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NOME	Antonio
Matricola di iscrizione al Dottorato	1467406

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Cartel Liability in M&A Deals: When Prevention is Better Than a Cure

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Ad Anna, solerte compagna di vita e unico amore

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ABSTRACT

This Thesis deals with the cartel risk for the parties of an M&A transaction, with a view to understand which role a pre-acquisition "anti-cartel" audit can play in this respect and, more broadly, in the ambit of the antitrust enforcement system.

The principles of "successor" and "parental liability" for cartel infringements established by the European Courts are identified as sources of liability. The profiles of inadequacy and insufficiency of the traditional contractual allocation of cartel risk are highlighted, also in consideration of the relevant effectiveness limited to the parties.

The Thesis then focuses on proposing an innovative approach to cartel liability risk grounded on two pillars: (i) the central role of pre-acquisition audits in detecting cartels and / or allocating cartel liability risk and (ii) the empirical extension of the effectiveness and, at the same time, the protection offered by private documents apportioning cartel liability risk.

As a result, the possibility of using an audit as a tool to secure the M&A parties from cartel risk is deeply inquired. The analysis covers all the relevant practical and legal aspects connected to the performance and it concludes by proposing a possible structure for the investigation.

Further, the crucial issue of demonstrating how the audit results may be beneficially used to eliminate cartel risk from the transaction is tackled. On the one side, the possibility of using an audit's result detecting a cartel as trigger for leniency is discussed. On the other side, a peculiar method of allocating cartel liability risk following an audit which shows the absence of cartel activities is also proposed. The peculiarity here is due to the empirical solution adopted to extend the effectiveness of such method *vis à vis* a qualified third parties such as a proceeding antitrust authority.

The last part of the dissertation scrutinizes the "anti-cartel" due diligence from a broader perspective by inquiring how its widespread use might affect cartel detection trends and, in general, the fight against cartels. In this respect, a comparison with the ongoing debate on the value of antitrust compliance programs is made and a conclusion will be drawn up also considering possible amendments of the current anti-cartel legislation.

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1. INTRODUCTION

Infringement decisions of the European Commission (hereinafter also the "Commission" or the "EU Commission") in cartel cases have increasingly tended to concern conducts (and sometimes even markets) that may be considered "historic" by the time the infringement decision is ultimately taken.[1]

Although the limitation period for the Commission to impose a fine in respect of infringing conduct is only five years,[2] in respect of a continuing infringement this period only begins to run when the infringement ceases,[3] and the period is paused by any action taken by the Commission or a national competition authority to investigate the infringement.[4]

In any event, such limitation period is only applicable to fining, and not the imposition of liability for an infringement by the Commission which is theoretically unlimited in duration.[5]

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1 A notable example is the Commission's infringement decision in Case COMP/39.605 *CRT Glass* of October 19, 2011 which concerned a cartel which existed during 1999–2004 in relation to cathode ray tube glass, used in traditional televisions and monitors. Most high-end production of CRT televisions and monitors had ceased by 2010, replaced by LCD flat panel technology.

2 Council Regulation 1/2003 of 16 December 2002 on the implementation of the rules of competition laid down in Articles 81 and 82 of the Treaty, OJ L1/1, January 4, 2003 (hereinafter the "Regulation 1/2003").

3 Regulation 1/2003 art. 25(2).

4 Regulation 1/2003 art. 25(3).

5 Under art. 7(1) of Regulation 1/2003 the Commission may make a declaratory finding of an infringement in respect of past conduct if it has a legitimate interest in doing so and on several occasions the Commission has taken an infringement decision without imposing a fine in cases where the limitation period has expired, for example: Case COMP/37.512 *Vitamins*, Commission decision of November 21, 2001, in respect of *Sumitomo Chemical and Sumika Fine Chemicals* (upheld by the General Court on appeal in *Sumitomo v Commission* (T-22 and 23/02) [2005] E.C.R. II-4605); Case COMP/38.337 *Thread*, Commission decision of September 14, 2005; Case COMP/37.860 *Morgan Stanley/Visa International and Visa Europe*, Commission decision of October 3, 2007. In

Furthermore, the development of the case-law concept of the "single and continuous infringement" in the decisional-practice of the Commission, as confirmed by EU court, has enabled the Commission to combine various strands of infringing conducts, sometimes over successive periods of time, into participation in a single continuing infringement, thereby preventing penalties in respect of earlier instances of infringing conducts from being time-barred.[6]

All this means that there may be a significant gap between the end of the infringing conduct and the date when the European Commission actually takes the infringement decision.[7] For instance, taking into account only the 13 cartel infringement decisions adopted by the Commission since 2010,[8] the average time between the cessation of the infringement and the infringement decision,

such cases, while the levying of a fine may be time-barred, the imposition of liability may still serve as the basis for follow-on claims in damages, as well as a basis for a fine uplift for recidivism in the case of future infringements by the same undertaking.

6 See for example, the Commission's finding of a single and continuous infringement in Case COMP/39.899 *Gas Insulated Switchgear*, Commission decision of January 24, 2007, upheld by the General Court in *Siemens v Commission* (T-110/07) [2011] E.C.R. II-477 at [236]–[255] and *Siemens Österreich and VA Tech & Distribution v Commission* (T-122/07-124/07) [2011] E.C.R. II-794 at [86]–[102], where the Commission contended with arguments from the parties that the cartel comprised two separate infringements.

7 Quite apart from the matter of the enforcement of fines, damages actions and consequent contribution proceedings have the potential to bite many years down the line after the infringement decision. While succession issues in respect of such actions would at first glance fall to be determined by national, rather than EU law, it is possible that EU law may well also influence the development of national laws in this area.

8 This takes into account cartel infringement decisions from January 1, 2010 to November 18, 2013. This does not include the infringement decisions in respect of Bolloré in Case COMP/36.212 *Carbonless Paper*, Commission decision of June 23, 2010 and *Mitsubishi and Toshiba* in Case COMP/39.966 *Gas Insulated Switchgear*, Commission decision of June 27, 2012, which were re-adopted by the Commission following successful challenges by these parties before the EU courts. Successful challenges and the re-adoption.

was around 5 years and 9 months,[9] a rather significant interval. In addition, looking at the average time between the actual commencement of the infringement and the infringement decision, this average increases to around 14 years.

During this long period of time, significant changes may have occurred in the ownership, organization or legal form of the entities that are liable for the infringing conduct. For instance, an entity that originally committed the infringement may have been sold to another company by way of a share sale, where it may have been left intact as an operating company, or by way of an asset sale, meaning that such entity may have been simply absorbed into the acquirer, having been dissolved as a legal entity.

In order to discipline the liability aspects of such change of control situations and to avoid the failure of the undertaking committing an infringement to answer for such infringement - due to the disappearance of the legal person responsible for the undertaking's operation - the EU courts have primarily developed and established the case-law principle of successor liability.

As a result of such principle being applied, where assets involved in an infringement are transferred, the acquiring company (hereinafter the "buyer") or the selling company (hereinafter the "seller") or, when the infringement

[9] The largest gap occurred in Case COMP/38.511 *DRAMs*—around 7 years and 11 months, notwithstanding that the Commission closed the proceedings with a settlement decision. The infringement came to an end on June 15, 2002 and the Commission issued its infringement decision on May 19, 2010.

continued after the transaction being made, both of them are called liable for the infringement.

In addition to it but with a more deterrent purpose, EU case-law has also introduced another principle which is applicable to change of control situations. This is the principle of parental liability. Should the company or business object of sale (hereinafter the "target entity") have infringed or be infringing antitrust laws, also the parent companies of both buyer and seller are deemed liable for the infringement (usually, jointly and severally with their subsidiary).

As a consequence, such established principles of EU Competition Law are able to strongly affect the dynamics and success of an M&A deal mainly exposing the relevant parties to the significant risk of being called liable for past or ongoing antitrust violations of the target entity which are unknown or undetectable at the moment of the acquisition.

This Thesis is however interested in focusing and studying the specific consequences of cartel infringements. Cartels are in fact widely known as the most serious, long lasting and undetectable anticompetitive conduct of ever. More precisely, the purpose of this Thesis is to scrutinize and assess cartel liability risk for the M&A parties, with a view to understand which role a pre-acquisition "anti-cartel" audit can play in this respect and, more broadly, in the ambit of the antitrust enforcement system.

In this respect, Chapter 2 thoroughly analyzes the successor and parental liability principles as source for cartel liability risk in M&A context. It investigates the severity of the risk, in terms of probability of exposure, monetary sanctions and other related consequences (e.g. reputational damages). In addition, the Chapter shows the limitedness and weakness of ex post legal arguments and defenses available for the M&A parties to discharge them from such liability.

Chapter 3 describes the traditional approach to tackle cartel liability risk in M&A transactions. M&A agreements normally contain detailed provisions allocating liabilities between the parties through a combination of representations, warranties and rights to indemnification. In this context, cartel liability risk may result to be covered by the specific representations and indemnification clauses classically released by the seller with regards to the target's compliance with law (including antitrust law) and the absence of undisclosed liabilities. The Chapter inquires the legal background and functioning of such provisions and concludes underlining the limited "inter partes" effectiveness of the protection granted.

Chapter 4 represents the core of this Thesis and focuses on proposing an innovative approach to cartel liability risk grounded on two pillars: (i) the central role of pre-acquisition audits in detecting cartels and / or allocating cartel liability risk and (ii) the empirical extension of the effectiveness and, at the same time, the protection offered by private documents apportioning cartel liability risk.

As a result, the possibility of using an audit as a tool to secure the M&A parties from cartel risk has been firstly deeply inquired. The analysis covers all the relevant practical and legal aspects connected to the performance and it concludes by proposing a possible structure for the investigation.

Further, the crucial issue of demonstrating how the audit results may be beneficially used to eliminate cartel risk from the transaction has been tackled. On the one side, the possibility of using an audit's result detecting a cartel as trigger for leniency is discussed. On the other side, a peculiar method of allocating cartel liability risk following an audit which shows the absence of cartel activities is also proposed. The peculiarity here is due to the empirical solution adopted to extend the effectiveness of such method *vis à vis* a qualified third parties such as a proceeding antitrust authority.

Lastly, Chapter 5 scrutinizes the "anti-cartel" due diligence from a broader perspective by inquiring how its widespread use might affect cartel detection trends and, in general, the fight against cartels. In this respect, a comparison with the ongoing debate on the value of antitrust compliance programs is made and a conclusion will be drawn up also considering possible amendments of the current anti-cartel legislation.

This Thesis focuses on the European dimension with due reference to EU competition legislation as applied by EU Commission and Courts. Nonetheless, references to Italian and US system are made with a view of comparing some of the empirical solutions proposed and attribute a juridical qualification through the method of comparative analysis.

2. THE CARTEL LIABILITY AS A RISK

EU law and practice in connection with fines and liability for cartel infringements[10] can have surprising results in the post-closing phase of an M&A deal, due to the Commission's practice – constantly upheld by EU Courts - of imposing fines not only on direct infringers, but also on their successors in law and parent companies together with the factors it uses to calculate fines.

This Chapter analyzes the "successor" and "parental" liability principles as source for cartel liability in the context of an M&A deal. It then assesses the probability of exposure and severity of such risk for the parties, should the target company be involved and fined for cartels wrongdoings.

The difficulties (*rectius* the impossibility) of discharging from such liability recurring to "*ex post*" legal defenses are lastly examined.

2.1 THE RISK FACTORS

This Section will extensively analyze the successor and parental liability rules as applied by EU Commission and courts.

Such exercise is then finalize to demonstrate how the application of such principles is able to affect M&A deals in terms of cartel liability be affirmed.

