LATHAM&WATKINS

Client Alert News Flash

Latham & Watkins Antitrust & Competition Practice September 9, 2014 | Number 1738

The European Court of Justice Caps Liability for Acquired Companies' Cartel Infringements

The ruling caps fines on companies with historic cartel exposure that are acquired by large companies and increases predictability of future antitrust exposure stemming from pre-acquisition conduct.

On 4 September 2014, the European Court of Justice ruled in *YKK and Others v Commission*[1] that where a company engaged in a cartel is subsequently acquired, the "inherited" liability for fines is capped at 10 percent of the acquired company's worldwide turnover for the year preceding the fining decision.

The judgment is an important and welcome development for large industrial or financial holding companies acquiring smaller companies with exposure to cartel liability, as it allows a buyer to predict with greater certainty the maximum amount of any fines that may be imposed on the target for pre-acquisition conduct.

The judgment thus allows for improved enterprise valuations and will facilitate the negotiation of indemnities. At the same time, however, the judgment is no reason for complacency, as it does not limit the acquired company's liability for civil damages or the acquiror's joint and several liability for fines where the acquired company continues the cartel conduct under new ownership. This is true even if the acquiror causes the cartel conduct to cease shortly after acquisition, and even if the acquiror is a financial investor or private equity fund as seen in the recent Commission decision in *Power Cables*. Acquirors must therefore remain vigilant with respect to cartel risks both in due diligence and in ensuring compliance post-closing.

Background

Article 23(2) of Regulation 1/2003 — which governs the European Commission's powers and procedures in policing cartel infringements — establishes that "[f]or each undertaking and association of undertakings participating in the infringement, the fine shall not exceed 10% of the total [worldwide] turnover in the preceding business year." This statutory cap is designed to avoid fines that addressees of the decision might be unable to pay.

The determination of the legal entities that make up the relevant "undertaking" is of critical importance for the degree of protection afforded by the cap. This is particularly the case in situations in which the corporate group to which the infringing entity belongs changes over time. In the most extreme case, the liability faced by a small, single-product company may multiply if the company is subsequently acquired by a large international conglomerate and the cap is applied to the latter's worldwide turnover.

The Commission's practice with respect to the application of the statutory cap to such situations has so far been inconsistent. Apart from an isolated precedent (*Organic Peroxides*), previous cartel decisions calculated a single 10 percent cap for the overall fine on the consolidated turnover of all legal entities in a group that were held liable for even a small duration of the infringement. Examples of this approach include *Industrial Bags* and *Marine Hoses.* The Commission justified its position by arguing that the 10 percent limit in Article 23(2) of Regulation No 1/2003 is a legal maximum linked to the financial capacity to pay the fine. It should therefore reflect the size of the "undertaking" at the time the decision is adopted.

The Commission showed some signs of reconsidering this approach in the *Prestressing Steel* decision of 2010. In that case, which was handled by this firm, the Commission had initially calculated the 10 percent cap of the entire fine on the consolidated turnover of the ArcelorMittal group, although the joint liability of the parent company had only been established for three out of the 18 years of total duration. As a result, the fines imposed on the subsidiaries for periods for which they were solely liable were a multiple of these entities' turnover. However, following discussions with the companies involved, the Commission decided to withdraw its original decision and adopt a new one where fines were calculated using separate 10 percent caps for the periods of sole and joint liability. As a result, the fines imposed on the subsidiaries were reduced by 93 percent. The Commission justified this turnaround on the basis of exceptional circumstances present in the case. Interestingly, the Commission followed a similar approach in the recent *Ball Bearings* case, stressing again that it was under no legal obligation to do so.

The *YKK* Judgment

In *YKK*, the Court of Justice clarified that the Commission has no discretion in this respect.

In 2007, the Commission imposed total fines of over EUR300 million on seven groups of manufacturers of "fasteners" (zippers) for multiple infringements of EU competition rules.[2] For one of these infringements, YKK Group received a fine of approximately EUR69 million, of which EUR19 million was imposed solely on YKK's subsidiary — YKK Stocko — for an infringement that lasted six years prior to YKK Stocko's acquisition by YKK Group.

In calculating the fine, the Commission used a single 10 percent cap for the entire duration of the infringement calculated on the consolidated global turnover of the YKK Group at the time the decision was adopted. This resulted in a fine on YKK Stocko for the infringement in the pre-acquisition period that was more than 50 percent of YKK Stocko's turnover the year preceding the imposition of the fine.

Before the General Court, YKK Stocko challenged the way the Commission had calculated the fine for the pre-acquisition period of the infringement, arguing that it infringed Article 23(2) of Regulation 1/2003. The General Court rejected the appeal and upheld the Commission's decision.

YKK Stocko thereafter appealed to the European Court of Justice. In the 4 September 2014 judgment, the Court of Justice set aside the General Court's analysis as regards the 10 percent limit on YKK Stocko's fine for the period before its acquisition. In line with Advocate General Wathelet's opinion of February 2014, the Court held that the Commission had erred in using a single 10 percent cap for periods of infringement during which different companies were liable. For the period of YKK Stocko's sole liability, the Commission should have capped the fine at 10 percent of YKK Stocko's own turnover in the year before the decision was adopted, rather than at 10 percent of the consolidated turnover of the YKK Group companies that were not liable for that period. In other words, the Court held, if the infringement for a certain period is attributed solely to a subsidiary and not to the parent company, the 10 percent limit on the part of the fine relative to such period shall be calculated only on the turnover of the liable subsidiary.

The Court dismissed the Commission's approach stating the concept of an "undertaking participating in the infringement" cannot have different scopes when attributing responsibility for the infringement and when determining the 10% upper limit on fines. Moreover, the Commission's approach to calculation of the 10% cap was incompatible with the fundamental principles of personal responsibility, individuality of penalties and proportionality.

Implications

The Court of Justice's judgment brings a much-awaited clarification on a lingering question of EU competition fining rules by solidifying the innovative approach in the revised *Prestressing Steel* decision. A 10 percent cap calculated on the basis of a company's own rather than of the group's turnover can significantly limit the amount of the fine, especially in situations in which for a significant part of the infringement no joint liability exists. This should ensure that fines are proportionate to the size of the company which committed the infringement. The ruling also increases predictability and will facilitate negotiation of indemnities in M&A transactions by allowing a purchaser to put a figure on the potential antitrust liability of the target company for past conduct.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Sven B. Völcker
sven.voelcker@lw.com
+32.2.788.6242
Brussels

Marc Hansen
marc.hansen@lw.com
+44.20.7710.1094
London

Luca Crocco
luca.crocco@lw.com
+32.2.788.6212
Brussels

Andreas Scordamaglia-Tousis
andreas.scordamaglia-tousis@lw.com
+32.2.788.6225
Brussels

You Might Also Be Interested In

EU Revises Conditions for Compatible State Aid in the Energy Sector

Introduction of Class Actions in France: A Growing Threat to Professionals?

Europe's Energy Markets: Navigating the New Commercial Reality

Practical Guide to the U.S. Merger Review Process

Endnotes

[1] Case C-408/12 P *YKK Corp. and Others v Commission* [2014], n.y.r.

[2] Commission Decision of 19 September 2007 in Case COMP/39.168 – PO/Hard Haberdashery: Fasteners.