COVID-19 and Its Impact on Contractual Relations: Competition Risks when Renegotiating Contracts (Part V)

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Introduction

In Part IV of our series on COVID-19 and its impact on contractual obligations, we looked at how to mitigate damages and renegotiate contracts to avoid disputes amidst the pandemic.

In this final part of our series, we look at competition law considerations that should be considered by companies seeking to renegotiate their contracts.

Competition Law Considerations

To restart the economy, the Kenyan Government has, since May 2020, gradually eased the restrictions it had imposed to curb the spread of COVID. As entities seek to recover from the slump of the last few months, some may be tempted to pool resources and information to benefit from potential synergies. However, care should be taken as collaboration amongst horizontal competitors or vertical players may be considered anti-competitive. In assessing their next steps, companies should consider the possible effects of any collaboration on their ability to compete with other businesses and the effects that such collaboration could have on consumers to ensure that they are not deemed to have engaged in anti-competitive conduct or restrictive trade practices.

Competition law has in the past decade played an increasingly significant role in commercial activities in Kenya. There are two active competition regimes which apply: Kenya's domestic competition regime and the Common Market for Eastern and Southern Africa (**COMESA**) competition regime. Both regimes need to be considered where parties are involved in cross-border investments or trade.

Potential competition control issues should always be considered at the earliest stage of any transaction and should continue to be re-analysed should the deal mechanics change. Failure to do so can lead to significant additional costs in the form of unplanned legal and other professional fees. More importantly, if the parties complete a transaction or enter into an agreement which could have an anti-competitive effect on the market without the relevant completion approval and a competition regulator determines that the transaction raises competition concerns, the parties risk:

a. a time-consuming and potentially expensive investigation which will delay completion or implementation and cause uncertainty for the parties;

b. being prevented from proceeding with the transaction, thus wasting time and resources that went into its completion;

c. potentially onerous undertakings required by the regulator to be allowed to proceed with the transaction, which may include unwinding or divesting significant portions of the transaction. This may ultimately negatively impact the financial justifications for the transaction; and

d. possible penalties, fines or criminal sanction meted out by the relevant competition regulator.

Regulation of Mergers

As the economy weakens, competition regulators around the world will be faced with increasing joint venture and distressed merger applications, especially in hard-hit industries such as in the hospitality and aviation sectors. While these transactions may boost the sectors in the short term, the result of such combinations would be to concentrate the affected markets, with competition implications as the economy grows in the future. The competition regulators are mandated to review such applications within the law, including assessing the effects of a proposed joint venture or merger on the market and consumers at large.

For companies considering a merger, alliance or arrangement, it is important to carry out a competition law analysis to determine whether the transaction requires a prior notification to or approval from either the Competition Authority of Kenya (CAK) and/or the COMESA Competition Commission (CCC). The parties will also need to review the markets in which they operate and their current and post-merger market shares.

Review of a merger in relation to the relevant markets

In carrying out a competition analysis, some of the assessments that ought to be taken into consideration are:

a. an analysis of the areas in which the business activities of the merging parties intersect, i.e. a determination on whether the merging parties are operating in the same market (a horizontal merger);

b. an analysis on whether the merging parties' activities are in the same industry but at different levels of production (a vertical merger).

c. an analysis on possible product market definitions in relation to the overlapping activities carried out by the merging parties, i.e. whether the merger is between companies in the same markets that sell different but related products or services (a product-extension merger); and

d. an assessment of all possible geographic market definitions, i.e. whether the merger is between companies in different markets that sell similar products or services (a market-extension merger).

Further, a review of the impact of a transaction in each product market and each geographic market will be guided by the following factors which require assessment:

a. the definition of the relevant market by looking at competing products or services;

b. the stability of market shares over time;

c. the degree of product differentiation and closeness of competition between the merging parties (i.e. whether they are each other's closest competitors);

d. the market position of competitors;

e. market concentrations including market shares and the diversity of competitors;

f. availability and responsiveness of alternative suppliers and resources to competitors in the relevant market;

g. the ability of other competitors to enter the market and to compete (e.g., access to capital, customers or raw materials);

h. the ability of the merged entity to act independently from its competitors in the post-merger market;

i. the extent of buyer power (i.e., the ability of customers to constrain the actions of the merging parties and other competitors in the post-merger market);

j. potential barriers to entry into and exit from the market;

k. prices of products and the stability of prices over time; and

l. customer choice.