2.1.1 Successor Liability Rule

Due to the long lifespan of many cartels and the length of the Commission's investigation, companies may only be directly confronted with the potential

10 The European Commission is well known for its very high cartel and other antitrust fines, including fines of almost €1.5 billion imposed in December 2012 on seven participants in a cathode ray tube cartel. To this extent, *see* Commission press release, December 5, 2012: http://europa.eu/rapid/press-release_IP-12-1317_en.htm.

consequences of an infringement after the acquisition of a new corporate identity or after the sale of the relevant business, either as assets or in the form of the entire legal entity.[11] As a result, also in such evolved scenarios, someone has to be made accountable for the infringement.[12]

To this specific purpose, the EU courts have developed the so called "successor liability" rule which is based on the combined application of the principles of "personal responsibility" and "economic / legal continuity".

Under the principle of "*personal responsibility*", "*itself the corollary of the principle of fault, <u>each person is responsible for his own acts</u>. In accordance with the principle that the principle that penalties must be specific to the offender and the offence and, more specifically, a person may be penalized only for acts imputed to him individually. In accordance with that principle, therefore, only the person responsible for the infringement may be punished for that infringement, and, consequently, no punishment may be imposed on any person other than the person at fault*" (emphasis assed).[13] As a result, liability is to be attributed to the legal person who operated the undertaking at the time that the infringement is committed.[14]

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11 See Faull/Nikpay, The EC Law of Competition, Oxford University Press, 2nd edition, 2007, New York, Recital 8.750.

12 'Based on the specific circumstances of the case, the liability will be imputed either to the seller, the buyer or the transferred business'.

13 Conclusions of AG Mengozzi, issued on September 19, 2013 in Joined Cases C-231/11 P, C-232/11 P e C-233/11 P, *Siemens Österreich*, para. 75; see also General Court on May 17, 2011, in Case T-299/08, *Elf Aquitaine SA*, para. 180; Case T-146/09, *Parker ITR srl*, para. 88, e 13-12-2001, Joined Cases T-45/98 e T-47/98, *Krupp Thyssen Stainless e Acciai Speciali Terni*, in OJ, II-3757, para. 63.

14 It should be noted that an important exception to the principle of personal responsibility being applied when the transfer does not imply a change of control (the so called "intra-group exemption"). In such cases, the liability has been found on the economic continuity even in case the transferor's entity has remained in existence as an

The principle of economic / legal continuity integrates the principle of personal responsibility by stating that the responsibility rests anyhow with the entity defined by its "*human and material resources*" (rather than by its form).[15] Such principle be affirmed and applied to prevent the company committing the infringement from failing to answer for it due to the disappearance of the legal person responsible for the undertaking's operation.[16] For this reason, it particularly applies where the entity ceases to exist, either in law or economically.[17]

As a result, under the successor liability principle, on the one side, so long as a legal person remains in existence, it retains its liability (this being also referred to as the so-called "*Anic rule*", after the case in which the principle was

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economically active legal entity. This exemption is designed to ensure the effective enforcement of competition law—if there was no possibility of imposing a penalty on an entity other than the one which committed the infringement, undertakings could escape penalties by simply changing their identity through restructurings, sales, or other legal or organization changes. See in this sense, Case (T-161/05), *Hoechst v Commission* [2009] E.C.R. II-3555 at [51].

15 The determining factor is whether there is an economic and functional continuity between the original undertaking and its successor. Based on these principles, the EU Commission considers that a change in the legal form and/or name of an undertaking does not create a new undertaking free of liability for the anticompetitive behavior of its predecessor where, from an economic point of view, the two entities are identical. See in this respect, Joined Cases T-40-48, 50, 54-56, 111, 113 and 114-73 "*Sugar*", paras. 75-88. The Court noted that the new company assumed all the rights and liabilities of the four cooperatives, used the same name as the former association ("Suiker Unie"), was run for the most part by the same persons, had its registered offices at the same address, and adopted the same conduct on the sugar market.

16 See Case T-6/89, *Enichem v Commission*, [1991] E.C.R. II-1623. See also *ETI v Commission*, Opinion of AG Kokott at [80], where the Advocate General argues that the principle of economic continuity therefore ensures that the person held responsible is the one who gains from any profits and increases in value of the undertaking due to the cartel, and that, as the economically active new operator, this person will conduct itself in future in compliance with competition law.

17 See *ETI v Commission* at [40]; *NHM Stahlwerke v Commissio*n (T 134/94) [1997] E.C.R. II-2293 at [135]–[137], referred to in *HFB v Commission* (T-9/99) [2002] E.C.R. II-1487 at [106].

articulated by the Court of Justice[18]) On the other hand, should the legal person liable for an infringement does no longer exist, the Commission may identify the "*combination of physical and human elements which contributed to the commission of the infringement*"[19] and then impose liability on the legal person which has become responsible for their operation (this is also known as the "*Suiker Unie rule*", after the case in which the principle was articulated by the Court of Justice[20]). For example, the company that "*absorbs*" another company by merger, also absorbs any liability held by the latter for an infringement.[21]

The effect of such rule being applied in the context of an M&A deal is that should the target company have committed a cartel wrongdoing there is the certainty[22] for both parties (or even the buyer alone should the target company be "absorbed")[23] to be held jointly liable with this latter.

2.1.2 Parental Liability Rule

18 See *Commission v Anic* (C-49/92 P) [1999] E.C.R. I-4925 at [145]; see also the conclusions issued by AG Mengozzi on December 19, 2013 in Cases C-231/11 P, C-232/11 P and C-233/11 P, *Siemens Österreich*, para. 75; see also the General Court on May 17, 2011, in Case T-299/08, *Elf Aquitaine SA*, para. 180; 17-5-2013, Case T-146/09, *Parker ITR srl*, para. 88, and 13-12-2001, cases T-45/98 e T-47/98, *Krupp Thyssen Stainless e Acciai Speciali Terni*, in ECLR II-3757, para. 63; ETI v Commission (C-280/06) [2007] E.C.R. I-10893 at [39]-[40].

19 See Case T-6/89, *Enichem v Commission* [1991] E.C.R. II-1623 at [237].

20 See Joined Cases 40-48, 50, 54-56, 111, 113 and 114-73 "*Sugar*", paras 75-88.

21 See T-259/02-264/02 and 271/02, *Raiffieissen Zentralbank Osterreich v Commission* [2006] E.C.R. II-5196 at [326].

22 For more precise considerations about the probability of exposure to the risk, see Subsection 2.2.1 below.

23 Such extension of liability to "innocent" legal entities (just because they purchased some assets has been defined as problematic by some scholars. This would appear with the principle of legal security. See in this respect, Karen Dykjaer-Hansen and Katja Hoegh, *Succession of liability for competition law infringements with special reference to due diligence and warranty claims*, European Competition Law Review, 24(5):203-212, 2003, p. 212.

The Commission and EU Courts use the "*single economic unit*"[24] doctrine and the principle of "*personal liability*" (this latter already discussed in the paragraph above as a basis for successor liability)[25] to extend liability for antitrust violations in general. With more specific reference to cartel infringements, Article 101 TFEU prohibits restrictive agreements and practices between undertakings. Under EU Law, the term undertaking "*covers any entity engaged in an economic activity, regardless of its legal status and the way in which it is financed*"[26] and in light with the "*single economic unit*" principle must be understood "*as*

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24 Under such doctrine, "*an undertaking is constituted by a single organization of personal, tangible and intangible elements, attached to an autonomous legal entity and pursuing a given long term economic aim*". See Case C-19/61, *Mannesmann v. Haute Autorité*, [1962] ECR 675, at paragraph 705. See also, more recently, Case C-407/08 P *Knauf Gips KG v Commission* [2010] ECR 00000. See also the most recent doctrine on this topic, A. Jones, *The boundaries of an undertaking in EU Competition Law*, in Eur. Comp. Journ., 2012, 301; C. Townley, *The Concept of an Undertaking: The Boundaries of the Corpo-ration. A Discussion of Agency, Employees, and Subsidiaries in EC Competition Law: A Critical Assessment*, directed by G. Amato, C. Ehlermann, Oxford, 2007; W. Wils, *The undertaking as subject of E.C. competition law and the imputation of infringements to natural or legal persons*, 25 Eur. L. Rev., 2000, 99.

25 However, it is important to remark that EU Courts have a different approach to such principle when it comes to apply it to support the application of parental liability rule. In this context, the beneficiary of the principle is meant the undertaking as a whole rather than the individual company to whom the decision is addressed (as it is when the same principle is considered as a base for successor liability). For example, the General Court explicitly stated that "the principle of personal responsibility [applies to undertakings rather than companies" in *Nynas Petroleum AB v European Commission*, Case T-347/06, [2012] 5 CMLR 23 at [40]. This application of the principle of personal responsibility to the concept of "undertaking" has been highly criticized arguing that such principle pre-supposes the existence of a person that is responsible while an "undertaking" is simply a construct of EU competition law which lacks legal personality and therefore cannot claim an infringement of its rights (including the principle of personal responsibility). In this sense, see S. Thomas, *Guilty of a Fault that one has not Committed. The Limits of the Group-Based Sanction Policy Carried out by the Commission and the European Courts in EU-Antitrust Law*, in Journal of Comp. Law & Pract., 2012, 11; and A. Winckler, *Parent's Liability: New case extending the presumption of liability of a parent company for the conduction of its wholly owned subsidiary*, in Journal of Comp. Law & Pract., 2011, 231.

26 See Joined Cases C-189/02 P, C-202/02 P, C-205/02 P to C-208/02 P and C-213/02 P *Dansk Rørindustriand Others v Commission* [2005] ECR I-5425, paragraph 112; Case C-222/04 *Cassa di Risparmio di Firenze and Others* [2006] ECR I-289, paragraph 107; and Case C-205/03 *P FENIN v Commission* [2006] ECR I-6295, paragraph 25.

designating an economic unit even if in law that economic unit consists of several natural or legal person".[27] As a result, and following the principle of personal liability, "*when such an economic entity infringes the competition rules, it is for that entity,* […] *to answer for that infringement"*.[28]

Therefore, in case of a cartel infringement made by a certain company, the economic unit as a whole is deemed responsible,[29] independently of any corporate law principle related to the "*piercing the veil*" theory.[30] As a result, the EU Court's position according to which liability for antitrust violations attaches to an entire "*economic unit*", could imply that all members of a corporate group

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27 See, *inter alia*, Case C-170/83 *Hydroterm Gerätebau v. Commission* [1984], E.C.R. 2999, at 11; Case C‑217/05, *Confederación Española de Empresarios de Estaciones de Servicio v. Commission* [2006], E.C.R. I‑11987, at 40; Case C‑97/08 P, *Akzo Nobel and others v. Commission* [2009], E.C.R. I‑8237, at 55, Case C‑407/08 P, *Knauf Gips v. Commissione* [2010], not yet published, at 64.

28 *Id.* . The doctrine has interpreted and described this effect as the "external face" of the single economic unit principle. See in this respect, P. Hughes, *Competition Law Enforcement and Corporate Group Liability – Adjusting the Veil*, in 35 Eur. Comp. L. Rev., 2014, 70, and P. Van Cleynenbreugel, *Single entity tests in U.S. antitrust and EU competition law*, mimeo 2013, www.ssrn.com/abstract=1889232 .

