February 2021

Follow **@Paul_Hastings**

EU Court Ruling Highlights Antitrust Risks for Investment Funds

By Camille Paulhac, Juliette Hua, Michael Wise & Pierre Kirch

A recent decision by the European Court of Justice ("ECJ"), the European Union's highest court, underscores the importance of antitrust compliance for investors that hold portfolio companies.

On January 27, 2021, the ECJ upheld a decision to hold a private equity ("PE") investor liable for an antitrust violation committed by a controlled entity, concluding that there was no need to show that the investor knew of or contributed to the infringement. According to the ECJ, it was sufficient to show that the investor had control ("*decisive influence*") over the portfolio company, and that this control could be demonstrated by various indicia. The PE investor claimed that it had only a minority interest in the infringing company and no direct involvement in the unlawful conduct. Based on these principles, the investor was determined by the ECJ to be jointly and severally liable for the antitrust violation.

The decision follows news in other major jurisdictions, including the United States and China, that antitrust compliance is increasingly in focus. The current environment is one in which PE houses and other investors must take affirmative steps to ensure that their *de jure* or *de facto* controlled companies adopt sound antitrust compliance regimes.

Factual background

In 2014, the European Commission ("EC") fined 11 high voltage power cables producers, including Prysmian, €302 million for operating a market-sharing cartel from 1999 to 2009. Parent companies exercising a decisive influence over the producers were held jointly liable. This notably concerned Goldman Sachs ("GS"), owner of Prysmian as from July 2005. GS appealed the EC decision before the General Court, disagreeing with the EC's presumption that it had exerted a decisive influence over Prysmian during the cartel period.

For background, GS initially owned all the equity in Prysmian. Over time, its economic rights gradually decreased, but GS kept 100% of the voting rights until May 2007. At that point, GS launched an IPO, which resulted in GS holding a minority of the outstanding voting and economic rights. The Board of Prysmian, however, did not change over the period. GS had nominated a Board pre-IPO, which governed Prysmian until April 2009.

The General Court dismissed the appeal. GS further appealed its ruling before the ECJ. On January 27, 2021, ECJ likewise dismissed the appeal.[1] The ECJ confirmed several holdings of the General Court:

- It can be presumed from the fact that GS held 100% of Prysmian's voting rights from July 2005 to May 2007 that it exercised decisive influence over Prysmian during the pre-IPO period, despite its declining ownership of the economic rights in Prysmian.[2]

- GS exercised decisive influence over Prysmian by holding the power, throughout the infringement period, to (i) appoint members of the Board of Prysmian, (ii) call shareholders meetings and (iii) propose the revocation of directors or of the entire Board. In particular, although only a minority of the Board members were GS employees, the ECJ also took account of GS's personal links with two independent directors who had provided 'previous advisory services' or signed 'consultancy agreements' with GS. Under EU antitrust law, even minority investors may be able to exercise a decisive influence (i.e., control) over a company's conduct if the investor's rights are greater than those normally granted to protect a minority shareholder's financial interests. The actual exercise of such decisive influence may be inferred from a body of consistent evidence. Here, the ECJ held that there were several indicia of GS's decisive influence, including specific management powers held by GS representatives, roles by GS representatives in different committees, regular reporting to GS, and other factors. Most notably, the ECJ's determination that independent directors could be deemed to be GS's directors due to their "informal links" is far-reaching and raises questions as to who will be sufficiently independent for purposes of the EC's analysis.

- Co-investors (who were, in fact, limited partners) were deemed to be "passive investors", without decisive influence and thus without any potential joint liability for part of the antitrust fine.

Implications for Investors

While the fact that portfolio company actions could be imputed to PE parent companies has existed in EU antitrust law for a number of years, the ECJ decision extends joint liability in a questionable way. In particular, it seems that the ECJ is unwilling to take into account the particularities of the relationship between a PE fund or similar investment vehicle and its portfolio companies. For such investment vehicles, the strategy may be purely financial, or the investment may involve limited involvement in day-to-day operations. Many of these investments are for relatively short durations. However, under the ECJ's reasoning, investors may inherit liability for violations that occur during a period in which the investor had *de facto* control, even where the offending conduct was initiated before the investment.

The ECJ's decision presents a clear challenge to the ordinary PE model of managing investments. Such investments are based on the premise that the investor can help the portfolio company increase profitability, often through expertise or capital that the investor brings to the table. But, such involvement will also make the investor liable if an infringement is found.

Furthermore, the ECJ's imposition of joint and several liability also raises the question of who, eventually, will pay the fine. The EC, in line with the ECJ,[3] refuses to determine the respective share of the fine for which each legal entity, fined jointly and severally with others, is responsible. Where there is no prior contractual agreement as to the allocation of the fine, it could fall on the national courts to determine those shares, by applying the national law applicable to the dispute.[4] For sure, the absence of individualization of the fine will cause further disputes—and related time and money spent—between parent and infringing subsidiaries.

Further potential victims could introduce follow-on actions against, and claim damages from, both the author of the infringement and the parent company.

