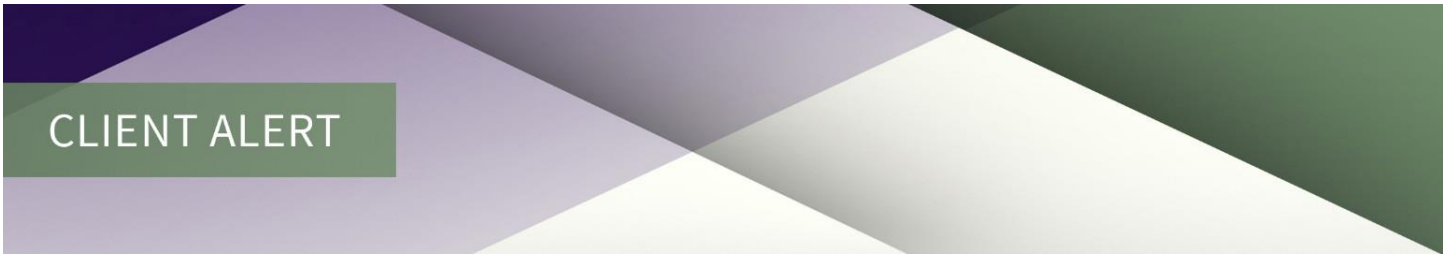

The EU's General Court Confirms the Responsibility of Investment Companies for Anti-Competitive Behaviour of Their Portfolio Companies

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On 12 July 2018, the General Court (the "Court") upheld the European Commission's ("Commission") *Power Cables* cartel decision [1]. In that decision [2], the Commission had, among other things, imposed a fine of approximately €37 million on a financial sponsor, arguing that the firm had been the indirect parent company, through its fund, of one of the industrial companies implicated in the cartel, i.e. Prysmian, for a number of years. The financial sponsor appealed the fine.

The Court upheld the fine despite the financial sponsor not having instigated or being involved in the cartel behaviour. It therefore remains jointly and severally liable with its former portfolio company, Prysmian, because, according to the Court, the financial sponsor and Prysmian formed one "undertaking" within the meaning of EU antitrust rules.

The judgment is of particular interest for financial investors because it clarifies when financial investors may become liable for the anti-competitive conduct of one of their portfolio companies, even if they are not involved or even aware of the infringing conduct.

1 General Court, 12 July 2018, *Goldman Sachs v. European Commission*, case T-419/14, ECLI:EU:T:2018:445.

2 Commission Decision, Case AT.39610 – *Power Cables* of 2 April 2014.

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1. Investors are presumed to exercise decisive influence on a company if their situation is "similar" to that of the sole owner of a subsidiary

It is settled case law that a parent company may be held jointly and severally liable with its subsidiary if the former is able to exercise decisive influence over the latter, having regard to the economic, organisational and legal links between them. In such a case the two companies are considered to form a single economic unit and therefore one undertaking within the meaning of EU antitrust laws. This means that the Commission may hold a parent company jointly and severally liable for the payment of a fine imposed on the subsidiary without having to establish the direct involvement of the parent company in the infringement [3].

The burden of proof to demonstrate that a parent company and its subsidiary form a single undertaking lies on the Commission. However, as a general rule, the Commission is entitled to rely on a rebuttable presumption that a parent exercises decisive influence over a subsidiary in which it holds 100% of the shares [4].

In the *Power Cables* case, the Commission applied the above presumption to the financial sponsor of one of the cartel members. It did so even though the financial sponsor only held 100% of the shares in Prysmian for a very short period (41 days) over the relevant cartel period. After this, it reduced its holding to 92%, then 84% and finally even more after Prysmian's IPO. However, the financial sponsor retained control of 100% of the voting rights associated with Prysmian's shares at all relevant times.

In its judgment, the Court upheld the Commission's approach and confirmed the applicability of the presumption in this case. The Court stated that the presumption can legitimately be applied where "*the parent company is in a similar situation to that of the sole owner of [a] subsidiary, since [the] parent company is able to determine the economic and commercial strategy of the subsidiary concerned, even if it does not hold all or virtually all the share capital of [the] subsidiary*" (para 50) (emphasis added).

The Court held that the "essence" of the presumption is to cover situations where the parent company has the power to exercise influence over the subsidiary's strategic decision or day-to-day business without being required to take into account the interests of any other shareholder. The Court concluded that this was the case for financial sponsors because the minority shareholders had no voting rights attached to their shares of Prysmian.

The Commission is therefore entitled to apply a rebuttable presumption that a parent company forms one "undertaking" with its subsidiary when the parent company either has a 100% shareholding of the subsidiary or finds itself in a "*similar situation*."

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[3] Court of Justice, 20 January 2011, *General Quimica*, case C-90/09 P, ECLI:EU:C:2011:21.

[4] Court of Justice, 14 July 1972, *International Chemical Industries*, case 48/69, ECLI:EU:C:1972:70.

The judgement therefore not only endorses the application of the presumption to situations where a parent company controls 100% of the voting rights (although its shareholding may be significantly below 100%) but also allows the Commission to apply the presumption to other "similar" cases. This opens the door for a new discretion of the Commission to identify such similar situations on a case-by-case basis. Companies, in particular financial investors, such as private equity firms and activist investors, therefore need to consider carefully whether the presumption may apply to their situation, exposing them to fines in relation to anti-competitive conduct of their portfolio companies.