29 See, *e.g.*, Case C-97/08 P *Akzo Nobel and Others v. Commission*, [2009] ECR I-8237, para. 56, ("*Akzo*"); Case C-286/98 P *Stora Kopparbergs Bergslags AB v. Commission* , [2000] ECR I-9925 ("*Stora*"); Case C-107/82 *Allgemeine Elektrizitäts-Gesellschaft AEG-Telefunken AG v. Commission,* [1983] ECR 3151; and Case C-48/69 *Imperial Chemical Industries Ltd. v. Commission*, [1972] ECR 619. Note, however, that identification of a group may raise issues where there is not a single group parent company. See, e.g., Case C-196/99 P *Siderúrgica Aristrain Madrid SL v. Commission*, [2003] ECR I-11005 ("*Aristrain*") (where the Court held that "[t]*he simple fact that the share capital of two separate commercial companies is held by the same person or the same family is insufficient, in itself, to establish that those two companies are an economic unit*" (para. 99)).

30 This imputation of liability to the "economic unit" instead to the legal person responsible for the infringement has been strongly criticized. It has been argued that it is not possible that legal prohibitions (such as the competition rules) are infringed by an "economic entity" which lacks legal personality. See in this sense, among the others S. Thomas, *Guilty of a Fault that one has not Committed. The Limits of the Group-Based Sanction Policy Carried out by the Commission and the European Courts in EU-Antitrust Law*, in Journal of Comp. Law & Pract., 2012, 11.

would be jointly and severally liable[31] for antitrust violations by any member. Notwithstanding such principle, however, the Commission typically imposes fines exclusively on the legal entities directly involved in a violation and their ultimate parent companies (though fines have also been imposed on intermediate holding companies).[32] So, a cartel infringement committed by a subsidiary may be attributed to the parent company if (i) there is evidence of the parent was directly involved in the infringement or (ii), in absence of such direct involvement, the parent effectively exercises a "*decisive influence*" over the conduct of the subsidiary.

On one side, the EU Court has considered the parent company as having actively participated in the infringement in case the employees of the parent company participated in cartel meetings,[33] or employees of the subsidiary participating in the meetings where also members of the management of the

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31 Some scholars have also isolated and pointed out a further specifically problem related to the joint and several attribution of liability. It concerns the uncertainty of EU Commission decisional practice in apportioning the fine between co-debtors and the relationship between them in the case in which one of them has performed the whole. See in this respect, S. Thomas, *Guilty of a Fault that one has not Committed. The Limits of the Group-Based Sanction Policy Carried out by the Commission and the European Courts in EU-Antitrust Law*, in Journal of Comp. Law & Pract., 2012, 11.

32 See, Case C-90/09 P, *General Química SA and others v. Commission* [2011], E.C.R. I-1, at 85-86; Case C-521/09, *Elf Aquitaine SA v. Commission* [2011], E.C.R. I-8947, at 57; Case T-348/06, *Total Nederland NV v. Commission* [2012], not yet published, at 102. Such tendency of the Commission to regularly search and additionally fine the ultimate parent has been strongly criticized for causing higher absolute fines for one and the same infringement and a higher exposure to being classified as a recidivist. In this respect, see, *ex multis*, Bourke J., *Parental Liability for Cartel Infringements*, in GCP: the Antitust Chronicle 1 (November 2009), p. .7.

33 Case COMP/38.857, *Organic Peroxides,* Commission decision of December 10, 2003 para. 373. M. Siragusa and C. Rizza, EU Competition Law, *Cartels and Horizontal Agreements*, Ed. Claeys & Castels page 494.

parent company,[34] or in case the parent company conceived, approved, and directed the infringement by the subsidiary,[35] or the parent company directly implemented certain aspects of the anticompetitive agreement.[36] The Commission may also hold the parent company liable where that company was aware and did not intervene to stop the infringement[37] or "*should have been aware*" of the infringing behavior of its subsidiary.[38] This will be the case in particular where more than one company in a group participated in the infringement.[39]

On the other side, when a subsidiary "*does not decide independently upon its own conduct on the market, but carries out, in all material respects, the instructions given to it by the parent company* [...] *having regard in particular to the economic, organizational and legal links between those two legal entities*",[40] the parent company is meant to exercise "*decisive influence*" over such "infringing" subsidiary and may held be jointly and severally liable for antitrust violations of such

34 Case T-309/94, "*Cartonboard*" paras. 34-47. Case T-31/99 "*Pre-Insulated Pipe Cartel*" paras. 35-36.

35 Case T-31/99 "*Pre-Insulated Pipe Cartel*" 37-39.

36 *Organic Peroxides* decision at 373.

37 Case T-309/94, *NV Koninklijke KNP BT v. Commission* [1998], E.C.R. II-1007, at [49].

38 Case COMP/36.212, *Carbonless paper*, Commission decision of 20 December 2001 at 354. "*Bolloré SA was necessarily informed of its subsidiary's participation in the cartel.*" The ECJ quashed the Decision as to Bolloré based on right of defense grounds. Even though the Commission issued a new Decision and finned Bolloré, it did not put forward this very same argument. However, the Decision of 2001 remains valid for another 10 companies. In the case of the company Zanders, the Commission concluded "*there is no indication that International Paper **knew** about the participation of Zanders to the cartel or was otherwise involved in it*".

39 See Case COMP/36.212, *Carbonless paper*, Commission decision of 20 December 2001 para. 357.

40 *Akzo*, para. 58.

subsidiary. In such circumstance, the burden of proofing that a parent company actually gave instruction to its subsidiary does not lie on the Commission but, instead, the parent company has to demonstrate that the subsidiary acted "*independently*". In order for the parent company to avoid being held jointly and severally liable for the conduct of its subsidiaries, it bears on it the burden to: *"produce any evidence relating to the economic, legal and organizational links between its subsidiary and itself which in its view are such as to demonstrate that they do not constitute a single economic unit*".[41] In order to determine whether a subsidiary conducts independently on the market, account must be taken of all the elements relating to the economic, organizational and legal links that join the subsidiary to its parent company.[42]

In addition to this and according to settled case law[43] confirmed by the recent leading case *Akzo*[44], should the parent company own 100% of the shares of its subsidiary, the exercise of decisive influence can be presumed.[45] In this respect,

41 Case T-12/03, *Video Games,* [2009] II-00909, para. 51 and Case T-175/05, *"MCAA"*, [2009] II-00184, summary publication, para. 96.

42 Case C‑286/98 P, *Stora Kopparbergs Bergslags v Commission* [2000] ECR I‑9925, para. 29; Akzo para. 61 and C‑201/09 P and C‑216/09 P, *ArcelorMittal Luxembourg v Commission and Commission v ArcelorMittal Luxembourg and Others*, (not yet reported), para. 98.

43 See*, e.g.*, joined Cases T-71, 74, 87 and 91/03, *Tokai Carbon Co. Ltd and others v. Commission*, 2005 E.C.R. II-10, para. 60; Case 107/82, 1983 E.C.R. 3151, para. 50, *Allgemeine Elektrizitäts-Gesellschaft AEG-Telefunken AG v. Commission*; Case T-65/89, *BPB Industries Plc and British Gypsum Ltd*, 1993 E.C.R. II-389, para. 149; Case T-354/94, *Stora Kopparbergs Bergslags AB v. Commission*, 1998 E.C.R. II-2116, para. 80

44 Case C‑97/08 P, *Akzo Nobel and Others v Commission,* Rec. p. I‑8237, para. 59.

45 However, if the rebuttal is then successful, the Commission can no longer rely on the 100% shareholding presumption alone, but has to provide evidence that the parent company actually exercised its power over the subsidiary. See in this respect Case T-197/06, *FMC Corp v European Commission*, [2011], CMLR 17 at [109]: where the parent company succeeds "*in demonstrating that the subsidiary does not, in essence, comply with the instructions which it issues and, as a consequence, acts independently on the market, the*

the Commission considers, and the EU Courts have widely confirmed, the existence of a rebuttable presumption that the parent company does, in fact, exercise such a decisive influence.[46] In the *Elf Aquitaine* case, the General Court indicated that the presumption also applies when the parent company holds "*almost all*" of the capital of the subsidiary, *e.g.* 98%.[47] In those circumstances, it is sufficient for the Commission to prove that the subsidiary is wholly owned by the parent company in order "*to presume that the parent exercises a decisive influence over the commercial policy of the subsidiary*."[48]

For the sake of completeness, it should be also noted that the Commission may, but is not obliged to, recur to the presumption in order to attribute liability to the parent company. Following the so called "*double basis*" method, in some cases the Commission has in fact decided to check whether decisive influence was actually exercised (but not that the parent specifically exercised that influence in connection with the illegal conduct) also in situations of wholly or nearly wholly ownership.[49] However, such approach has been more

Commission will not be able to impute to it the conduct of the subsidiary unless the Commission rebuts the evidence".

46 Case 107/82 *AEG-Telefunken v Commission* [1983] ECR 3151, para. 50; C‑97/08 P, *Akzo* para. 60; Case C‑90/09 P, *General Química and others v. Commission* [2011], E.C.R.. I‑1, at [39].

47 Case C-521/09 P, *Elf Acquitaine v. Commission*, paragraph 52; Case C‑90/09 P, *General Química and others v. Commission* [2011], E.C.R.. I‑1, at [40].

48 *Akzo* at 60.

49 See *e.g.*, Case C107/82 *AEG-Telefunken v. Commission*, [1983] ECR 3151, para. 50 and Joined Cases T-109/02, T-118/02, T-122/02, T-125/02, T-126/02, T-128/02, T-129/02, T-132/02, T-138/02, *Bolloré SA v. Commission*, [2007] ECR II-947, para. 132.; Cases C-628/10 P and C-14/11 P, A*lliance One International v Commission* [2012], at [50-53]. In this respect, it should be also specified that should the Commission have used the "double basis" approach in a certain Decision, it does not constitute a "binding precedent" for

and more abandoned by the Commission in the recent years.[50]

Although the presumption does not apply in respect of majority-owned subsidiaries significantly below 100%,[51] the same principle that unlawful conduct performed by a subsidiary can be attributed to its parent entity applies equally where the subsidiary company is a joint venture. [52] In two recent judgments, in fact, the General Court affirmed the liability of the parents of a 50/50 joint venture in which neither parent, by definition, had the ability to give instructions to the joint venture.[53]

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the following Decisions. Differently, once used in the ambit of a proceeding, the Commission shall stick to the same approach also to impute liability to the other undertakings involved.

50 Such recent trend followed the Conclusions presented by AG Kokott on January 12, 2012 in Cases C-628/10 P e C-14/11 P, *Alliance One International Inc.*, para. 62.

51 See, *e.g.*, Cases T-64/06 *FLS Plast A/S v. Commission*, judgment of March 6, 2012, not yet reported, para. 36 (pertaining to a 60% shareholding) and T-65/06 *FL Smidth & Co. A/S v. Commission*, judgment of March 6, 2012, not yet reported.

52 It should be noted that the General Court initially took the position that the presumption that operates where a parent company holds all (or "*virtually all*") of the shares in a subsidiary would also apply to the parents of a 50/50 JV. In this regard, the Court found that "*the situation is analogous to that […] in which a single parent company held 100% of its subsidiary, for the purpose of establishing the presumption that that parent company actually exerted a decisive influence over its subsidiary's conduct*. *See* Cooperatieve Verkoop- en Productievereniging van Aardappelmeel en Derivaten Avebe BA v. Commission ("*Avebe*"), Case T-314/01, 2006 E.C.R. II-3085, para. 138. However, in subsequent judgments, the General Court has retreated from this position, and found that a 50/50 JV does not give rise to such a presumption. *See* Alliance One International, Inc. and others v. Commission ("*Raw Tobacco – Spain*"), Case T-24/05, para. 165. Similarly, in *Fuji*, the General Court confirmed that a minority shareholding also does not give rise to a presumption of decisive influence. See *Fuji Electric Co. Ltd v. Commission* ("*Fuji*"), Case T-132/07, not yet reported, paras 182, 183. This is in line with the Commission's own approach in the case: The Commission had found that the respective stakes alone of the parent companies in the joint venture did "*not allow [it] to presume that they have exercised a decisive influence*" on the joint venture's market behavior in general or its cartel activities in particular, *see Gas Insulated Switchgear*, Case COMP/F/38.899, Commission decision of January 24, 2007, para. 389.