Calculation of market share

Generally, competition regulators will have jurisdiction over merger control within a particular country. Some competition regulators, however, operate across a wider geographical region, such as the COMESA Competition Commission (the CCC), which covers the COMESA trading block, or the European Competition Commission which has jurisdiction over the European Economic Area. Therefore, when analysing market share for purposes of an application to a competition regulator, the merging parties may need to consider the applicable jurisdiction.

The calculation of market shares for the merging parties depend on their geographic market. To determine the extent of the geographic market requires an analysis of the positions of the parties in the particular industry and the strength of actual and potential competition across the jurisdictions in which they supply their products. Market position across the geographic market is then based on the turnover derived by the merging parties against the total industry sales, or total products produced in an industry or total number of customer subscriptions across that geographic market.

Calculation of market concentration

Market concentration is essentially the number of market participants and their respective portion of total production in the relevant geographic market.

Market concentration can be measured using data such as sales revenue, quantity of goods/services sold or capacity of the market participants. Some of the ways market concentrations are measured are:

1. **Number of market participants:** Based on a headcount of the participants in the relevant market. Although straightforward, this method does not take into account some variables, such as differences in markets shares, the respective party's distribution networks, etc

2. **Analysis of the market share of the market participants:** This involves weighing the importance of merging firms in a market through apportionment of market shares across all competitors in the relevant market calculated based on pre- and post-merger market shares.

3. **The Herfindahl-Hirschman Index (HHI):** The HHI is a measure of competitiveness of an industry based on the levels of market concentration of the market participants[1]. First used by US competition regulators, it is now widely used by numerous competition regulators, including the CAK.

In Kenya, the CAK has sought to ensure a competitive playing field by imposing financial penalties on mergers implemented without its approval. The CAK has the power to impose a financial penalty of up to 10 percent of an undertaking's gross annual turnover in Kenya for the preceding year for a failure to procure the relevant merger approval. Criminal sanctions may also be imposed by the office of the Director of Public Prosecutions (the **DPP**) on an undertaking which is prosecuted and found guilty in a court of law.

[1] Encyclopaedia Britannica (https://www.britannica.com/topic/Herfindahl-Hirschman-index) accessed on 3 August 2020.

The CAK also issues conditional approvals to allow a merger to proceed but reduce its impact on competitors or where there are larger public interest concerns. The CAK monitors post-merger compliance to ensure that mergers are implemented as disclosed to it and in accordance with any conditions it imposes.

Restrictive Trade Practices

To ensure a fair playing field is maintained, the CAK is increasingly focusing on the regulation of restrictive trade practices, cartel enforcement and consumer protection.

The Competition Act provides that, '*agreements between undertakings, decisions by associations of undertakings, decisions by undertakings or concerted practices by undertakings which have as their object or effect the prevention, distortion or lessening of competition in trade in any goods or services in Kenya, or a part of Kenya, are prohibited, unless they are exempt in accordance with the provisions of Section D of this Part*'[2]. Therefore, restrictive trade practices, such as price fixing, limitations on sales and production, restrictions on advertising, the exclusion of competitors from the market and the entry into agreements that would otherwise assign distributors to specific regions, are unlawful unless exempted by the CAK. The CAK has the power to impose a financial penalty of up to 10 percent of the undertaking's gross annual turnover in Kenya in the preceding year, for unfair trade practices.[3]