2. Investors may provide evidence rebutting the presumption of exercise of decisive influence

The application of the presumption shifts the burden of proof from the Commission to the parent company which must provide evidence of the strategic independence of its subsidiary to avoid being held jointly and severally liable for any anti-competitive conduct of the subsidiary.

The legal and evidential threshold for rebutting the presumption is high: the parent company must provide compelling evidence that the subsidiary actually "*acted independently on the market, without any direction from [the parent company]*" (para 69). This confirms well-established case law that a company which acts as a "*pure financial investor*" cannot be held liable for the infringements of an investee company.

In the present case the financial sponsor claimed, *inter alia*, that: (1) the funds that owned the Prysmian shares did not have the requisite expertise or resources to determine the conduct on the market of Prysmian; (2) the management of its subsidiaries did not fall within its mandate; (3) the management team of Prysmian was in fact directing the company's commercial policy; and (4) Prysmian was not perceived externally as being part of the financial sponsor group and was not included in that group for accounting purposes.

The Court rejected the arguments advanced by the financial sponsor to rebut the application of the presumption. In particular, the Court considered that the fact that the sponsor's funds did not have the expertise, resources or mandate to be involved in Prysmian's commercial management was irrelevant for the purposes of finding whether decisive influence was actually exercised. According to the judgment, the finding that the parent company exercised decisive influence over its subsidiary's business decisions does not need to be necessarily restricted to matters relating solely to the commercial policy on the market *stricto sensu* (para 152). Other objective considerations, such as those used by the Commission in this case (see below, section 3), are also relevant to establish the exercise of a decisive influence.

3. The Commission may establish the exercise of decisive influence on objective factors to fine the investor together with its subsidiary

In order to strengthen its conclusion, the Commission had based its decision to hold the financial sponsor jointly and severally liable with Prysmian not only on the application of a presumption of decisive influence but also on a number of specific factors which, in its view, supported the finding that the financial sponsor did *actually* exercise decisive influence

over its subsidiary. The Court assessed these factors, and the Court's considerations represent an important point of reference for investors who wish to *self-assess* whether they may in fact, for the purposes of the attribution of liability in EU antitrust cases, exercise decisive influence over their investee companies.

Relevant considerations for an assessment of the actual exercise of decisive influence include the following:

- the power to appoint members of the board of directors of the subsidiary;
- the power to call shareholder meetings and to propose the revocation of directors or of entire boards of directors;
- the investor's actual level of representation on the subsidiary's board of directors;
- the management powers of the investor's representatives on the board of directors;
- the role played by the investor on the committees established by the subsidiary;
- the receipt of regular updates and reports concerning the subsidiary's business activities; and
- evidence of behaviour typical of an industrial owner [5]

Overall, in considering each of these factors, the Court confirmed that evidence of the ability of an investor to approve or reject strategic decisions of a company is evidence of "decisive influence."

Further, the Court held that influence over the commercial strategy decision-making of board or similar committees, for example over budgets or investments, may be evidence of "decisive influence." Conversely, this is not the case if the investor's representative does not have decisive influence in such a committee (e.g. he is only one of three members) or if the committee does not have decision-making powers in relation to the commercial strategy of the company. For example, the Court held that the financial sponsor's significant influence on Prysmian's internal control committee was not [relevant] for the assessment of "decisive influence." This committee only reviewed and verified internal accounting documents and assisted in drawing up balance sheets (para 123).

The Court also held that any direct involvement by an investor in encouraging cross-selling between the subsidiary and other portfolio companies of the investor amounts to a strong indication that the investor adopts the behaviour of a "typical industrial owner" rather than a "pure financial investor." In the present case, the financial sponsor was determined to have encouraged cross-selling with other investee companies, at a time when the financial sponsor held less than 32% of Prysmian's shares. The Court noted that even if the encouragement to engage in such cross-selling was a systematic

[5] Given the specific features of the case, the Commission also considered the decisive control of Prysmian by the financial sponsor after Prysmian's IPO.

practice, the Commission was allowed to include this behaviour as a relevant consideration in its analysis "*as a factor capable of demonstrating the applicant's involvement in Prysmian's business*" (para 141).

4. Practical 'checklist' considerations for investors emerging from the case

The judgment provides investors with a number of practical "checklist" considerations to assess and minimise their potential exposure to the anti-competitive conduct of their investee companies.

Investors should consider:

- conducting sufficient antitrust due diligence before investing in a company to either avoid acquiring a company engaged in an antitrust infringement or take appropriate steps to mitigate the risks and ensure sufficient protection of their interest (e.g. contractual guarantees provided by the seller, or using leniency policies to self-report the conduct in return for protection from sanctions);

- assessing the degree of influence they acquire (legally and practically speaking) in light of the EU notion of "decisive influence";

- ensuring that stringent compliance policies and procedures are put in place in investee companies. While this is generally best practice, it is of particular relevance for an investor where the investor risks being deemed to exercise "decisive influence" over the portfolio company; as noted above, in such a case, an investor can be held jointly and severally liable for anti-competitive conduct which it did not participate in and did not even know about;

- their representation not just on the board of the investee company but also its role, representation and influence over the company's committees which have decision-making power over commercial strategy issues;

- providing clear guidance to their representatives in the company regarding their behaviour. For example, should these representatives encourage the business to engage in commercial dealings with other investee companies of an investor, this may be a strong indication of the exercise of decisive influence by the investor; and

- in the case of co-investment structures, the implications on the level of influence of each individual investor on the company and, where appropriate, clarifying an investor's role as a "pure financial investor" and ensuring that this position is clearly and consistently reflected in the investor's interactions with the company.

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