53 See, *Dow case* and *DuPont case*, in which the General Court upheld the Commission's imposition of liability on The Dow Chemical Company ("Dow") and EI du Pont de Nemours and Company ("DuPont"), in relation to conduct by their 50/50 joint venture DuPont Dow Elastomers LLC ("DDE"). The General Court found that Dow's and

The EU Courts have indicated, in this regard, that the mere joint control is not sufficient for holding a parent company liable for the conduct of a jointly-controlled JV. As a result, if, from the one side, joint control confers the ability to exercise decisive influence over the subsidiary, from the other side, imposing liability on a parent company in such circumstances require the Commission to establish that the parent company actually exercised decisive influence over the JV during the relevant period.[54] The assessment of whether a parent company exercised decisive influence over a JV subsidiary takes place on a case-by-case basis, taking into account all the relevant factors relating to the economic, organizational and legal links between the JV and the parent company.[55] The EU Courts have noted that the factors to be considered in this assessment "*may vary from case to case and […] cannot, therefore, be exhaustively listed*."[56] In previous

DuPont's "*negative control*" rights were sufficient to impute liability for DDE's actions. *Dow case*, paras. 78-104; *DuPont case*, paras. 63-83. Such judgments being recently upheld by the Court of Justice, see Cases C-172/12 P, E*l du Pont de Nemours and others v. Commission* and Case C-179/12 P, *Dow Chemical v. Commission* [2013], not yet reported; See also Case T-314/01 *Coöperatieve Verkoop- en Productievereniging van Aardappelmeel en Derivaten Avebe BA v. Commission*, [2006] ECR II-3085, in which the General Court upheld the Commission's imposition of liability on the owner of a 50% share of a contractual joint venture (paras. 137-139). See, however, Case COMP/F/C.38.443, *Rubber Chemicals*, Commission decision of December 21, 2005, in which the parent companies of a 50/50 joint venture were not fined and the Commission held that "[i]*n the case of a joint venture, jointly owned by its parents (and over which none of the parents has de facto or de jure sole control) the joint venture can be presumed to be autonomous from its parent companies (i.e. can be presumed to constitute a separate undertaking with respect to its parents)*", para. 263. See also Case COMP/F/38899 *Gas Insulated Switchgear,* Commission decision of January 34, 2007, in which two parties taking part in the infringement created a joint venture continuing the infringement; the Commission held that the parties' "*choice to pursue their involvement in the cartel by means of a joint venture should not allow them to evade liability for it*", para. 402.

54 See *Alliance One International, Inc. and others v. Commission* ("*Raw Tobacco – Spain*"), Case T-24/05, para. 165.

55 *Raw Tobacco – Spain*, note 54, para. 171.

56 *Ibid*.

cases relating to jointly-controlled (principally 50/50) JVs, the Commission's test for establishing decisive influence appears similar to the one for establishing joint control over an undertaking for purposes of the EU Merger Regulation, *i.e.*, the Commission has typically examined the extent to which the parents are able to determine the strategic commercial behavior of the JV.[57] In addition and as explained in the paragraphs above, the EU Courts have indicated that, when considering the issue of parental liability more generally (*i.e.*, in circumstances other than those involving jointly-controlled JVs), other factors shall be taken into account in determining whether parental liability exists in a given case. Those may include influence of the parent company on issues such as pricing policy, production and distribution activities, sales objectives, gross margins, sales costs, cash flow, stocks and marketing, and all other relevant factors that tie the two companies to one another.[58] For the JVs, the Commission will look at the constitutional documents (JV agreement, articles of association *etc.*) and the operation of the JV in practice in order to determine whether the parent companies exercised "*management power*" sufficient to constitute decisive influence over the JV. As a result and as a matter

[57] *See*, in this regard, Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings, (2008 O.J. C95/1), para. 62.

[58] *Ibid.*, para. 103; *see also* Case T-112/05, *Akzo Nobel NV and others v. Commission*, 2007 E.C.R. II-5049, para. 64.

of fact, in the majority of cases, the parent companies of the JV have been found to be jointly and severally liable for the conduct of the JV.[59]

2.1.3 Conclusions

This Section has extensively explained and discussed how the successor and parental liability rules work under the current system of EU competition law.

Such exercise has been finalized to better understand how the application of such rules becomes a risk factor for cartel liability be applied in the context of an M&A deal. This specific aspect will be analyzed in the following Section 2.2. .

2.2 PROBABILITY OF EXPOSURE AND SEVERITY OF THE RISK

The application of the successor and parental liability regimes in the context of an M&A transaction produces the undesirable effect of exposing both the buyer and the seller (also for their "role" of former and the perspective parent companies) to the risk of being caught liable for past or ongoing cartel activities of the target company. The parental liability rule - working also as multiplier factor for the relevant sanctions – has the additional "side effect" of exponentially expand the severity of the liability (and the related risk).

In this respect then, it should be also noted that the position of the buyer is

59 The EU Courts have held that when the Commission imposes a fine on an entity that must be paid jointly and severally with one or more other entities, the share that these entities must ultimately bear *vis-à-vis* the other entities should be calculated by the Commission. In order to break down the fine, the Commission must, *inter alia*, specify the periods during which the entities were jointly liable for the unlawful conduct of the undertaking which participated in the cartel and, where necessary, the "*degree of liability*" of those entities for that conduct. See Joined Cases T-122/07 to T-124/07, *Siemens AG Österreich, Siemens Transmission & Distribution Ltd. and Nuova Magrini Galileo SpA v. Commission*, Judgment of the General Court of March 3, 2011, not yet reported.

even worsen then the seller.[60] It in fact simply “inherits” the cartel risk as a result of the transaction being made, without no means to have controlled and/or prevented it before. As a result, the buyer can be considered the weakest contractual party *vis à vis* cartel risk.

In light of the above, the following paragraphs will make an assessment of the probability of exposure to the risk and the relevant severity.

2.2.1 The probability of being exposed to the risk

Following the combined application of successor and parental liability rules, there is 100% probability for the buyer and / or the seller to be exposed to the risk of being held liable for the infringements of the target company should a competent antitrust authority ascertain (and fine) after the transaction being made: (i) the target company for having committed a cartel infringement or (ii) the target company being the parent company of a subsidiary that committed a cartel infringement (*i.e.* the cartel risk related to an M&A transaction).

However, the specific positions of the buyer and the seller (considered as separated entities) in terms of probability of exposure to the the risk deserves to be differentiated. The demonstration of such statement is contained in the table herebelow. The table takes into account two difference scenarios in terms of duration of the infringement: (i) a cartel that ceases before the transfer; and (ii) a cartel that lasts also after the transfer.

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60 Differently, the position of the seller appears unaltered. Being the party under which the cartel activity has started and developed, it is exposed to relevant risk of being called liable for such illegal activity in any event and regardless from the transaction being made.

	Cartel ceases before the transfer		Cartel continues after the transfer	
	The seller ceases to exist	The seller remain in existence	The seller ceases to exist	The seller remain in existence
Liability on the buyer	100%		100%	[…]%[61]
Liability on the seller		100%		[…]%[61]

As shown, there is only one case out of eight (possible cases) in which the buyer escapes liability: when the cartel ceased before the transfer being made and the seller remained in existence. It means that the buyer has (singularly) a 87,5% probability to be exposed to the cartel risk related in the context of a M&A transaction. Differently, each time the seller ceases to exists it skips the relevant liability as a whole. As a result, for the seller the probability of being call liable decreases to six cases out of eight. Meaning that for the sellers the probability of exposure to cartel risk in the context of an M&A deal decreases to 75%. These data confirming again the buyer being the weak contractual party *vis à vis* cartel risk.

2.2.2 The severity of the risk

2.2.2(i) Sanctions

<u>The EU Commission fining policy</u>

Subject to a five-year statute of limitations, the Commission may impose fines for EU competition law infringements of up to 10% of the worldwide

61 The allocation of liability between buyer and seller is proportional to the duration of the ownership of the company that committed the cartel infringement.

turnover of the group to which an infringing company belongs,[62] although in practice the Commission's fines rarely approach this ceiling.[63] The Commission provided guidance as to how it calculates fines in its Fining Guidelines published in 2006.[64] The 2006 Fining Guidelines were drafted with a view to increasing the deterrent effect of fines in cartel cases[65] and to encourage companies to "*blow the whistle*" on fellow infringers under the Commission's leniency program.

In general, the amount of a fine is set based on the gravity and duration of the infringement. The Commission first sets the "*basic amount*" of the fine as a percentage (up to 30%), known as the "*gravity*" percentage,[66] of the

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62 Article 23(2) Regulation No 1/2003.

63 See official statistics of the EU Commission at http://ec.europa.eu/competition/cartels/statistics/statistics.pdf .

64 Guidelines on the method for setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003, OJ 2006 C 210/2 (hereinafter the "*2006 Fining Guidelines*"). In 1998, the Commission adopted for the first time guidelines on the method of setting fines, in order to enhance the transparency of its fining policy. After more than eight years of implementation, the Commission deemed it necessary to revise them in order to develop further and refine its policy in this matter in the light of its experience, and adopted the 2006 Fining Guidelines, which are currently in force. For an extensive comment see, inter alia, Wils, Wouter P. J., *The European Commission's 2006 Guidelines on Antitrust Fines: A Legal and Economic Analysis*. World Competition: Law and Economics Review, Vol. 30, No. 2, June 2007.

65 The Competition Commissioner at the time of the enactment of the Fining Guidelines expressly declared that the effect of the 2006 Guidelines would be to increase the amount of fines by a factor of three: "*These innovations are likely to increase average fines, particularly for long lasting infringements in large markets, where fines could well increase by a factor of three. I think all this will make potential cartelists think twice!*". Neelie Kroes, Delivering on the crackdown: recent developments in the European Commission's campaign against cartels, Speech at the European Institute 10th Annual Competition Conference, Fiesole, October 13, 2006.

66 The gravity percentage (or gravity multiplier) will be set taking into account a number of factors, including the nature of the infringement, the combined market shares of all companies concerned, the geographic scope of the infringement, and whether the infringement was, in fact, implemented. In recent cases, the gravity percentage has usually been around 15-20%.

undertaking's "*value of sales*" (turnover) in the relevant market affected by the infringement.[67] The Commission's basic amount is determined on the turnover of the group to which the infringing company belonged in the year prior to imposition of the fine, not to the turnover of the infringing company itself or the group to which it belonged when the infringement ended.[68] The General Court has rejected arguments that basing the fine on the entire buyer group's turnover led to imposition of an excessive fine, noting that "*it would be impractical and completely excessive* [...] *to require the Commission to take account of the evolution of the turnovers of the undertakings at issue throughout the entire duration of the cartel.*"[69] The same principle applies "*where, prior to its acquisition, the company acquired participated in the infringement* [...] *as a subsidiary of another group.*"[70] Thus, in the *Gas insulated switchgear* cartel, the Commission considered that Schneider's liability ended in 2001, when its stake in two of the infringing companies dropped from 60% to 40%, even though Schneider continued to hold a 40% interest in three infringing companies from 2001 to 2004.[71]Therefore, the starting amount of the fines imposed is likely to be higher where the buyer's group is larger than the seller's group, and *vice versa*. The increase or reduction in the total amount of the fine will impact not only the fine imposed on the

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67 *2006 Fining Guidelines*, paras. 19 ss.

68 *Siemens*, paras. 124-126.

