SHEARMAN & STERLING LLP

ANTITRUST CLIENT PUBLICATION

7 April 2014

Cartel Fines: Liability of Private Equity Funds

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The European Commission has held Goldman Sachs jointly and severally liable for a cartel infringement committed by Prysmian, an Italian cable maker formerly owned by Goldman Sachs' private equity arm. The decision is a stark reminder that EU competition law allows the corporate veil to be readily pierced and that private equity companies are no exception.

The *Power Cables* Decision

The European Commission has found that 11 producers of underground and submarine high voltage power cables operated a cartel; it has imposed fines totalling EUR 302 million.[1]

Goldman Sachs (GS) has been held liable for the infringement. There is no allegation that GS actually participated in, or was even aware of, the alleged cartel. Rather, the Commission imposed a fine on GS purely on the basis of its parental liability doctrine because GS, through its private investment fund GS Capital Partners, held a stake in Prysmian, a cable manufacturer, at the time of the alleged cartel infringement.[2]

The Commission has frequently been successful in imputing, in case of a cartel infringement, the illegal conduct of a subsidiary to its parent. The fine imposed on GS makes clear that EU competition law allows the corporate veil to be readily pierced and that private equity companies are no exception.

1 "*Antitrust: Commission fines producers of high voltage power cables € 302 million for operating a cartel,*" IP/14/358.

2 Prysmian's Annual Reports indicate that in July 2005, GS acquired indirect control over Prysmian. In 2007, Prysmian held an initial public offering through which GS reduced its stake to 31.8%. In 2009, GS sold its last shares.

Parental Liability – Principles Applicable in the European Union

In the EU, it is established case law that, in case of a cartel infringement, the conduct of a subsidiary may be attributed to the parent company even if the parent did not participate in, or was not aware of, the alleged cartel. This is particularly the case where the parent exercises "decisive influence" over the conduct of its subsidiary.[3] In practice, the test is easy for the Commission to satisfy. Liability may be imputed to the parent even if its influence only has to do with high level strategy or commercial policy.

The Commission cannot, however, merely find that the parent is in a position to exercise decisive influence over the conduct of its subsidiary; it must also check whether that influence was actually exercised.[4] Where a parent company holds (almost) all of the capital in a subsidiary, there is a rebuttable presumption that the parent exercises decisive influence over its subsidiary.[5] In the absence of a (nearly) 100% shareholding, the Commission must adduce evidence of the exercise of decisive influence.[6]

The so-called "100% presumption" is rebuttable. A parent company may rebut the presumption of exertion of decisive influence "*by demonstrating that it exercised restraint and did not influence the market conduct of its subsidiary*."[7] But the rebuttal has proven a "*very difficult onus to discharge*."[8]

The "Pure Financial Investor" Defence

A number of parents have avoided liability for cartel infringement by their subsidiaries, successfully arguing that they behaved like pure financial investors.[9] However, private equity companies cannot expect the "pure financial investor" argument to succeed each time.

A "pure financial investor" is an investor who holds shares in a company in order to make a profit, but who refrains from any involvement in its management and in its control.[10] In *Calcium Carbide and Magnesium*[11], the Commission held Arques, a private equity company specializing in the acquisition and restructuring of companies in distress,

3 Case 107/82, *AEG v. Commission* [1983] ECR 3151, para. 49.

4 *Id*., para. 50.

5 Case C-97/08 P, *Akzo Nobel and Others v. Commission* [2009] ECR I-8237, para. 60. As a result, it is sufficient for the Commission to prove that (almost) all of the capital in the subsidiary is held by the parent in order to take the view that that presumption is fulfilled. See Case C-289/11 P, *Legris Industries SA v. Commission*, not yet published, para. 46.

6 The exercise of decisive influence may be established where, e.g., the parent company is able to influence pricing policy, organisational links tie the subsidiary to the parent, etc.

7 Opinion of Advocate-General Kokott delivered on 23 April 2009 in *Akzo Nobel NV* (see note 5), para. 75.

8 Opinion of Advocate-General Warner delivered on 22 January 1974 in Cases 6 and 7/73, *Instituto Chemioterapico Italiano S.p.A. and Commercial Solvents Corporation v. Commission* [1974] ECR 223, p. 264.

9 See, e.g., Commission decision of 20 October 2004 relating to a proceeding under Article [101(1) TFEU] (Case COMP/38.238 – Raw Tobacco Spain), para. 383.

10 Case T-392/09, 1. *garantovaná a.s. v. Commission*, not yet published, para. 52.

11 Commission decision of 22 July 2009 relating to a proceeding under [Article 101 TFEU] (Case COMP/39.396 – Calcium carbide and magnesium based reagents for the steel and gas industries). The General Court confirmed the Commission's findings on appeal (Case T-395/09, *Gigaset AG v. Commission*, not yet published).

jointly and severally liable for the illegal behaviour of its subsidiary, SKW.[12] The Commission relied on the parental liability principles to attribute the illegal cartel behaviour of the portfolio company to the parent company.

Arques argued that, as a financial investor, it focused on strategic decisions and never took any business decision, given its lack of know-how and experience of the operative business. The private equity company conceded receiving information on turnover, result, cash-flow and liquidity planning or on the progress of the restructuring process of the subsidiary, but did not consider this to be an indicator of influence over its subsidiary's conduct. The Commission and the General Court dismissed the arguments, pointing out in particular that (i) Arques closely monitored the restructuring process and (ii) the private equity company had the interests of the group in mind when taking decisions in relation to its portfolio company such as whether the subsidiary should be sold and for which price.[13]

This precedent confirms the difficulty of successfully asserting the "pure financial investor" defence. Private equity funds may be at risk whenever they exercise decisive influence over the conduct of one of their portfolio companies, even where their interests in their subsidiaries have subsequently been divested. Accordingly, it is important that private equity funds and investors devise mitigating strategies

What to Do to Avoid Risks?

- Prevention is key. Robust and effective competition compliance programmes should be implemented to (i) disseminate adequate knowledge within the parent and portfolio companies of how to avoid infringements of competition law and (ii) encourage internal reporting for employees to speak up when they are confronted with questionable situations.
- Thorough due diligence process on competition risks must be undertaken when considering any potential investment.
- Appropriate antitrust warranties and indemnities and other contractual provisions, though not constituting cast-iron guarantees, should be considered when acquiring portfolio companies, such as contractual allocation clauses that enable recourse to the seller if a fine is imposed. The provisions would ideally need to survive after the private equity fund has exited the investment.
- If practically possible, ensure that no decisive influence is exercised over portfolio companies, i.e., the private equity house should not exercise any operational, commercial and/or strategic influence over the business.

[12] Arques acquired control over SKW in August 2004 and remained the owner of 100% of SKW until November 2006, when SKW was quoted on the stock market. Arques kept the majority of the shares until July 2007.

[13] See note 11, Commission decision, para. 257 and 262, and General Court judgment, para. 54.

The decision serves as a salutary reminder that private equity funds may find themselves punished for the activities of their subsidiaries. The notion of control will be key and it is possible to have a decisive influence without direct control.

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