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Mitigating EU Antitrust Liability Risk in Private Equity Deals

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Private equity firms could be liable to pay hefty fines for violations of EU antitrust law committed by the companies they invest in.

For example, on 28 January 2021, the European Court of Justice upheld a €37.3 million fine on Goldman Sachs for the participation by its indirect investment company, Prysmian, in a global undersea-cable cartel.[1]

After a summary of this recent case by way of background, this brief commentary summarises the law and practice on EU antitrust liability in the context of private equity deals and identifies some practical steps to reduce or eliminate antitrust risks.

Parent Liability

Under EU law, a private equity firm owning all or almost all of the share capital or voting rights of an investment company, even indirectly, may be presumed to be jointly and severally liable for any antitrust violations committed by that investment company. Fines can be hefty, up to 10% of the worldwide group turnover.

Although, in principle, this presumption of parent liability may be rebutted, in practice, there has been no precedent to date in which the parties have succeeded in rebutting it. In cases where the parent owns less than a 100% shareholding or voting rights, the parent will still be liable for the conduct of its subsidiary if the parent controlled the subsidiary at the time of the infringement, regardless of whether the parent was aware of, or was involved in, its subsidiary's illegal activity. "Sufficient" involvement in the management of the subsidiary – to date, not defined – is enough to give rise to a potential liability. The resulting fine will be calculated as a percentage of the entire annual group turnover.

A seller and its former subsidiary may be held jointly and severally liable for a portion of the total fine that is attributable to the period during which the seller controlled the former subsidiary, while the buyer and its newly acquired subsidiary may be jointly and severally liable for the portion attributable to the period after the sale.

The Goldman Sachs Case

Goldman Sachs indirectly invested in 100% shareholding of Prysmian through one of its funds in 2005. Goldman Sachs reduced its shareholding to 84.4% in 2006 through a series of divestments and Prysmian's shares were then progressively floated and sold through an IPO on the Milan Stock exchange from 2007 onwards. In 2014, the European Commission adopted an infringement decision against Prysmian for its involvement in a global undersea-cable cartel between 2005 and 2009. In that decision, the Commission found that Goldman Sachs may be presumed to have exercised, and had actually exercised, a decisive influence on Prysmian over that period (including after the IPO) and was, therefore, jointly and severally liable for the infringement committed by Prysmian. To reach that conclusion, the European Commission held that Goldman Sachs did not behave like a pure financial investor (described as an "investor refraining from any management and control"). In reaching this conclusion, the European Commission highlighted the following factors:

- Goldman Sachs' voting rights
- Its powers to appoint board members
- Its powers to call shareholders meetings
- Its powers to revoke directors
- Goldman Sachs received regular/monthly reports from Prysmian
- At the time, Goldman Sachs acted like an industrial owner of Prysmian (e.g. by favouring cross-selling between Prysmian and other subsidiaries)
- Other management powers

Goldman Sachs appealed this decision, but the Court of Justice of the EU rejected the appeal, on the following grounds, among others:

- "It is not the mere holding of all or virtually all the capital of the subsidiary in itself that gives rise to the presumption of the actual exercise of decisive influence, but the degree of control of the parent company over its subsidiary that this holding implies. Consequently, [...] a parent company which holds all of the voting rights associated with its subsidiary's shares is, in that regard, in a similar situation to that of a company holding all or virtually all the capital of the subsidiary, so that the parent company is able to determine the subsidiary's economic and commercial strategy." (para. 35 of the judgment).

1 Case C-595/18 P, *The Goldman Sachs Group Inc. v European Commission*, 27 January 2021

- "The public statements of independence made by the Prysmian's board of directors [...] were in themselves incapable of establishing the veracity of their content" (para. 52), and "the fact that the board of directors evaluated some of its directors as independent, or that it published such an evaluation in its corporate governance reports" is irrelevant for the purpose of trying to rebut the presumption of liability of the parent company for the illegal conduct of its subsidiary (para. 100, *ibid.*).
- The assessment of control by the parent company over the subsidiary may rely "on elements relating to a prior period" to the infringement period (para. 68, *ibid.*) – so the Commission was right in considering that because Goldman Sachs exercised control over Prysmian in the period prior to the divestment of part of its shareholding in 2006, it could be presumed to have continued to exercise such control even after the IPO.
- The existence of control may be demonstrated through a "formal relationship" between the parent and subsidiary "but also on informal relationships, consisting *inter alia* in personal links between the legal entities comprising" the "economic unit formed by the parent company and its subsidiary" (para. 93) – for example, "this may be the case where a person who sits on the board of directors of a company is connected to another company by means of previous advisory services or consultancy agreements" (para. 94, *ibid.*).

The annex to this client alert provides a list of the indicia that have been considered in EU antitrust case law and decision-making to date in order to conclude that a company can direct the conduct of a subsidiary to such an extent that the two must be regarded as a single economic unit and, therefore, that the parent is liable for the conduct of the subsidiary.

