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What Fund Managers Need to Know About Price Gouging Laws

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During the current COVID emergency, every state that has price gouging laws on its books has activated them. States without official statutes are regulating prices by executive order or existing consumer protection and unfair trade practice laws. Never before have these price controls been activated across the entire United States, and for such a lengthy time period. This creates a new and unprecedented investment environment. To assess and manage the impact, fund managers should consider diligence related to the risks of price gouging enforcement.

Numerous private class action lawsuits for alleged price gouging already have been filed against portfolio companies. More lawsuits are likely to follow. Moreover, the limitations on price increases for suppliers of a wide range of goods and services likely will impact revenue and profits even for companies that have fared relatively well in the crisis. The longer the period of emergency, the greater the likely impact. Fund managers should consider a due diligence framework to assess and manage these risks.

As a due diligence framework, fund managers should assess portfolio investments in light of the key attributes of price gouging statutes:

- Price gouging statutes are designed to prevent certain price increases during a local, statewide or national emergency.
- State statutes prevent price increases on a wide range of goods and services, including not just food, water, and medical supplies, but also computers, software, storage space, lodging, telecommunications and others.
- The statutes typically impose a form of strict liability that do not take motive into account.
- While their duration varies from state to state, many will likely remain in place for months.
- States are leading the way on price gouging enforcement, and each state law is different. Recent action in Congress, however, may ultimately lead to overlapping federal government enforcement.

Price gouging laws can create significant portfolio exposure given risks from lawsuits and government enforcement:

- Enforcement is widespread, and likely to continue.
- Price gouging investigations have in some cases turned into antitrust investigations. In an emergency, an entire industry may reasonably and independently move to higher prices, but industry-wide shifts often lead to scrutiny about their cause.
- Some state laws include private rights of action, and even where a private right of action is not explicitly provided for, claims of unfair trade practices may be available to purchasers.
- While any of these actions can have serious financial repercussions, the mere allegation of price gouging can cause public outcry, which may negatively impact the company and its investors.

In addition to the risk of legal action, there are valuation risks due to price controls, which may hold down revenue and profits. To account for those concerns, fund managers can update policies and procedures used while conducting research and information gathering when investing in companies, to consider the following:

- Determine whether the goods or services a company provides are covered by relevant state price gouging laws. Proskauer's State Price Gouging Laws: A Coast-to-Coast Reference Guide compiles the state price gouging laws and emergency measures currently in effect across all 50 states.
- If the goods or services a company provides are covered, compare their current prices to pre-pandemic benchmarks, and consider whether any of the company's post-emergency price increases may have been prohibited. The benchmark price analysis varies from state to state, as does the analysis for permissible price increases.
- Consider whether there are legitimate business justifications or defenses for price increases. Almost all states, for example, include exceptions for price increases directly attributable to unavoidable cost increases.
- Consider whether a company is expanding into a new market. If so, their pricing may be constrained by how that market calculates baseline price, or by a measure of the cost for the new product.
- Consider whether any price changes have been industry-wide. If so, investigate whether there is evidence that industry-wide price increases were responsive to market conditions, such as shortages, supply difficulties, increased demand, and

higher input costs.

Compliance with price gouging prohibitions is manageable but requires stepped-up compliance efforts and scrutiny of pricing movements. Fund managers may wish to consider these additional risks due to the pandemic when conducting diligence and valuations in order to be better positioned to account, manage and plan for them.

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Please visit Proskauer on Price Gouging for in-depth insights and the latest updates concerning price gouging compliance issues nationwide.

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