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M&A Risks: The Potential Responsibility of the Purchaser for Prior Infringements

BY PIERRE KIRCH AND JOSSELIN LUCAS

The European Court of Justice has reaffirmed the potential attribution of liability to parent companies for cartel infringements committed by an acquired company before an acquisition

In a cartel case involving a group of leading Austrian banks and known as the "***Lombard Club***" case, the European Court of Justice has reaffirmed -- in a ruling of **September 24, 2009** -- the potential responsibility of parent companies for anti-competitive conduct by an acquired company before the acquisition itself[1].

1. In the framework of M&A transactions, infringements committed by an acquired company before the acquisition itself may constitute a significant risk for the purchaser

There are **three fundamental principles** which were at stake in the *Lombard Club* case.

The general rule is that a business ("enterprise"/"undertaking") which infringes competition rules must itself answer for that infringement (this rule is known as the "**principle of personal responsibility**"). This means that it falls upon the legal entity operating the business at the time that the infringement was committed to answer for that infringement, even if, at the time of the decision finding the infringement, another legal or natural person has assumed responsibility for operating the business. As long as the entity that operated the business at the time of the infringement exists, the responsibility for the infringement follows that legal entity. The enterprise doing business is the same as before and continues to constitute a going concern and thus the legal entity operating the enterprise continues to be held liable for infringement.

On the other hand, where a business responsible for an infringement of the EU competition rules has ceased to exist or does not exist in an identical legal form at the date that enforcement proceedings are commenced or concluded, the European Commission (and the European courts) apply a "**principle of economic continuity**" test: the application of that test makes it possible to prevent undertakings from escaping penalties imposed by the European Commission by simply changing their identity through restructurings, sales or other legal or organizational changes and thus to ensure the effective application of the competition rules. In such circumstances, the European Commission considers that where, between the infringement and the time when the enterprise in question must answer for it, the legal entity responsible for the operation of that enterprise has ceased in law to exist, it is necessary (i) to establish the combination of material and human resources which contributed to the infringement and then (ii) to identify the legal entity (or natural person) who has become responsible for their operation.

Finally, pursuant to the "**single enterprise theory**", the European Commission, in enforcing the rules prohibiting anticompetitive conduct, may opt to attribute – *at its discretion* – liability for a subsidiary's participation in a cartel to its parent company, provided that the subsidiary was not autonomous in the determination of its behavior but, given the legal and economic relationship between it and the parent, simply complied with directives from the parent. The parent (and its entire group are deemed to constitute together one and the same enterprise (one and the same "economic unit") In this respect, EU competition law see the parent and subsidiary as being part of one and the same economic unit ("enterprise" / "undertaking"). For attribution of responsibility, the temporal reference is the time during which the infringement was committed. Thus, where a subsidiary participates in a cartel and then is transferred to a purchaser before the European Commission has carried out enforcement action and imposed a fine, the Commission has the choice of bringing enforcement action against (i) the former parent (alone), (ii) the subsidiary (alone) or (iii) both the former parent and subsidiary (jointly and severally liable). If the Commission elects to bring the action against the subsidiary alone, this means in cases of a change of control after the infringement, that the purchaser bears de facto the financial and legal responsibility for the fine (not the parent at the time of the infringement). And that is what happened in the *Lombard Club* case.

The ruling of **September 24, 2009** concerned principally collusion within the "**Lombard Club**", a top-level body of senior management of the main Austrian banks (the ruling also concerned collusion amongst the Austrian banks at lower levels of responsibility). In this respect, banks in Austria had a long tradition of making agreements among themselves about interest rates and charges/fees. This was perfectly legal before Austria became a member of the EU, under Austrian national law, which supported the practice, in some measure. On January 1, 1994, the European Economic Area came into being (Austria was an EFTA member) and then, on January 1, 1995, Austria became a Member State of the European Union, and these traditional "clubby" practices became illegal in Austria under Article 81 of the EC Treaty, which prohibits collusion in absolute terms.

In the case, one of the cartel members, GiroCredit, was controlled by a different parent company (Bank Austria group) at the time of committing the infringement, before its purchase by Erste Bank afterwards.