The Competition Act provides a non-exhaustive list of behaviour that may constitute a restrictive trade practice. These include:

a. Price Fixing: This is the artificial setting or maintenance of prices at a certain level, contrary to the workings of a free market[4], in contravention of antitrust laws and without the approval of the CAK. This can take the form of price collusion on a commodity between competitors on the same level in a particular industry (horizontal price-fixing) or price collusion between competitors on different levels in a particular industry (vertical price-fixing);

b. Dividing markets by allocating customers, suppliers, areas or specific types of goods or services: This is where competitors divide sales territories or assign customers to reduce competition and keep competitors from participating in a market. For example, competitors can agree not to compete in a certain market: *"I won't sell in your market if you don't sell in mine"*;

c. Collusive tendering: This is the practice where two or more parties agree and collaborate to undermine a competitive tender to make an unfair gain or where competitors agree on who will win a tender. The latter occurs when two or more competitors agree not to bid against each other for a tender;

d. Stipulating minimum resale price maintenance: These are agreements where a manufacturer or supplier stipulates that purchasing retailers, resellers, or wholesalers can resell a product only at a prescribed minimum price. These types of agreements are generally construed as anti-competitive. However, this does not prevent a manufacturer/supplier from recommending a non-binding

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2 Competition Act, Section 21(1) Part III A
3 Section 36(d) of the Competition Act
4 Black's Law dictionary, 9th edition, 2009.

retail price for the products, which would be applied by the purchasing retailer/reseller/wholesalers;

e. Limiting or controlling production, market outlets or access, technical development or investment: An example of such behaviour is where a manufacturer, in an attempt to increase its market share, includes non-compete clauses which retailers/wholesalers would have to abide by to trade with the manufacturer. This means that the retailers/wholesalers cannot accept to buy or sell goods from another manufacturer in the same market;

f. Dissimilar conditions: Applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing one at a competitive disadvantage;

g. Supplementary Conditions: Concluding contracts subject to acceptance by other parties of supplementary conditions which by their nature or according to commercial usage have no connection with the subject of the contracts; and

h. Abuse of buyer power: This refers to instances where a buyer uses dominance in a particular market to extract favourable terms from their manufacturers/suppliers. An example of this would be a retailer who uses their market strength and position to gain a significant discount from a manufacturer/supplier.

Therefore, when renegotiating contracts or commercial arrangements in general and especially when under the pressure of reduced sales due to the COVID-19 pandemic, companies should be extremely careful that those arrangements do not prevent, restrict, or distort the competitive landscape. Economic distress may push companies to find new ways to remain afloat in a tough environment, but it is important to be aware that if such arrangements result in any of the conduct outlined above they may be the subject of enforcement action by the competition authorities.

The CAK regularly conducts sector studies seeking to unearth restrictive trade practices in those sectors. Past sector studies have covered the alcoholic beverage sector, advertising sector, fertiliser sector and cement sector.

In mid-2017, the CAK gazetted the Leniency Guidelines aimed at enhancing cartel enforcement in Kenya. The guidelines provide for leniency programme in which a partial or full immunity from financial penalties is given to entities that report cartels to the CAK. The immunity, however, does not absolve parties from criminal sanctions under the Competition Act and therefore the DPP may still prosecute an undertaking which has been granted leniency by the CAK.

Measures Undertaken by the CAK During the Pandemic to Promote Consumer Protection

Following the onset of the COVID-19 pandemic, the CAK, in line with its consumer protection mandate under the Competition Act, has taken steps to prevent abusive or anticompetitive increases of prices and issued notices to manufacturers, distributors and retailers to avoid such practices. The CAK also has attempted to promote and enforce general compliance with the Competition Act.

On 13 March 2020, the CAK issued a, "cautionary notice on illegal price increases and hoarding". In the notice the CAK stated, *"It has come to the attention of the Authority that following a pronouncement by the Government of a confirmed Coronavirus disease (COVID-19) case, some manufacturers and retailers are contemplating collusive increases of prices and/or hoarding to subsequently increase prices of various consumer goods."*[5]

Following the issuance of the cautionary notice, the CAK issued a remedial order dated 16 March 2020 against Cleanshelf Supermarket which it noted had, *"unconscionably adjusted prices of Tropikal brand hand sanitizers…"*, in contravention of the Competition Act[6].

The CAK carried out investigations and noted that Cleanshelf Supermarket increased the price of a particular brand of hand sanitiser by KES 200 (approx. USD 2) within a few hours. The CAK stated that, *"The retailer therefore exploited its relative strength as a retailer to commercially detriment consumers whose bargaining position has been diminished following the pronouncement of existence of COVID-19 in Kenya."*

The CAK ordered Cleanshelf Supermarket to contact and refund all the consumers who purchased 960 pieces of the Tropikal brand hand sanitisers above the usual selling price.