69 *Siemens*, para. 127.

70 *Siemens*, para. 141.

71 *Siemens*, para. 142. Instead of using the Schneider group's turnover in 2000 as the starting point for calculation of its fine, however, it used the figure of 40% of the turnover of the buyer's group in 2003, the year prior to the end of the infringement. *Siemens*, para. 175.

infringing subsidiary and the buyer, but also the fine imposed on the seller in respect of the period when the infringing subsidiary belonged to the seller's group.

The basic amount is then multiplied by the number of years the infringement lasted (with any period of more than 6 months counting as a full year).[72] In addition, the Commission adds a so-called "*entry fee*" to the basic amount, irrespective of the duration of the infringement.[73] This is normally set as a percentage of the turnover in the affected market that is close to the "*gravity*" percentage (*i.e.*, around 15-25%).[74] In particular, according to the Fining Guidelines, such an "*entry fee*" will (surely) be applied in cartel cases and may be applied in other types of anti-trust infringements. In other words, the mere fact that a company enters into a cartel could "cost" it at least 15 to 25% of its yearly turnover in the relevant product.

The Commission may then apply aggravating and mitigating circumstances to adjust the fine upward or downward, respectively. Aggravating circumstances may include a party's failure to cooperate with the Commission or its role as instigator or "*ring leader*" of the infringement.[75] An especially

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72 *2006 Fining Guidelines*, para. 24.

73 *2006 Fining Guidelines*, para. 25.

74 The exact percentage will be determined by reference to a number of factors, including those relevant to the gravity multiplier. In practice, it appears that the percentage is typically either the same as the gravity multiplier or slightly lower, in effect adding almost a year to the duration. For this reason, the entry fee can be disproportionately large for an infringement with a relatively short duration. For example, it could add roughly 50% to the fine that would otherwise be imposed for a two-year infringement. *2006 Fining Guidelines*, paras. 25 and 22.

75 *2006 Fining Guidelines*, para. 28.

strong aggravating circumstance is recidivism (repeat offences), as demonstrated by previous decisions adopted by the Commission or national competition authorities applying EC rules.[76] Repeat offenses may increase the basic amount by up to 100% for each previous infringement. As a result, the Commission's fines can be significantly increased where the addressee of the fine or a company controlled by it has previously infringed EU competition law. According to the General Court's judgment in *Michelin*,[77] a fine can be increased for recidivism if *"the Commission could have imposed the fine on the same parent company in both decisions."* Although subsequent judgments have raised questions about whether the parent company must actually have been fined in the prior proceeding for the Commission to be able to increase the parent's fine for recidivism,[78] the application of recidivism-based increases in a change-of-control situation is reasonably clear.

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76 *2006 Fining Guidelines*, para. 28. For a critical view of the Commission's practice in applying such aggravating circumstance see generally, Wils, Wouter P. J., *Recidivism in EU Antitrust Enforcement: A Legal and Economic Analysis (October 31, 2011)*. World Competition: Law and Economics Review, Vol. 35, No. 1, March 2012; M. Barennes and G. Wolf, *Cartel Recidivism in the Mirror of EU Case Law*, [2011] JECLAP, vol. 2, n° 5, p 423 and J. M. Connor, *Recidivism Revealed: Private International Cartels*, 1990-2009, [2010] CPI, vol.6, n° 2, p. 101; K. Nordlander, *The Commission's Policy on Recidivism: legal certainty for repeat offenders?* (2005) 2 Competition Law Review 55-68; A. Winckler, *La récidive en droit européen de la concurrence: Un droit d'exception?*, Concurrences N° 4-2010, 21; L. Truchot, *Le regime de la récidive en matière de pratiques anticoncurrentielles: Garanties et dissuasion*, Concurrences N° 4-2010, 17. .

77 Case T-203/01 *Manufacture française des pneumatiques Michelin v. Commission*, [2003] ECR II-4071, para. 290.

78 In the Case T-144/07 *ThyssenKrupp Liften Ascenseurs v. Commission*, judgment of July 13, 2011, not yet reported ("*ThyssenKrupp*"), the General Court held that a fine cannot be increased for recidivism if the legal entity to be fined had not been fined and had not been addressee of the statement of objections in the earlier infringement decision, since the parent must have had the opportunity in the original infringement proceedings to be heard with its argument that it does not form a single economic entity with the fined subsidiary (para. 319). On the other hand, in the case T-38/07 *Shell Petroleum and Others*

Finally, the Commission may apply the so-called "*deterrence multipliers*" to increase the amount of the fine of large multi-product companies with significant operations outside the specifically affected product market(s).[79] The Commission typically applies a deterrence multiplier when imposing fines on very large multinational companies and where the company has a "*particularly large turnover beyond the sales of goods or services to which the infringement relates*."[80] When possible, the Commission also takes into account the gains resulting from the infringement to ensure that the fine exceeds any unlawful gain. The fact that the deterrence multiplier is based on the turnover of the infringing undertaking also has important consequences in change-of-control situations. In general, the deterrence multiplier is based on the turnover of the group to which the infringing entity belongs at the time of the infringement decision.[81] Thus, it has been held that the turnover of the seller may not be taken into account for determining the deterrence factor of a fine imposed on the target in case the target is sold before the infringement decision is issued.[82] On the other hand, a fine imposed on the seller after the closing of the

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v. Commission, judgment of July 13, 2011, not yet reported ("*Shell*"), issued on the same day as *ThyssenKrupp*, the General Court upheld a fine that was increased for recidivism although the legal entity in that case was not an addressee of the earlier infringement decision. See also, in line with ThyssenKrup, Case T-103/08, *Eni and Versalis v Commission* [2012], not yet reported

79 *2006 Fining Guidelines*, paras. 30-31.

80 *2006 Fining Guidelines*, paras. 30-31.

81 Case T-279/02 *Degussa AG v. Commission*, [2006] ECR II-897, paras. 285 and 288.

82 Case T-217/06 *Arkema France and Others v. Commission*, judgment of June 7, 2011, para. 339. See also Case C-421/11 P, *Total SA and Elf Aquitaine SA v. Commission*, judgment of February 7, 2012, not yet reported, para. 82.

transaction has, in principle, to take into account the reduction of its turnover following the sale of the target.[83]

On the other hand, the basic amount may be reduced where the Commission finds mitigating circumstances, such as where the anticompetitive conduct was encouraged by public authorities or where a company has cooperated with the Commission outside the scope of the Commission's leniency notice.[84] The Commission may also reduce the fine determined in this way under its leniency and settlement policies.[85]

The European Commission's decisional practice and the EU Courts' case-law have however been criticized by industry, scholars[86] and legal practitioners as disproportionate and lacking limiting principles.

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83 Case T-206/06 *Total SA and Elf Aquitaine SA v. Commission*, judgment of June 7, 2011, not yet reported, para. 303. In that case, however, the General Court held that, in view of the small proportion of group turnover generated by the target (around 4%), the sale of the target did not require an adjustment of the deterrence multiplier applied by the Commission upon determining the seller's fine.

84 *2006 Fining Guidelines*, para. 29.

85 See Commission Notice on Immunity from fines and reduction of fines in cartel cases, OJ 2006 C 298/17 (the "Leniency Program") and Commission Notice on the conduct of settlement procedures in view of the adoption of Decisions pursuant to Article 7 and Article 23 of Council Regulation No 1/2003 in cartel cases, OJ 2008 C 167/1 (the "Settlement Procedure").

86 See, among others, J. Lever, Opinion *Whether, and if so how, the EC Commission's 2006 Guidelines on setting fines for infringements of Articles 81 and 82 of the EC Treaty are fairly subject to serious criticism*, BDI – Federation of German Industries (12 November 2007); E. Barbier de La Serre and C. Winckler, *Legal Issues Regarding Fines Imposed in EU Competition* Proceedings (2010) 1 Journal of Competition Law & Practice 327 at 336-337 and *A Survey of Legal Issues Regarding Fines Imposed in EU Competition Proceedings* (2010) (2011) 2 Journal of Competition Law & Practice 356 at 360-361; J.M. Connor, *Has the Commission become more severe in punishing cartels? Effects of the 2006 Guidelines* (2011) European Competition Law Review 27 at 30. See also more generally, L. Ortiz Blanco, *EC Competition Procedure* (3rd edn., Oxford University Press, 2011), chap. 11; C. Kerse and N. Khan, *EC Antitrust Procedure*, (5th edn. Sweet & Maxwell, 2005), chap. 7; Bellamy and Child (p. Roth and V. Rose, (eds.)), *European Community Law of Competition* (6th edn., Oxford University Press, 2008); D. Gerardin and D. Henry, *EC Fining for Competition Law Violation: An Empirical Study of the Commission's Decisional Practice and the Community*

The main criticisms moved to the Commission is in fact about the margin of the discretion it enjoys in calculating fines, allegedly too broad.

In this respect, the Commission, in spite of enjoying a wide margin of discretion[87] as regards the calculation of fines for an infringement of EC competition rules, is bound by the rules established in Regulation No 1/2003 and by the Fining Guidelines, as well as by the general principles of law as interpreted by the European Courts, including the principle of proportionality.[88]

In practice, the Courts have endorsed the Commission´s decisions as long as they keep within the limits imposed by Regulation No 1/2003, that is to say, as long as they take into consideration the gravity and duration of the infringement and provided that the final amount of the fine does not exceed the 10% cap. However, some Scholars[89] believe that staying within the limits set out in Article 23 of Regulation No 1/2003 does not necessarily mean that the

Courts' Judgments' (2005) 1 European Competition Journal 401; F. Castillo de la Torre, The 2006 *Guidelines on Fines: Reflections' on the Commission Practice*, in World Competition, 2010, 359.

87 Joined Cases 100-103/80 *Musique Diffusion Française a.o./Commission* 1983 ECR 1825, para 106 and 108, Joined Cases T-202, 204 and 207/98 *"Industrial Sugar"*, paras 101 and 133-135, and Case T-31/99 *"Pre-Insulated Pipes"*, para 122, and T-220/00 *"Amino Acids"*, paras. 60 and 76.

88 See *inter alia* Judgment of the Court of First Instance of 8 July 2004 in Case T-44/00, *Mannesmannröhren-Werke v. Commission*, ECR II-2223, para. 231; Judgment of the Court of First Instance of 21 October 1997 in Case T-229/94, *Deutsche Bahn AG v. Commission*, ECR II-1689, para. 127; Judgment of the European Court of Justice of 7 June 1983 in Joined Cases 100/80, 101/80, 102/80 and 103/80, *Musique Diffusion Française et al. v. Commission*, ECR I-1825, paras. 120 and 129.

89 See for example, among the others, Ortiz Blanco, Luis, Givaja Sanz, Ángel and Lamadrid de Pablo, Alfonso, *Fine Arts in Brussels: Punishment and Settlement of Cartel Cases under EC Competition Law. Antitrust: between EC Law and National Law*, Bruylant, Bruxelles, 2008.

principle of proportionality has been observed. Since the application of the 2006 Fining Guidelines, the Commission´s calculation will begin by fixing a starting amount which is already above the 10% threshold - which is the case of any firm which operates in only one market, given that pursuant to the new Guidelines the starting amount will equate to 30% of their turnover in that market. In all these cases, if the Commission has greatly exceeded the 10% limit from the outset, any moderation of the initial amount, due, for instance, to a mitigating circumstance, could not affect at all the final amount of the fine. The European Courts have established that the observance of the 10% limit set out in Article 23 of Regulation 1/2003 "*does not prohibit the Commission from referring, during its calculation, to an intermediate amount exceeding 10% of the turnover of the undertaking concerned, provided that the amount of the fine eventually imposed on the undertaking does not exceed that maximum limit*".[90] Nonetheless, such Scholars argue that the fact that a starting amount above the 10% limit does not generally contravene the principle of proportionality does not mean that the Commission has been given one more *carte blanche*.