It should be noted that R&W insurers usually do not have a general policy to indemnify antitrust risk, although it is possible, in theory, to craft a custom-made policy for the risk of antitrust fine. In practice, it will however be complex to quantify the risk, while quantification is key to insurance logic. Insuring the risk of follow-on actions by potential victims is even more complex for this particular reason.

Global Context

While this decision by the ECJ is related to conduct in Europe, the last year has seen heightened focus on antitrust and competition compliance regimes around the world. For example, in June 2020, the United States Department of Justice updated its guidelines for evaluation of the effectiveness of Corporate Compliance Programs, highlighting the need for internal compliance to be “adequately resourced and empowered to function effectively.”

Similarly, in September 2020, China’s antitrust and competition regulator, the State Administration for Market Regulation (generally referred to as “SAMR”) released its own guidelines for effective antitrust compliance. Like the United States and Europe, China emphasizes the need for leadership commitment to compliance efforts and ongoing assessment of risk areas and effectiveness of a compliance program.

Recommendations

In light of this global regulatory landscape, there are two key areas for all companies to focus on to ensure appropriate antitrust awareness and compliance.

First, investors should evaluate their current holdings for potential trouble areas. Because PE firms and other investors may incur liability for the actions of their controlled companies, a proactive approach is prudent. Moreover, given the ECJ precedent, investors must take into account that they may be deemed to have control even if they hold a minority position.[5] In this regard, investors should (i) evaluate potential antirust compliance issues during diligence; (ii) consider antitrust audits or spot checks to identify gaps in antitrust compliance; and (iii) ensure that portfolio companies have adequate antitrust compliance policies and programs in place.

Secondly, when considering a new investment, PE houses and other investors should properly weigh antirust considerations during negotiation and formalization of future investments. In particular, we recommend the following:

- Proactively address antitrust risks identified in the context of new acquisitions.
  - If identified pre-signing negotiate specific reps and warranties
  - If identified pre-signing negotiate a decrease in the purchase price
  - If identified post-signing: stop the conduct and consider available procedural steps (such as leniency application) to control damage
- Craft governance provisions with an eye toward potential antitrust liability concerns. For example, consider the level of involvement (i.e., voting rights), in particular when only a minority shareholding is held, and be mindful of informal links that may be held with independent directors. Likewise, recognize that the communication of strategic and financial updates and reports from the portfolio company to the investor may support a finding of de facto control. If there are grounds for concluding that control may exist, even on a de facto basis, a proactive strategy toward identifying potential antitrust compliance risks becomes far more important. Where required introduce antitrust compliance programs

At Paul Hastings our purpose is clear—to help our clients and people navigate new paths to growth and mitigate legal risk.

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

Paris

Camille Paulhac
33.1.42.99.04.10
camillepaulhac@paulhastings.com

Pierre Kirch
33.1.42.99.04.23
pierrekirch@paulhastings.com

Juliette Hua
33.0.14.29.90.43
juliettehua@paulhastings.com

Washington, D.C.

Michael Wise
1.202.551.1777
michaelwise@paulhastings.com

[1] ECJ, judgment of 26 January 2021, Case C-595/18 P. The ECJ also dismissed Prysmian and Pirelli's appeals (respectively, judgment of 24 September 2020, Case C-601/18 P, and judgment of 28 October 2020, Case C-611/18 P).

[2] For context, it is settled case law that where a parent holds the entire capital, or almost all the entire capital of a company, it is presumed that it exercises decisive influence over its commercial policy. The ECJ extends this presumption to voting rights.

[3] ECJ, judgment of 10 April 2014, *Siemens Österreich e.a. v Commission*, joint Cases C-231/11, C-232/11 and C-233/11.

[4] Internal allocation of the debt could for instance be based on the relative responsibility or culpability for the commission of the infringement, or, if it cannot be shown that one entity had a greater degree of responsibility than the other, the companies concerned could be considered to be equally liable.

[5] It should be emphasized that the concept of "control" in an antitrust setting can be different from that under corporate law. As a general rule, the concept of "control" corresponds, in fact, to a concept of "decisive influence". As noted above, there is a presumption of control where a parent (whether a PE house or an industrial company) owns more than 50% of the shares/voting rights (it is extremely rare that such a presumption can be undone). Below the 50% figure, the shareholder may have sole or joint control, based on analysis of a series of strategic factors, which could be deemed to grant decisive influence. In a recent decision, the UK's Competition and Markets Authority ("CMA") decided that Amazon would obtain, with just 16% of the shares, a decisive influence and thus control over the well-known UK-based food delivery operator, Deliveroo. The issue is particularly acute in PE transactions.

Paul Hastings LLP

Stay Current is published solely for the interests of friends and clients of Paul Hastings LLP and should in no way be relied upon or construed as legal advice. The views expressed in this publication reflect those of the authors and not necessarily the views of Paul Hastings. For specific information on recent developments or particular factual situations, the opinion of legal counsel should be sought. These materials may be considered ATTORNEY ADVERTISING in some jurisdictions. Paul Hastings is a limited liability partnership. Copyright © 2021 Paul Hastings LLP.