Implications for Private Equity Deals

Private equity deals typically contain detailed provisions allocating liabilities through a combination of warranties and indemnities, including the target's compliance with antitrust law. The seller's obligations are often subject to thresholds and caps, as well as to procedural requirements regarding how warranty and indemnity claims must be asserted. A change of control of a company found to have infringed antitrust law can have significant implications for the fines imposed. Therefore, a number of modifications to certain clauses traditionally contained in private equity deals may be appropriate to avoid problems.

For the Buyer

The buyer group (excluding the target) will usually only be exposed to fines in respect of violations that continued after the buyer acquired control – although the target investment will itself be liable for the entire period of the infringement. Some practical steps to reduce the antitrust risk include the following:

- Avoid provisions that could be construed as an acceptance of liability for the target's conduct prior to closing.
- Extend the period for which the warranties and indemnities survive closing – it can take many years for competition authority investigations to reach an infringement decision and impose fines and it can take even longer for any follow-on damages actions to conclude (by settlement and/or final judgment).
- Extend the seller's liability not only for the fines imposed on the target but also fines imposed on the buyer as a result of the target's conduct post-closing or at least for a reasonable transition period post-closing, during which the buyer assumes control over the target.
- Extend the seller's indemnity liability to cover the entire fine calculated on account of the buyer's group turnover, if the buyer's group turnover is higher.
- Extend the seller's indemnity liability to cover any civil damages awards and costs flowing from an eventual infringement decision (customers of cartelists can generally rely on infringement decisions to bring follow-on damages claims for cartel overcharge loss).
- Resist procedural rights requiring the buyer to coordinate with the seller on any internal audit, inquiry or investigation; however, the buyer would want to retain the ability to seek and obtain the seller's cooperation where needed.

Additional care is needed in investments in distressed assets where the seller ceased to exist, as the buyer of assets comprising the material and human resources responsible for an antitrust violation could be held liable for the entire duration of the infringement in certain circumstances – even prior to its acquisition.

For the Seller

For EU antitrust fines, a seller will remain liable for violations by the investment target that occurred during the period prior to closing. However, a seller may still be liable through the operation of warranties and indemnities after this period.

Some practical steps to reduce the antitrust risk include the following:

- Limit the period for which the warranties and indemnities survive closing.
- Limit the seller's liability to the level of the fine that would be imposed on account of the seller's group turnover prior to closing, if the buyer's group turnover is higher, and for any civil damages awards and costs flowing from an eventual infringement decision, or retain the ability to control the defence of any investigations/claims if the seller agrees to bear any related costs.
- Include procedural rights requiring the buyer to coordinate with the seller on any internal audit, inquiry or investigation that could result in the imposition of fines for the target's conduct prior to closing.

Due Diligence

Finally, normal pre-completion due diligence is ill equipped to uncover a cartel. Therefore, if the target is active in an industry where there have been cartels or there is a suspicion of cartel, the buyer may consider conducting an enhanced pre-completion antitrust audit or requiring the target to identify the antitrust risk and to implement any reasonable risk mitigation option (including, e.g. applying for/securing immunity or leniency).

In any event, a post-completion antitrust audit would be prudent to assess the risk and mitigation options, including, for example, applying for immunity or leniency. Any post-completion antitrust audit should have certain characteristics to be effective, including the following:

Scope

Step one – To define the objectives and scope of the audit. This type of audit broadly consists of a targeted review of the issues currently facing the target, collecting the relevant information (documents) in connection with such issues, meeting with the relevant custodians of such information and identifying the locations (physical and electronic) where the information is stored.

Brief Senior Management on the Scope

Step two – Inform the senior management team on the reasons for the audit and the potential outcomes. This is to ensure top-level buy-in the audit.

Agree Review Protocols and Arrangements

Step three – Agree the protocols for the rollout of the audit, timetable and practical arrangements, including identifying the issues to cover, information/documents to collect, their collection procedure, location and custodians.

Collection

Step four – Collect the relevant information and meet the relevant custodians based on the agreed protocols.

Review and Assessment

The selected information and documents will be assembled into topics and assessed in order to estimate their level of potential antitrust risk and, for high antitrust risk areas, to identify the authority that would be more likely to assert jurisdiction and conduct a dawn raid. Electronic copies of privileged materials should be stored in a secured file under the control of a lawyer overseeing the audit and subject to some additional safeguards that take account of the different standards applying to legal privilege in different jurisdictions. In particular, only advice from EU qualified competition lawyers would be protected from disclosure to the European Commission under the current case law on EU legal privilege protection.

Having a targeted and effective post-completion antitrust audit also potentially mitigates the consequences of a finding of an infringement that occurred prior to completion, through a reduction of the fine imposed on the target on account of the buyer having taken effective compliance action as soon as the cartel is uncovered post-completion. By contrast, having a general "box ticking" compliance policy and training, without targeted follow up, may be considered as an aggravating circumstance for the purpose of the fine calculation.

Conclusion

The case involving Goldman Sachs illustrates the risk that private equity firms face when acquiring control in investment companies that are involved in an antitrust violation without either the seller's or the buyer's knowledge. This is particularly the case with cartels that are inherently secret and difficult to uncover through standard due diligence. It is, therefore, important to put in place the appropriate safeguards to mitigate exposure to potential problems.