From another point of view, practitioners have also strongly contested the Commission *marge de manœuvre* by arguing, among the others, it that it infringes art. 7(1) of the *European Convention on Human Rights* (ECHR).[91]

90 Joined Cases 100/80, 101/80, 102/80 and 103/80, *Musique Diffusion Française et al. v. Commission*, ECR I-1825, paras. 120 and 129.

91 Council of Europe, *European Convention for the Protection of Human Rights and Fundamental Freedoms*, as amended by Protocols Nos. 11 and 14, 4 November 1950, ETS 5, available at: http://www.refworld.org/docid/3ae6b3b04.html [accessed 3 October 2014 – Art, 7(1) "*No one shall be held guilty of any criminal offence on account of any act or omission which did not constitute a criminal offence under national or international law at the*

However the EU Courts continue to consistently dismiss such argument by stating that "*the fact that a law confers a discretion is not in itself inconsistent with the requirement of foreseeability, provided that the scope of the discretion and the manner of its exercise are indicate with sufficient clarity, having regard to the legitimate aim in question, to give the individual adequate protection against arbitrary interference*".[92]

<u>The multiplier effect on fines of parental liability rule be applied</u>

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time when it was committed. Nor shall a heavier penalty be imposed than the one that was applicable at the time the criminal offence was committed."

92 Among the others, see Case T-69/04, *SchunkGmbH v. Commission* [2008] ECR II-2567, para 33. See also, *Carbonless Paper* Commission decision, *Vitamins* decision, *Graphite Electrodes* decision and *Pre-Insulated Pipe Cartel* decision. However, in two cases, the Commission imposed increases for deterrence despite the fact that the infringement was imputable to the subsidiary rather than to the parent company (see Luxembourg Brewers decision and Citric Acid decision). In the Methacrylates decision, in which, inter alia, Arkema and its subsidiaries Altuglas International and Altumax Europe, as well as their parent companies at the time Total and Elf Aquitaine, were found liable for participation in a cartel infringement, the Commission imposed a fine of €219.1 million on Arkema and its subsidiaries. Total, which controlled all the companies in the group from April 2000 until the end of the infringement, was held jointly and severally liable for the payment of €140.4 million, and Elf Aquitaine, which held more than 96% of Arkema's share capital throughout the period of the infringement, was held jointly and severally liable for the payment of €181.35 million. In calculating the fine imposed on Arkema and its subsidiaries, the Commission imposed an increase of 200% – based on Total's worldwide turnover – in order to ensure that the sanction would have a sufficient deterrent effect, in the light of the undertaking's size and economic strength. The GC, however, decided to reduce the amount of the said fine to €113.3 million. The Court took the view that, since Arkema and its subsidiaries were no longer controlled by Total and Elf Aquitaine as from May 18, 2006, when Arkema was floated on the stock exchange –i.e., a few days before the Commission adopted its decision –, a 200% increase in the fine by way of deterrent effect is not justified in respect of them. The Court observed that the need to ensure a sufficient deterrent effect for a fine requires, inter alia, that its amount be adapted to take account of the impact sought on the undertaking on which it is imposed, so that the fine is not made negligible or, on the contrary, excessive, in the light of, inter alia, its financial capacity. Therefore, in the Court's view, the objective of deterrence can be legitimately attained only by reference to the situation of the undertaking on the day when the fine is imposed, meaning that, in the case under review, the 200% increase could be justified only in the light of Total's sizeable turnover figures on the day when the fine was imposed. Since the economic unit which linked Arkema to Total was broken before the date on which the decision was adopted, the latter company's resources could not be taken into account in determining the increase in the fine imposed on Arkema and its subsidiaries. The Court thus concluded that a 25% increase was adequate to ensure a sufficiently deterrent effect of the fine: Case T-217/06 "Methacrylates", paras 254-280 and 339-351.

The application of such Fining Guidelines in connection with the parental liability rule – determining, as shown, the involvement of the parent company of the infringer - may lead to the exponential increase of the level and payment of the fine imposed.

First, as the 10% ceiling on fines is set as a percentage of the addressee undertaking‘s turnover, parental responsibility will usually increase the potential size of the fine because the consolidated turnover of the parent company is generally larger than that of the relevant subsidiary. [93]

Second, in calculating a fine, the Commission may apply a ―deterrence multiplier‖ by reference to the addressee undertaking‘s total size and financial resources. In most decisions, the Commission has imposed increases for deterrence in cases where the parent company was liable for the infringement of the subsidiary, since the parent company was financially strong;[94]

Third, when fixing the fine, the Commission may apply an increase in the basic amount of the fine to take into account aggravating circumstances, in particular repeated offence. Accordingly, the imputation of liability to the parent company may lead to an increase of the fine for recidivism where: (a) the parent company was previously condemned for an infringement, even if the past infringement was committed by another subsidiary, including in a

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93 See e.g. *Electrical and Mechanical Carbon and Graphite Products*, [2004] OJ L125/45, para. 318.

94 See *Fining Guidelines*, para. 30.

different sector, or (b) when the parent company was not condemned for the past infringement.[95]

This conclusion sounds even more alarming when confronted with some statistical data concerning those critical factors.

Based on an analysis of cartel prosecution since 2007, recidivism is in fact the principal aggravating circumstance applied by the EU Commission and the deterrence multiplier has been imposed very often in the published decisions varying between 10% and 70% of the turnover of the infringing company.[96] The imposed fines have achieved an amount equal to the 10% maximum turnover ceiling in about 10% of the cases.[97] Moreover, In the last few years, the Commission has issued several decisions and imposed fines amounting overall to billions of euros. Statistical analyses demonstrate that the size and degree of severity of cartel fines (*i.e.*, the *ratio* of a fine to affected sales) have significantly increased since the adoption of the new guidelines for setting fines in

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95 In this respect, in the *Michelin* case the GC rejected the applicant's argument that recidivism is not applicable where in previous infringements only the wholly-controlled subsidiary/ies – but not the parent company – were condemned and sanctioned. The GC noted that, "*since [EU] competition law recognises that different companies belonging to the same group form an economic unit and therefore an undertaking within the meaning of Articles [101 and 102 TFEU] if the companies concerned do not determine independently their own conduct on the market and since, in accordance with the case-law, the Commission, had it so wished, could have imposed the fine on the same parent company in both decisions, the Commission was entitled to consider in the contested decision that the same undertaking had already been censured in 1981 for the same type of infringement*" (Case T-203/01 Michelin/Commission 2003 ECR II-4071, para 290). For a critical view of the Scholars see note 58 above.

96 See Veljanovski, Cento, *Deterrence, Recidivism and European Cartel Fines* (July 14, 2013). Available at SSRN: http://ssrn.com/abstract=1758639 or http://dx.doi.org/10.2139/ssrn.1758639 . Also in this respect, Barennes and G. Wolf, *Cartel Recidivism in the Mirror of EU Case Law*, [2011] JECLAP, vol. 2, n° 5, p 423.

97 See official statistics of the EU Commission at http://ec.europa.eu/competition/cartels/statistics/statistics.pdf .

competition cases in 2006.[98] Fines imposed by the Commission under the 2006 fining guidelines are much higher than those imposed under the 1998 fining guidelines.[99]

This specific multiplier effect of the European Commission's decisional practice – backed up by the EU Courts' case-law - have been again strongly criticized by scholars. In particular, the Commission have been accused to have too much stretched and extensively applied the parental liability rule (especially in cartel cases) with the sole aim of increasing the deterrence effect of the antitrust provisions and the relevant sanctions.[100] In fact, when the "parents" are accountable for the wrongdoings of their "sons",[101] the applicable sanction increases as well as the probability of the sanction being paid since the "parents" are on average more wealthy of their "sons".[102]

98 Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003 (2006/C 210/02).

99 In particular, in the *Car glass* case, the Commission imposed its highest fine per cartel case (€ 3,338 million) and per undertaking for a cartel violation (€ 896 million). See Commission Decision of November 12, 2008, Case COMP/39.125, *Car glass*. In the *Intel* case, the Commission imposed its highest fine ever per undertaking – € 1.06 billion – on Intel for an alleged abuse of dominant position. See Commission Decision of May 13, 2009, Case COMP/C-3/37.990, *Intel*.

100 For arguments in favor of the theory that parental liability rule as shaped by EU Court is necessary to guarantee optimal deterrence see Ackermann, *Deterrence as paradigm: In defense of an effective system of antitrust sanctions* (2010) Journal of Competition Law/Zeitschrift fu¨r Wettbewerbsrecht (ZWeR) 329 et seq.

101 Conclusions of AG Kokott issued on January 1, 2012, in Joined Cases C-628/10 P e C-14/11 P, *Alliance One International Inc.*, not yet published in OJ, para. 1.

102 In this sense, see R. Burnley, *Group Liability for Antitrust Infringements: Responsibility and Accountability*, in World Competition Journal, 2010, 596. S. Thomas, *Guilty of a Fault that one has not Committed. The Limits of the Group-Based Sanction Policy Carried out by the Commission and the European Courts in EU-Antitrust Law*, in Journal of Comp. Law & Pract., 2012, 11; K. Hofstetter, M. Ludesher, *Fines against Parent Companies in EU Antitrust Law: Setting Incentives for "Best Practice Compliance*, in 33 World Comp., 2010, 55, e J.M. Connor, *Has the European Commission Become More Severe in Punishing Cartels? Effects of the 2006 Guidelines*, in Eur. Comp. Law Rev., 2011, 27 ss.

According to some other scholars such multiplier effect may even lead to over-deterrence.[103] Since – as explained - it is basically not necessary for the Commission to show an involvement of the parent in its subsidiary's infringement in order to hold liable the former for the latter, it is in fact argued that seems hard to see from what particular conduct or omission the parent company should be deterred.[104]

2.2.2(ii) Other collateral consequences

The first collateral consequence is a decrease of the corporate value of the companies involved. A recent study[105] which evaluated the impact of European antitrust policy by analyzing the stock market response to investigation announcements, infringement decisions, of a sample of 253 companies involved in 118 European antitrust cases over the period 1974-2004 demonstrated a significantly negative stock price responses of almost -5% around the dawn raid and -2% around the final decision, and a significantly positive response of up to 4% around a successful appeal. These numbers corresponds to a total market

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103 See for example, . L. La Rocca, *The controversial issue of the parent-company liability for the violation of the EC competition rules by the subsidiary*, in 32 Eur. Comp. L. Rev., 2011, 74. To underline the risk of over-deterrence, an author have effectively cited a passage by Cesare Beccaria in *On crimes and Punishments* saying: "*that a punishment may produce the effect required, it is sufficient that the evil it occasions should exceed the good expected from the crime; including in the calculation the certainty of the punishment and the privation of the expected advantage. All severity beyond this is superfluous*" (emphasis added); see E. Barbier de La Serre and C. Winckler, *A Survey of Legal Issues Regarding Fines Imposed in EU Competition Proceedings* (2010) (2011) 2 Journal of Competition Law & Practice 356 at 360-361.

104 See in this respect Thomas, *Guilty of a Fault that ones has not committed. The Limits of the Group-Based Sanctions Policy Carried out by the Commission and the European Courts in EU-Antitrust Law*, in Journal of European Competition Law & Practice, 3, 2012.

