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The EU General Court's judgment last summer confirms that PE firms are not immune to antitrust risks

On July 12 2018, the General Court of the European Union ("General Court") handed down several judgments relating to the European Commission's *Power Cables* cartel case. Among these was a judgment which confirmed the joint and several liability of a private equity investor for antitrust infringements committed by a former portfolio company (Case T-419/14 – *The Goldman Sachs Group, Inc. v. Commission*).

The judgment is significant in three respects:

- The General Court confirmed that a private equity investor can be held jointly and severally liable for antitrust infringements committed by a portfolio company, even if the investor was not directly involved in or had knowledge of the anti-competitive conduct.
- The General Court extended the so-called *Akzo presumption* according to which a parent company exercises decisive influence over a subsidiary if it holds all (or practically all) of the subsidiary's shares to situations in which the parent company does not have such a high share in the capital, but is able to exercise 100% of the voting rights.
- The General Court confirmed that parental liability for antitrust infringements does not extend to so-called purely financial investors who are not involved in the management or control of a portfolio company. However, "purely financial investor" is not a legal criterion – which would shift the burden of proof back to the Commission – but an example of a situation where it is open to the investor to rebut the *Akzo presumption* of decisive influence. Whether a private equity investor is able to do so depends on the individual facts and circumstances of each case.

The General Court's ruling is an important reminder that private equity investors are not immune to antitrust risks. When the European Commission determines liability for antitrust infringements committed by their portfolio companies, they can expect to be treated in the same way as industrial parent companies unless they are able to prove that they acted as purely financial investors. While the judgment provides some guidance on factors that may be relevant to the assessment of whether an investment can be deemed purely financial,

1 MINUTE READ

In July 2018 the General Court of the European Union upheld a fine imposed by the European Commission on a private equity investor for antitrust infringements committed by a former portfolio company. The General Court's ruling is significant in several respects, and must be viewed as a stark reminder that private equity investors are not immune to antitrust risks. Here Dechert lawyers Clemens Graf York von Wartenburg and Michael I. Okkonen analyse the judgment and discuss its practical implications for private equity companies.

the General Court noted that the objective factors will vary from case to case, and cannot be set out in an exhaustive list.

European Commission fining decision

In April 2014, the European Commission imposed fines totaling nearly €302 million ($348 million) on a number of producers of underground and high-voltage power cables. The decision was based on its findings that the producers had engaged in illicit market-sharing and customer allocation for a period of almost ten years, beginning in 1999 (Case COMP/39.610 – *Power Cables*).

The list of entities fined by the Commission includes not only the companies directly involved and their industrial owners, but also an investment firm, Goldman Sachs (the "investor"), whose private equity arm formerly owned Prysmian, one of the producers that participated in the cartel. The investor was held jointly and severally liable for €37.3 million of the €104.6 million fine imposed on Prysmian, a share corresponding to the four-year period during which it held a stake.

One of the investor's funds had acquired 100% of the capital and voting rights in Prysmian in July 2005. It subsequently reduced its capital interest to between 84.4 and 91.1%, but retained 100% of the voting rights. It later reduced its capital interest to 31.69% and lost its majority of the voting rights following Prysmian's IPO in May 2007. The investment fund eventually sold its remaining shares in the company in 2010.

There was no suggestion that representatives of the investor were involved in, or had knowledge of, Prysmian's anti-competitive conduct. The Commission nonetheless concluded that the investor had exercised decisive influence over Prysmian during the entire period from July 2005 to January 2009 (when the cartel ended) by virtue of its organisational, economic and legal links with the company, and was therefore liable.

Those links included: the power to appoint the Prysmian board of directors; the power to call a shareholder meeting and propose the revocations of directors or the entire board of directors; representation on strategic committees; receipt of regular updates and monthly reports; a range of measures to ensure control over Prysmian's board members; and a number of measures taken in order to ensure that, after the IPO (when its shareholding in Prysmian decreased to 31.69%) the investor would remain in a position to exercise control. Further, in the Commission's view, there was evidence that the investor had engaged in behavior typical of an industrial owner (for instance, the fact that companies operating on the market considered it appropriate to approach the investor as an interlocutor rather than Prysmian directly in relation to the possible sale of power cables).

Background: EU approach to parent company liability

In its decision the Commission invoked the very broad case law of the European courts regarding the imputation of liability to a parent company for its subsidiary's participation in a cartel. According to that case law, the Commission is not required to demonstrate that the parent company was involved in or aware of competition law infringements or encouraged its subsidiary to commit them in order to establish parental liability.

Instead, it suffices that the parent company was, by virtue of economic, organisational and structural links, in a position to exercise decisive influence over the commercial conduct of its subsidiary, and did subsequently exercise such influence.

In other words: the key factor for assessing parental liability is the degree of autonomy a subsidiary has with respect to its general commercial policy.