The fact that GiroCredit was controlled by a different parent company at the time of committing the infringement in its individual capacity did not preclude Erste Bank, the new parent company, from being responsible, within its group, for that subsidiary's conduct before the acquisition.

In those circumstances, the ultimate attributability to Erste Bank of responsibility for the infringement committed by GiroCredit as purchaser of its new subsidiary could not be precluded for the sole reason that GiroCredit was controlled by a different parent company at the time of committing the infringement.

This said, under the **single enterprise theory**, the European Commission *could have* attributed responsibility for the infringement to the parent at the time of the infraction, Bank Austria, but it elected not to do so. The Commission attributed sole responsibility to the subsidiary, GiroCredit. Under the **principle of personal responsibility**, GiroCredit, although probably following the directives of its parent, was held responsible for the infringement and a negative decision and fine assessed against it. Thus, after the purchase of GiroCredit by Erste Bank, the latter found that it had purchased a company tainted at the time of the acquisition by a significant undisclosed future liability. In its ruling of September 24, 2009, the European Court of Justice rejected the claim of the purchaser according to which the Commission should have sought out the responsibility of the former parent. According to the Court, the Commission had no obligation to determine whether the original parent could have also been held liable. According to the Court, the Commission could validly limit its investigation to the subsidiary, which would remain liable regardless of its sale to another group and this pursuant to the **principle of personal responsibility**.

2. Is this Risk Important for the Purchaser?

The attribution to parent companies of liability for infringements of EU rules prohibiting cartels committed by an acquired company before the acquisition itself may have significant consequences for a purchaser.

First, in terms of calculation of the fine: under EU rules prohibiting anti-competitive behavior, the maximum fine that can be imposed by the European Commission is 10% of the total worldwide revenues of each entity or group participating in the infringement (in practice, fines, even when substantial, do not (yet) reach that percentage of revenues). In recent years, in the most serious cartel cases, the total of the fines assessed upon the colluding entities has sometimes approached and even exceeded one billion Euros.

Second, the type of inherited liability referred to above may result in a considerable fine increase in any future cartel cases, due to the fact that a repeat offense ("recidivism"). is a significant aggravating factor under the European Commission's fining guidelines.

Finally, it should also be emphasized that the European Commission considers that it has jurisdiction over non-EU entities that sell products and / or services into the EU or make arrangements or conduct their affairs in a manner which has an effect on inter-state trade in the EU. For example, in the "*Wood Pulp*" cartel case, the European Commission applied the EU rules prohibiting cartels to agreements between producers of woodpulp from the United States, Canada and Finland on grounds that their acts had direct, substantial and reasonably foreseeable effects within the EU market.

3. How to Reduce this Risk?

Due Diligence before the transaction is the first response, of course. However, this implies the capacity to detect and understand evidence of anticompetitive conduct which has not yet been discovered by customers or competitors nor any competition authority nor presumably by Target management or the seller.

Moreover, where purchaser is a competitor of Target, there is a risk that antitrust issues arise as a result of the due diligence itself, due to potential exchange of confidential market sensitive information through such exercise. Thus, care must be exercised.

Carefully and skillfully drafted **Representations and *Warranties*** in the contractual documentation will be extremely important for the purchaser in this context.

In order to reduce the risk, the implementation of an ***Antitrust Compliance Program*** could also have significant positive aspects. If the purchaser is considered liable by the European Commission for past infringements of an acquired subsidiary, it will be able to argue that after the acquisition, an Antitrust Compliance Program had been implemented within the whole group, including acquired subsidiaries, and potentially hope to obtain on this basis a reduction in the amount of the fine.

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

Josselin Lucas
Associate
00-32-2-641-74-60
josselinlucas@paulhastings.com

Pierre Kirch
Partner
00-32-2-641-74-64
pierrekirch@paulhastings.com

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[1] European Court of Justice, Erste Bank der Österreichischen Sparkassen AG et al vs. Commission of the European Communities, September 24, 2009, joined cases C-125/07 P, C-133/07P, C-135/07P, C-137/07P.

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