105 Andrea Günster and Mathijs A. van Dijk, *The Impact of European Antitrust Policy: Evidence from the Stock Market*, 2011, available at http://ssrn.com/abstract=1598387

value loss of €24 billion around the raid and the decision, of which roughly 75% cannot be explained by fines and legal costs. The stock market thus anticipates a significant decrease in future profitability as a result of European antitrust action. The magnitude of the stock market response depends on the fine, the duration of the infringement, and in particular the size of the firm and media attention. Small firms suffer more from an infringement decision than large firms. Greater newspaper coverage is associated with a more pronounced response, which suggests an important role in terms of reputational effects.

In addition, public antitrust enforcement has a strong facilitating effect on private actions for damages, above all on the so called "follow-on" actions.[106] Indeed, those actions are much easier to bring than stand-alone actions for damages, because the public enforcement action will have established the existence of the antitrust violation, and may also have generated useful evidence as to causation and as to the harm caused to the claimant in the follow-on action. Article 16(1) of Regulation 1/2003 provides that, when courts of the EU Member States rule on agreements, decisions or practices under Articles 101 or 102 TFEU which are already the subject of a European Commission decision, they cannot take decisions running counter to the

[106] "Follow on" actions define those civil action aimed at recovering antitrust damages brought after a competition authority has found an infringement. However, there are also actions for damages which do not follow on from a prior finding of an infringement of competition law by a competition authority but are brought autonomously, for example following the simple initiation of a procedure for antitrust infringement (so called "stand alone" actions).

decision adopted by the European Commission.[107] In other terms, in case the European Commission has adopted a decision finding that one or more undertakings have committed an infringement of Articles 101 or 102 TFEU, a court of an EU Member State ruling on an action for damages brought against one or more of these same undertakings on the basis of the same infringement must take as proven the existence of the infringement.[108] The claimants in the follow-on action for damages need thus only establish the harm they have suffered and the causal link between the infringement and this harm. This binding effect of the finding of a violation of Articles 101 or 102 TFEU of EU decisions only extends to follow-on actions for damages against the same undertakings and based on the same antitrust violation as that found in the Commission decision (same geographic scope, time period, etc.).[109]

107 Council Regulation No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty [2003] OJ L1/1, last amended by Council Regulation No 1419/2006 [2006] OJ L269/1. This provision codifies case law of the EC Court of Justice; see Judgment of 14 December 2000 in Case C-344/98 Masterfoods [2000] ECR I-11427.

108 If the Commission decision has been appealed to the EU Courts, and the appeal is still pending, the national court is also prevented from contradicting the European Commission's finding of the infringement, even if the execution of the European Commission's decision has been suspended by the EU Courts by way of interim measure. The national court can however wait until the EU Courts have decided upon the appeal, and can also refer to the EU Court of Justice a preliminary question under Article 234 EC on the validity of the European Commission's decision; see last sentence of Article 16(1) of Regulation 1/2003. However, if the addressees of the European Commission's decision have failed to appeal against this decision before the EU Courts, or their appeal has been rejected, the decision is definitive vis-à-vis these addressees; see Judgments of the EC Court of Justice of 9 March 1994 in Case C-188/92 TWD Textilwerke Deggendorf [1994] ECR I-846 and of 14 September 1999 in Case C-310/97 P Commission v AssiDomän [1999] ECR I-5363.

109 See Judgment of 19 July 2006 of the United Kingdom House of Lords, *Interpreneur v Crehan*, [2006] UKHL 38, and Judgment of the EC Court of First Instance of 22 March 2000 in Joined Cases T-125/97 and T-127/97 T*he Coca-Cola Company and Coca-Cola Enterprises v Commission* [2000] ECR II-1733.

2.2.3 Conclusions

This Section has demonstrated how the risk factors – successor and parental liability – are able to affect M&A deals by determining a liability risk which probability and severity may not neglected any more.

2.3 LIMITED AVAILABILITY OF "EX POST" LEGAL DEFENCES

This Section will demonstrate the difficulties the parent companies are destined to encounter should they try to challenge in courts the liability and fines inflicted to them as a result of one of its subsidiaries being found guilty of cartel wrongdoings. In this respect, all the relevant case law will be examined and discussed. For the sake of completeness, the critical opinion of scholars and practitioners will be also exposed.

2.3.1 The constant dismissal trend of EU Courts

Should a fine be imposed to a parent company (also as a result of the successor liability be applied), very few (at the limit of inexistence) are the legal arguments that can be used in courts to challenge the EU Commission decision and be discharged from the relevant liability.

On the one side, the cases in which successor liability have been challenged in EU Courts are very few,[110] and this demonstrates the strength of such principle under EU case law and the difficulties in contesting the relevant application.

110 See, for example, *Hoechst v Commission* (T-161/05) [2009] E.C.R. II-3555 at [65] in which Hoechst unsuccessfully tried to challenge successor liability opposing the contractual arrangements entered into between the parties in order to transfer liability for the infringement.

On the other side, the cases in which instead parental liability has been contested are far more common but the relevant outcomes are not encouraging for the claimants.

In this latter respect, the demonstration of not having exercised a decisive influence over the "infringing" subsidiary appears in most of the cases to be the typical "*probatio diabolica*"[111] for the parent.[112] In fact, it is not immediate and easy to *"produce any evidence relating to the economic, legal and organizational links between its subsidiary and itself which in its view are such as to demonstrate that they do not constitute a single economic unit*"[113]. This becoming even more difficult - as we will discuss in the following Chapters - when the infringement is unveiled and contested after the "infringing" company be the object of an M&A transaction in which a change of control occurs. In fact, one of the parties of the transaction – typically the seller (but also the buyer in case it acquires a parent

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111 Several parent companies have claimed in courts that the case law on the "decisive influence" criteria as rule of imputation of liability requires them to perform a *probatio diabolica*. See in this respect, *Elf Acquitaine*, Case C-521/09P, at [65] (and *Elf Acquitaine* (T-174/05) [2009] ECR II-183 [143]); *Arkema SA v Commission of the European Communities*, Case T-168/05, [2009], ECR II-180 at [54]; *Groupe Gascogne*, Case T-72/06, at [37], [64]. See also in this specific respect, Vandenborre and Goetz, *Rebutting the presumption of parental liability – a probation diabolica?*, in International Comparative Legal Guide to Cartels and Leniency 2012, Ch. 3.

112 The difficulties in satisfying such burden of proof is also due to the fact that the Commission is used to indicate in its Decisions only the elements that are not sufficient to exclude that the parent concretely exercised decisive influence on the "infringing" subsidiary. In such a manner, it renders each decision fact specific and allow itself to preserve a wide range of discretion in this respect. See in this sense, F. Ghezzi and M. Maggiolino, *L'imputazione delle sanzioni antitrust nei gruppi di imprese, tra responsabilità personale e finalità dissuasive*, [not yet published].

113 Case T-12/03, *Video Games,* [2009] II-00909, paragraph 51 and Case T-175/05, *"MCAA"*, [2009] II-00184, summary publication, paragraph 96. For a detailed explained list of the factors considered as relevant and taken into account for actually demonstrating (not presuming) the parent's decisive influence see E Islentyeva, *Like father like son – The parental liability under EU competition law today*, in Global Antitrust Review, 4, 2011.

company of an "infringing subsidiary) – loses the ownership connection with the "infringing" company and practically does not any mean to collect the necessary evidences to challenge its indirect involvement.

In addition, when it comes to the 100% shareholding presumption, while the EU Courts continue to hold out the possibility that such presumption is rebuttable, but in fact this presumption has never been rebutted.[114]

However, in some cases the Courts annulled findings that have not been rebutted, but has done so on procedural grounds, essentially failure to state reasons.

In the *General Quimica*[115] case, the companies claimed that the General Court had failed to conduct a concrete examination of each the factors which were raised by them to rebut the presumption of decisive influence. The CJEU upheld that argument and annulled the General Court's judgment considering that "*the [General Court] committed an error of law in affirming (…) that the arguments raised in order to establish such independence could not succeed 'in the light of the case-law cited', without carrying out a* <u>*concrete examination*</u> *of the factors raised*

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114 The only exception appears to be the Spanish Raw Tobacco Decision of 2004, (COMP/C.38.238/B.2). In this case, the Commission stated that: "*apart from the corporate link between the parents and their subsidiaries, there is no indication in the file of any material involvement of Universal Corporation and Universal Leaf in the facts which are being considered in this Decision. It would therefore not be appropriate to address them a decision in this case. The same conclusion would apply, a fortiori, to Intabex insofar as its 100% shareholding in Agroexpansión was purely financial*". See, in this respect, Svetlicinii, Alexandr, *Parental Liability for the Antitrust Infringements of Subsidiaries: A Rebuttable Presumption or Probatio Diabolica?* (October 1, 2011). European Law Reporter, No. 10, pp. 288-292, 2011;

115 Case C-90/09 P, *General Quimica*, [2011] E.C.R. I, paras 60-62, 78. On this specific case see, among the others, Cauffman, Caroline and Olaerts, Mieke, *Química: Further Developing the Rules on Parent Company Liability (October 14, 2011)*. Maastricht Faculty of Law Working Paper No. 2011/33.

by the appellants."[116] According to the CJEU "*the [General Court] was … required to take account of and to conduct a concrete examination of the factors which were raised by the appellants to show that GQ implemented its commercial policy independently*".[117]

In *L'Air Liquide,*[118] *Edison*[119] and *Elf Acquitaine*[120] *case*, the CJEU and the General Court annulled the Commission's decisions for failure to state the reasons why the evidence provided by the defendants was not sufficient to rebut the presumption. In *L'Air Liquide* and *Edison* cases, the General Court considered the Commission's decisions did not address the specific arguments put forward by the incumbents and instead just referred to some additional pieces of circumstantial evidence to show the decisive influence of the parent over the subsidiary. In *Elf Acquitaine* case, the CJEU specified that the Commission merely rendered simple negative or affirmative repetitive and not detailed statements which did not allow the incumbent to know the reasons of its imputability. Both Courts acknowledged that even if the Commission is not obliged to respond to all the allegations put forward by the incumbents, especially in cases where these are out of context, meaningless, or clearly secondary,[121] in the specific cases at stake the Commission could not rule out

116 *General Química* at 79.

117 *General Química* at 78.

118 Case T‑185/06, *L'Air liquide v. Commission,* judgment of June 16, 2011, (not yet reported).

119 Case T-196/06, *Edison SpA v. Commission*, judgment of June 16, 2011 (not yet reported).

120 Case C-521/09 P, *Elf Acquitaine v. Commission*, judgment of at 52 (not yet reported.

121 *Air Liquide* at 71, *Edison* at 72 and *Elf Acquitaine* at154.

that the elements adduced by the incumbent as regards the autonomy of the subsidiaries were devoid of meaning.[122] In *Elf Acquitaine* case, the CJEU held that in cases where a Commission's decision is based exclusively on the presumption of the actual exercise of a decisive influence, the Commission is required to set out adequate reasons why the elements of law and fact put forward by the defendant in order to rebut the presumption were not sufficient. Failure to do so would render the presumption irrebuttable. This duty results from the rebuttable nature of the presumption, which requires the defendant to produce evidence of economic, organizational and legal links between the two companies.[123].

In *Grolsch*[124]case, the parent argued before the General Court that the Commission had breached its obligation to state reasons by having attributed liability to *Koninklijke Grolsch* for an infringement committed by its subsidiary (*Grolsche Bierbrouwerij Nederland BV*), without justifying this attribution of liability. In its judgment, the General Court ruled that if the Commission wished to attribute liability to the parent for the conduct of its subsidiary, it should have provided a detailed statement of reasons as to why it should be attributed.[125] The key point at *Grolsch* is therefore the obligation on the

122 *Edison* at 72.