If you have any questions, or would like to discuss any specific issues in confidence, please contact the EU Competition/ Antitrust team.

Annex – Indicia of Parent Liability

The bullet points below provide a list of the indicia which have been considered in EU antitrust case law and decision making to date in order to conclude that a company can direct the conduct of a subsidiary to such an extent that the two must be regarded as a single economic unit and, therefore, that the parent is liable for the conduct of the subsidiary. The list below is non-exhaustive, is not specific to private equity deals and does not represent a check list. A case-by-case assessment is always required.

- Significant shareholding[2]
- Voting rights[3]
- Board representation[4]
- Shared/overlapping directors or senior management people[5]
- Management powers of the parent's representatives on the board of directors[6]
- Power to appoint members of the board of directors[7]
- Power to call shareholder meetings[8]
- Power to propose the revocation of directors[9]
- Right to approve and refuse/reject proposals from the subsidiary – e.g. transactions exceeding a certain value (including loans, guarantees, mortgages or selling property), business plans or other strategic document(s))[10]
- Receipt of regular updates and monthly reports concerning sales, production and financial services even through a single director to the parent [11]
- Common resources made available to the subsidiary, e.g. legal, health and safety, financial controls, trademark registration or procurement support[12]
- Activity on the same market(s)[13]

2 C-97/08 P *Akzo Nobel and Others v Commission.*
3 Case C-595/18 P, *The Goldman Sachs Group, Inc.,* para 17
4 Case T-419/14, *The Goldman Sachs Group, Inc. v European Commission*, paras 103-109
5 T-208/08 *Gosselin Group NV v Commission* [2011] ECR II-3639, para 56
6 Ibid., paras 110-119
7 Ibid., paras 89-102
8 Ibid.
9 Ibid.
10 Case T-399/09, *HSE v Commission*, para 63
11 Case T-419/14, *The Goldman Sachs Group, Inc. v European Commission*, paras 125-129
12 Case CE/7510-06, *Construction Recruitment Forum*, para 2.51
13 Commission decision in Case COMP/F-1/38.121 – Copper Fittings, para 680

- External perception by customers/competitors – including the subsidiary presenting itself as part of the corporate group to potential clients and others (including in financial statements or on the parent company's website)[14]
- Consolidation of accounts[15]
- Commitment to operate in different spheres of work (and to redirect tenders accordingly)[16]
- Exclusive distribution agreement – i.e. if the subsidiary is appointed the sole supplier of the parent[17]
- Intragroup transactions – i.e. transactions that one would expect to see within a group and they are not the kind of transactions that you would expect to see if the subsidiary in question was being operated as an autonomous company with its own entirely separate commercial policy and independent financially from the parent entity and the other subsidiaries.[18]
- Ability of the parent company to transfer shares in another company to the subsidiary[19]
- Presence of the parent company's finance director to meetings with subsidiary's customers (who owned money)[20]
- Interlocutor in judicial or administrative proceedings – e.g. if the parent company and the subsidiary present themselves as the same interlocutor before the European Commission[21]
- Any other indicia showing the parent company's involvement/ influence over its subsidiary as regards corporate strategy, operational policy, business plans, investment, capacity, provision of finance, human resources and legal matters, including the following:
  - The parent's unilateral determination of the content of the decisions of the management board (or supervisory board or general meeting) of the subsidiary[22]
  - The parent's unilateral approval of investment, budget, appointment and dismissal of managers and business plan of the subsidiary[23]
  - The parent's specific instructions, guidelines or rights of co-determination in terms of pricing, production and sales activities or similar aspects essential to market conduct. [24]

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14 Case T-185/06, *L'Air Liquide v Commission*, para 29
15 Case T-399/09, *HSE v Commission*, para 63
16 Case No. 1121/1/1/09, *Durkan Holdings Limited, Durkan Limited and Concentra Limited (formerly Durkan Pudelek Limited v Office of Fair Trading*, ([2011] CAT 6), para 35
17 Joined Cases C-293/13 P and C-294/13 P – *Fresh Del Monte Produce, Inc. and others v European Commission and others* and Case C-286/13 P, *Dole Food Company, Inc. and Dole Fresh Fruit Europe OHG v European Commission*, paras 93-94
18 Case No. 1121/1/1/09, *Durkan Holdings Limited, Durkan Limited and Concentra Limited (formerly Durkan Pudelek Limited v Office of Fair Trading*, ([2011] CAT 6), para 70
19 T-45/10, *GEA Group AG v Commission*, para 176
20 Case No. 1121/1/1/09, *Durkan Holdings Limited, Durkan Limited and Concentra Limited (formerly Durkan Pudelek Limited v Office of Fair Trading,* ([2011] CAT 6), para 77
21 Case C-236/98, *Stora Kopparbergs Bergslags AB v European Commission, judgment of 16 November 2000 (Stora))*, para 85
22 Case T-419/14, *The Goldman Sachs Group, Inc. v European Commission*, para 94
23 Case T-541/08, *Sasol and others v Commission*, para 120
24 Case T-77/08, *Dow Chemical v Commission*, para 77