The European Court of Justice held in its landmark *Akzo* judgment (Case C-521/09), that where a parent company, either directly or indirectly, holds 100% or close to 100% of the shares in a subsidiary, there is a presumption that the parent exercises decisive influence. In such circumstances, the Commission can (conveniently) rely on the *Akzo presumption* and does not need to prove that decisive influence has actually been exercised by the parent entity over a subsidiary in order to establish the parent entity's liability. While a parent company can theoretically rebut the presumption by demonstrating that the subsidiary acted autonomously in the market, making such a showing has proven extremely difficult in practice.

Attributing liability to parent companies in this way will often allow the Commission to substantially increase the fine it imposes. This is because the maximum fine that can be imposed by the Commission – 10% of worldwide turnover – is calculated on the basis of revenues generated by the entire group to which the infringing entity belongs. Parental liability for infringements committed during the period in which there was a parent-subsidiary relationship can arise even if the infringing subsidiary has already been sold.

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General Court judgment

The investor appealed the Commission's decision holding it jointly and severally liable for Prysmian's conduct to the General Court. In its appeal, the Investor contended that (i) the Commission was wrong to apply a presumption of decisive influence by reference to its voting rights as opposed to the level of its shareholding during the period prior to Prysmian's IPO, (ii) the Commission failed to establish – to the requisite legal standard – the investor's ability to exercise decisive influence over Prysmian's market conduct, and the fact that it actually exercised such influence during the entire period during which it held shares in Prysmian, and (iii) the Commission failed to recognise that the investor was, in fact, a purely financial investor, and as such not involved in Prysmian's management or control.

The General Court rejected the investor's arguments and upheld the Commission's decision. In respect of the investor's first argument, it held that, where a parent company is able to exercise all of the voting rights associated with its subsidiary's shares – in particular when combined with a high majority stake in the share capital – the parent company is in a similar position to that of the sole owner of that subsidiary, even if it does not hold all of the share capital.

In doing so, the Court extended the *Akzo presumption* to the case where a parent company is able to exercise all of the voting rights associated with the shares of its subsidiary, even if it does not hold 100% of the subsidiary's share capital. The presumption of exercise of decisive influence over Prysmian's conduct was therefore applicable to the period between July 2005 and May 2007, during which the investor's shareholding was between 84 and 91%, but with 100% of the voting rights.

The General Court also rejected the investor's second argument, concluding that the Commission was entitled to consider that the investor exercised decisive influence over Prysmian during the entire period in which it held shares in the company. This included the period following the IPO in May 2007, when the investor's shareholding in the company decreased to 31.69%. It agreed with the Commission that the evidence the investor had put forward in support of its case was inadequate. It further considered the merits of each factor the Commission relied upon to justify its finding of parental liability, and found the Commission's assessment of those factors to be correct. On that basis, it held that investor had not demonstrated that Prysmian did in fact act independently on the market.

Finally, the General Court held that the investor failed to show that its shareholding in Prysmian was intended solely as a purely financial investment. While parental liability does not extend to purely financial investors who hold shares in a company in order to make a profit but are not involved in its management or control, whether or not an investment is purely financial depends on the facts and circumstances of each case.

In the past, private equity investors whose portfolio companies were involved in cartels have, on occasion, successfully argued that they acted as purely financial investors and therefore did not meet the Commission's decisive influence test.

Private equity investors should consider revisiting their standard due diligence processes

Based on its findings with respect to decisive influence, the General Court however held that the investor had failed to demonstrate that its shareholding in Prysmian had been a purely financial investment, and that it had no involvement in the management and control of the company. In this context, the Court clarified that "pure financial investor" is not a legal criterion, which would shift the burden of proof back to the Commission, but an example of a situation in which it is open to the parent company to rebut the presumption of decisive influence.

Practical considerations for the future

The General Court's judgment is currently under appeal to the European Court of Justice, the EU's highest court. Private equity investors should nonetheless be aware of its key aspects and consequences.

Fines for antitrust infringements can be substantial. The General Court has held that the Commission is not required to apportion the fine between a subsidiary and its parent by taking into account their internal relationship. The Commission is therefore free to hold the parent liable for the entire fine imposed for the subsidiary's infringement.

Accordingly, private equity investors should consider revisiting their standard due diligence processes to ensure that they sufficiently take into account antitrust risks. On the contractual side, private equity investors should consider the feasibility of provisions enabling recourse to the seller in case of antitrust fines, and potentially even allocating antitrust risk between themselves and the portfolio company. Private equity firms with large ownership stakes in their portfolio companies should consider potential antitrust liability when balancing risks and rewards associated with holding high shares of voting rights. Finally, private equity investors should encourage tailored and effective compliance programs at all of their portfolio companies and their subsidiaries – no matter how obscure.

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