recent General Court judgment on the Hutchison/O2 matter, which raised the standard of demonstration for prohibiting mergers. Failing firms arguments will need to be considered very seriously, as will efficiency arguments, in sectors where market forces will steer significant restructuring with only a few firms being able to remain viable. Remedies that can be revisited once the economic environment has stabilised could in some cases be superior to simple structural divestitures, as the latter are more irreversible and decisions at times of considerable uncertainty are likely to generate large error costs.

Haegler: As the consequences of the crisis intensify and governments seek to lessen the impact of the economic fallout and protect businesses, the European Commission (EC) and national competition authorities may come under even more pressure to adjust their approaches to merger control. Governments may seek to pursue public policy objectives that go beyond concerns about potential anticompetitive effects or efficiency considerations. There will likely be renewed calls for changes to the rules that could help pave the way for the creation of European champions. Attempts to exert political influence on merger control were on the rise even before the COVID-19 crisis hit. The debate following the Siemens/Alstom prohibition is perhaps the most prominent example. It appears that the EC has so far been able to resist such pressure and it may continue to do so to avoid setting a precedent for future merger reviews. Whether it succeeds will depend on how the pandemic and its economic impact evolve.

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FW: In your opinion, is the European Commission likely to be more lenient in its approach to state aid?

Haegler: With the adoption of the initial temporary framework on 19 March, the EC enabled member states to take swift action to mitigate the economic fallout, by applying state aid rules flexibly and approving notified aid measures at record speed. The EC has so far – at the end of June – approved more than €2.5 trillion across around 200 national aid schemes, mainly under the temporary framework, which since its adoption has been amended three times. However, it should be remembered that it is member states, not the EC, that decide whether they wish to grant aid and, if so, to what extent. To say that the EC's approach toward state aid has become more lenient would not be appropriate. Instead, in setting up the temporary framework and widely approving the notified aid measures, the EC has simply made extensive use of the room for manoeuvre that the rules afford it in the specific context of the COVID-19 crisis. The temporary framework is based on Article 107(3)(b) of the Treaty on the Functioning of the European Union which provides the legal underpinning of government support measures adopted to remedy the serious disturbance to the European economy. Member states can also invoke Article 107(2)(b), which enables them to compensate companies for the damage directly caused by natural disasters or exceptional occurrences. Although, in principle, the 107(2)(b) route lends itself well to compensate for damage suffered by sectors that have been particularly hard hit, there have so far only been about 15 cases of this type. One of the main reasons is likely that a member state must still demonstrate that the aid it grants does not overcompensate, which in practice may not always be straightforward. Moreover, outright compensation of damages also has more severe budgetary implications for the countries that provide it. Initially, member

states focused on adopting general support measures that account for about 95 percent of the volumes of state aid granted so far, with only the remaining 5 percent going to single-firm beneficiaries. However, the second amendment to the temporary framework enables member states to provide aid in the form of recapitalisations and subordinated debt to companies with urgent liquidity needs. These kinds of support measures pose a greater threat to competition and the level playing field. Arguably the most prominent example so far is the Lufthansa bailout, which has raised a great deal of controversy. This likely signals a shift toward further sizeable interventions targeted more specifically at individual and predominantly large companies. These support measures, and the conditionality attached to them to avoid undue distortions of competition, will undoubtedly continue to be the focus of heated debates. The recently introduced third amendment softens the conditions associated with recapitalisation measures to encourage private capital injections and company participations in order to limit the need for state aid and the risk of competition distortions. It also allows for support of certain small enterprises, including start-ups that were already in difficulty before the end of 2019. The EC argues that these companies have been particularly affected by the liquidity shortage, exacerbating their existing difficulties to access financing compared to larger enterprises.

FW: What essential advice would you offer to companies and their legal advisers on assessing and managing competition/ antitrust risks amid the COVID-19 crisis?