Additionally, the CAK has carried out investigations into unconscionable increases of prices and/or hoarding of essential foodstuff during the COVID-19 pandemic. The CAK uncovered that some manufacturers and distributors of essential commodities were engaging in exclusive agreements without obtaining approval in line with the provisions of the Competition Act. These exclusive contracts dealt in essential commodities such as maize flour, wheat flour, edible oils, rice, sanitizers and toilet paper. According to the CAK, these exclusive agreements:

i. facilitated the allocation of distributorship territories;

ii. facilitated the allocation brand exclusivity;

iii. facilitated the allocation quantities supplied; and

iv. deterred manufacturers of competing brands from accessing the same distributors to deliver their products to certain retail outlets.

The CAK determined that the exclusive arrangements distorted the allocation of optimal prices for the commodities, ultimately denying consumers in some regions of the country from accessing the commodities at competitive prices. Pursuant thereto, the CAK issued a cease and desist order[7]:

a. ordering the manufacturers and distributors of certain essential commodities to expunge exclusivity clauses in their contracts;

b. ordering all manufactures and distributors not to enter into exclusive agreements without the CAK's approval; and

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[5] "CAK cautionary notice on illegal price increases and hoarding" (http://www.cak.go.ke/sites/default/files/2020-03/CAK%20Cautionary%20Notice%20on%20Illegal%20Price%20Increases%20and%20Hoarding.pdf)

[6] CAK Remedial order to Cleanshelf Supermarkets (http://www.cak.go.ke/sites/default/files/2020-03/CAK%20Remedial%20Order%20to%20Cleanshelf%20Supermarkets.pdf)

[7] CAK "Order on Exclusivity Agreements on Essential Commodities" (https://twitter.com/CAK_Kenya/status/1241002531695681536/photo/1)

c. that distributors who also operate their retail outlets avail the essential commodities and other commodities which they distribute to other retail outlets.

In line with the provisions of the Competition Act, the cease and desist letter sets out that the CAK has the authority to approve exclusive arrangement in contracts. To procure an exemption the party(ies) must apply to the CAK and demonstrate the economic rationale and public benefit that will accrue from the exclusive or otherwise anti-competitive arrangement.

Practical Considerations

In light of the above, companies should keep in mind the following:

1. companies should be careful about how they choose to deal with the impact of the pandemic especially where solutions involve close collaboration with other companies, including competitors;
2. in instances where companies wish to collaborate whether by way of mergers, joint ventures or by contractual arrangements (written or oral) and are uncertain as to whether the proposed collaboration is lawful, they should seek legal appropriate advice; and
3. companies keen on pursuing exclusive arrangements should review the economic and public interest needs behind the arrangement and if deemed sufficient to counteract the anti-competitive effects, apply for an exemption under the Competition Act.

As of 30 April 2020, the CAK operationalised an e-filing portal aimed at increasing its efficiency and automation of its technical processes. These include filing of mergers and exemption applications as well as submission of restrictive trade practices, abuse of buyer power and consumer protection complaints[8]. In addition the CAK will generally fast track reviews of merger notifications for distressed businesses.

It is worth noting that the Kenyan competition regime is suspensory, which means that a planned merger or restrictive trade practice requires CAK approval before taking effect. However, the COMESA competition regime operates a non-suspensory filing regime for mergers. This means that a COMESA wide merger may complete prior to receipt of approval from the CCC provided that the relevant notification has been made to the CCC. Therefore, urgent COMESA wide transactions may complete without the CCC's prior approval but there remains a risk that the CCC could order the acquirer to divest all or part of the acquired business or impose conditions which would then be binding on the merged entity.

[8] https://www.cak.go.ke/cak-automates-its-technical-processes

Key contacts

Should you have any questions on the impact of COVID-19 on your contractual agreements, please do not hesitate to contact **Dominic Rebelo**, **Luisa Cetina**, or your usual A&K contact.

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