Sevy: For firms contemplating the acquisition of a rival in distress, thoroughly investigate the likelihood that the target might disappear or be absorbed by another company, which competition authorities may not take for granted. More broadly, in any merger, assessing possible scenarios of key supply or demand parameter evolutions can be helpful to delineate relevant markets and assess the merger's competitive impact beyond the very short term. For dominant firms adapting their business models to new market realities, systematically document the assumptions on which these changes are predicated and their efficiency rationales, to limit the risks of confusion with an opportunistic, anticompetitive exclusion strategy, in an environment in which smaller competitors may struggle to survive.

> THE DAMAGE TO THE ECONOMY RESULTING FROM THE FIRST WAVE OF INFECTIONS HAS BEEN BRUTAL, BUT IT MAY BE DWARFED BY THE CONSEQUENCES OF A SECOND OR THIRD WAVE.
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> JORGE PADILLA
> Compass Lexecon

Padilla: I believe efficiencies are likely to play a much more important role going forward, both in connection with merger control and in the assessment of cooperation agreements. Thus, companies need to be able to better articulate the rationale for their strategies. Why are they proposing a merger? What are the efficiencies brought about by an agreement? So far, companies have dealt with these issues rather loosely, providing only vague qualitative answers which were hard to verify. On some occasions, this simply reflected that their plans were unlikely to deliver any efficiencies and were possibly motivated by market power. In some others, the reason was incompetence, or a lack of resource and attention put into this area. In other cases, their lack of initiative was due to concerns about potential 'efficiency offence' allegations, such as claims that the efficiencies they would achieve would foreclose their competitors. I do not believe those concerns are justified. And I sincerely believe that the competition agencies will be more open to accepting and factoring in well-documented and quantified efficiencies in years to come, even when the benefits will not necessarily materialise in the markets directly affected by the merger or agreement. A merger or agreement that is not backed up by a cogent and well-documented business rationale is likely to be detrimental to welfare for a variety of reasons, including its potential anticompetitive effects.

Sangha: The disruption caused by COVID-19 provides a 'natural experiment' that could yield relevant evidence on supplier responses for future merger or antitrust cases. In certain sectors, for example in food supply and local delivery, firms have been able to adapt their businesses to enter into new areas or expand quickly to meet unmet or new demand. If this type of adaptation or supplier response has occurred in your business's sector, it would be useful

to document what has occurred or is occurring. This could potentially assist with providing evidence in support of arguments about entry, expansion or repositioning by rivals in merger cases.

FW: Looking ahead, how do you expect competition/antitrust law and enforcement to evolve over the course of the pandemic, and beyond?

Padilla: The evolution of antitrust law and enforcement will depend on how the pandemic evolves. The damage to the economy resulting from the first wave of infections has been brutal, but it may be dwarfed by the consequences of a second or third wave. Competition agencies may be forced to deal with transactions and agreements in sectors experiencing a collapse in demand. They would need to assess them by reference to a counterfactual – the scenario without the merger or the agreement – which is riddled with uncertainty. Agencies will have to determine what the market is likely to look like with or without the agreement or merger when demand and supply conditions are nearly impossible to forecast accurately. As the pandemic evolves, and especially once a vaccine is available, the economic context will stabilise, and mergers and agreements will be easier to assess. Before that is the case, the agencies' job will be very difficult and the possibility of erroneous decisions very real.

Coppi: If the worst of the pandemic is beyond us, then I expect competition authorities to return to a 'business as usual' stance relatively quickly. This would be the case especially in the antitrust scrutiny of digital and platform markets, and in the merger area – except perhaps for those sectors where the pandemic has had profound and possibly permanent effects, such as airlines. Heightened scrutiny over price gouging and excessive pricing, and the lenient approach to certain exchanges of information among competitors, will also fade relatively quickly if the worst of the pandemic is over. On the other hand, state aid will take some time to go back to business as usual, if the experience of the financial crisis is repeated. If, instead, we have another significant wave over the autumn and winter, then competition authorities may have to take an even more radical approach, including mergers, state aid, cooperation among competitors and prices oversight. ■

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