123 *Elf Acquitaine*

124 Case T-234/07, *Koninklijke Grolsch NV v. Commission*, Judgment of September 15, 2011 (not yet reported).

125 *Grolsch* at 90 *"Il s'ensuit que la Commission a omis d'exposer, dans la décision attaquée, les motifs de l'imputation à la requérante du comportement de sa filiale Grolsche Bierbrouwerij Nederland qui découlerait de la participation des salariés de celle-ci aux réunions litigieuses."* (English version not available).

Commission to expressly explain its reasons for considering the parent liable for the conduct of its subsidiary, thus, providing the companies an opportunity to reverse the presumption of parental liability.[126]

Finally, the only case in which the presumption has been held to be inapplicable[127] on substantive grounds (but again not rebutted) was in *Gosselin*[128] case. Here the the Court first held that the shareholder could not be fined because it was not an undertaking or enterprise. It was a trustee for a family, a stitching or non-profit body. The Court said that *"the mere fact of holding shares, even controlling shareholdings, is insufficient to characterise as economic and activity of the entity holding those shares, when it gives rise only to the exercise of the rights attached to the status of shareholder or member as well as, if appropriate, the receipt of dividends, which are merely the fruits of the ownership of an asset"*. Since the shareholder was not an enterprise, the presumption did not apply to it. That obliged the Commission to rely on the evidence, and the Commission was unable to show that the shareholder had involved itself directly or indirectly in the management of *Gosselin*. The directors of the shareholder met for the first time after the price fixing had ceased. The

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126 Similarly, in *Elf Acquitaine* at 152

127 See for example, Case C-521/09 P *Elf Aquitaine SA v European Commission* [2011] ECR 00000, see paragraphs 53-67. Moreover, the EU Commission has set the following test for rebuttal: to rebut the presumption, it must be shown that under special circumstances of the case where the parent company was not in a position to exert a decisive influence on its "wholly-owned" subsidiary, the latter nonetheless determined autonomously its commercial policy (that is, the parent company, despite its controlling rights, did not actually exercise a decisive influence as regard the basic orientations of the subsidiary's commercial strategy and operations on the market). See, for example, *Commission Decision, PO/Elevators and Escalators*, cited above, paragraph 605.

128 Joined Cases T-208/08 and T-209/08, *Gosselin*, [2011] E.C.R. II.

shareholder's only activity consisted of exercising its voting rights at the shareholders' meeting of *Gosselin*, but during the relevant period no such meeting was held. Three of the six directors of *Gosselin* had later become directors of the shareholder, so that their presence on *Gosselin*'s board was not the result of anything *Gosselin* had done. So the shareholder was not liable because it was not an enterprise, and because it had not exercised any decisive influence over the subsidiary in any way. However, the Court of Justice recently annulled such decision of the General Court arguing that the adoption of formal decisions by the competent corporate bodies is not necessarily required to ascertain the existence of an economic unit composed by the author of the infringement and its controlling entity and differently such unity can be grounded also on informal links, including the personal relationship between the entities by which the economic entity is composed.[129]

In light of the case-law analysed in the paragraphs, it can be concluded that is very difficult (at the limit of impossibility)[130] for a parent company to escape liability once one of its subsidiaries is found guilty of having infringed competition law, particularly for cartel wrongdoings. Moreover and due to the unpredictability of the relevant standard of proof required, the cartel fine

129 Causa C-440/11P, Portielje, para. 68 of July 13, 2013.

130 In favor of the virtual impossibility to escape parental liability see, among the most recent, B. Leupold, *Effective enforcement of EU Competition law gone to far? Recent case law on the presumption of parental liability*, in 34 Eur. Comp. L. Rev., 2013, 579.

would amount to (and sound as) a mere "*sanction at random*" for the parent companies.[131]

2.3.2 The critical approach of Scholars and practitioners

A vast portion of antitrust scholars and practitioners strongly criticizes the parental liability rule as such and also contests that the relevant 100% shareholding presumption can be actually rebutted.[132] Several arguments have been used in this respect.

First, some scholars have based their critiques by challenging the *status quo* of parental liability by reference to fundamental rights. They have grounded such challenges on the circumstance that - although in fact Article 23(5) of Regulation No 1/2003 provides that the decisions by which the Commission imposes fines

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131 This specific definition "sanction at random" used by S. Thomas, *Guilty of a Fault that one has not Committed. The Limits of the Group-Based Sanction Policy Carried out by the Commission and the European Courts in EU-Antitrust Law*, in Journal of Comp. Law & Pract., 2012, 11.

132 Among the most recent see, K. Hofsetter, M. Ludescher, *Fines Against Parent Companies in EU Antitrust Law – Setting Incentives for "Best Practice Compliance"*, in World Competition: Law and Economics Review, 33(1), 2010; E Islentyeva, *Like father like son – The parental liability under EU competition law today*, in Global Antitrust Review, 4, 2011; S. Thomas, *Guilty of a Fault that ones has not committed. The Limits of the Group-Based Sanctions Policy Carried out by the Commission and the European Courts in EU-Antitrust Law, in Journal of European Competition Law & Practice*, 3, 2012; Wahl, Nils, *Parent Company Liability – A Question of Facts or Presumption?* (June 7, 2012). 19th St.Gallen International Competition Law Forum ICF - June 7th and 8th 2012 . Winckler, '*Parent's Liability: New Case Extending the Presumption of Liability of a Parent Company for the Conduct of Its Wholly Owned Subsidiary*', Journal of European Competition Law & Practice 2. (2011): 231, 233; Bronckers and Vallery, *No Longer Presumed Guilty? The Impact of Fundamental Rights on Certain Dogmas of EU Competition Law*, (2011), 34(4), in World Competition Law and Economics Review 535; Vandenborre and Goetz, *Rebutting the presumption of parental liability – a probation diabolica?*, in International Comparative Legal Guide to Cartels and Leniency 2012, Ch. 3; Joshua; Botteman and Atlee, *You Can't beat the Percentage – the parental liability presumption in EU cartel enforcement*, in Global Competition Review, The European Antitrust Review 2012, EU Cartels and Leniency, Briggs and Jordan, *Presumed Guilty: Shareholder liability for a subsidiary's infringement of Articles 81 EC Treaty, 2007*, 8(1) in Business Law International; La Rocca, *The controversial issue of the parent-company liability for the violation of the EC competition rules by the subsidiary*, in 32 Eur. Comp. L. Rev., 2011, 74.

for the infringement of the competition rules "*shall not be of a criminal law nature*"- the rights enshrined in the European Convention of Human Rights ("ECHR")[133] have been held to be applicable to sanctions proceedings in the field of European competition law given that the level of the fines imposed within the framework of such proceedings justifies attributing them a quasi-criminal nature.[134] A circumstance that in the last years has started to be more and more widely accepted.[135]

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133 Council of Europe, *European Convention for the Protection of Human Rights and Fundamental Freedoms*, as amended by Protocols Nos. 11 and 14, 4 November 1950, ETS 5, available at: http://www.refworld.org/docid/3ae6b3b04.html [accessed 14 October 2014]

134 See, in this sense, Judgment of the European Court of Human Rights of 8 June 1976, *Engel and Others v. Netherlands*, Series A nº 22, para. 81; Judgment of the European Court of Human Rights of 21 February 1984, *Öztürk v. Germany*, Series A nº 73, para.para. 46 et seq; and Judgment of the European Court of Human Rights of 25 August 1987, *Lutz v. Federal Republic of Germany*, Series A, n. 123.

135 See Judgment of the European Court of Human Rights of September 27, 2011, Case No. 43509/08, *A. Menarini Diagnostics/Italy*. On the *Menarini* case, see G. Muguet-Poullennec-D.P. Domenicucci, *Amende infligée par une autorité de concurrence et droit à une protection juridictionnelle effective: les enseignements de l'arrêt* Menarini *de la CEDH*, Revue Lamy de la Concurrence: droit, économie, régulation 2012, n. 1; A.E. Basilico, *Il controllo del giudice amministrativo sulle sanzioni antitrust e l'art. 6 CEDU*, AIC, 2011, available at http://www.associazionedeicostituzionalisti.it/sites/default/files/rivista/articoli/allegati/Basilico_0.pdf; and M. Bronckers-A. Vallery, *Business as Usual after* Menarini?, MLex Magazine, 2012, vol. III, No. I, 44. Within the framework of Article 6 ECHR, the ECtHR has developed an autonomous notion of "criminal" charge, which includes those contested in administrative proceedings fulfilling the following conditions: (i) the offences are defined by a general rule, applicable to all citizens; (ii) the rule is linked to penalties in the event of non-compliance; (iii) the sanctions are intended not as a pecuniary compensation for damage but essentially as a punishment to deter re-offending; and (iv) the sanctions are severe. See Judgment of June 8, 1976, Cases No. 5100/71, 5101/71, 5102/71, 5354/72 and 5370/72, *Engel and others/The Netherlands*, para. 82; Judgment of February 21, 1984, Case No. 8544/79, *OÈzturk/Germany*, para. 50; Judgment of February 24, 1994, Case No. 12547/86, *Bendenoun/France*, para. 47. On the criminal nature of EU antitrust fines, see also Opinion of Advocate General Kokott, Case C-97/08, *Akzo Nobel NV and others* v. *Commission*, para. 39 ("The consequence of the *sanctionative nature* of measures imposed by competition authorities for punishing cartel offences - in particular fines - is that the area is at least akin to criminal law"); opinion of Advocate General Vesterdorf, case T-1/89, *Rhone-Poulenc SA* v. *Commission*, para. 3 (referring to the "substance of the [competition] cases, which all broadly exhibit the characteristics of a criminal law case").

On such basis, one strand of scholars,[136] have argued that the attribution to a parent company of liability for an infringement committed by a subsidiary should be applied in a much more restricted manner, otherwise it would be contrary to the principle of presumption of innocence embodied in Article 6(2) of the ECHR and Article 48(1) of the EU Fundamental Rights Charter.[137]

As a result, they claim that the application of the presumption of joint liability of parent companies by the European Commission must comply with the case law of the European Court of Human Rights ("ECtHR") which has expressly stated that "*[p]resumptions of fact or of law operate in every legal system. Clearly, the Convention does not prohibit such presumptions in principle. It does, however, require the Contracting States to remain within reasonable limits in this respect as regards criminal law*". [138] In addition, the ECtHR has established that Article 6(2) of the ECHR "*requires States to confine them within reasonable limits which take into account the importance of what is at stake and maintain the rights of the defence*".[139] Consequently, the attribution of liability to a specific legal person cannot occur in the absence of sufficient evidence which individually

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136 See in this sense, A. Montesa, and A. Givaja, *When Parents Pay for their Children´s Wrongs: Attribution of Liability for EC Antitrust Infringements in Parent-Subsidiary Scenarios*, 29(4) World Competition, Kluwer Law International, pp. 555-574; Ortiz Blanco, Luis, Givaja Sanz, Ángel and Lamadrid de Pablo, Alfonso, *Fine Arts in Brussels: Punishment and Settlement of Cartel Cases under EC Competition Law. Antitrust: between EC Law and National Law*, Bruylant, Bruxelles, 2008.

137 European Union, Charter of Fundamental Rights of the European Union, 26 October 2012, 2012/C 326/02, available at: http://www.refworld.org/docid/3ae6b3b70.html [accessed 15 October 2014] .

138 Judgment of the European Court of Human Rights of 7 October 1998, *Salabiaku v. France*, Series A, n. 141- A, para. 28.

139 *Id.*

incriminates that person,[140] nor can it be based on presumptions not supported by additional solid incriminating evidence, as it is sometimes the case with Commission decisions.

A second strand of scholars[141] have attacked the notion of a rebuttable presumption of liability claiming that it violates the fair trial principle as set by 6(1) of the ECHR.[142] The violation of such fundamental right would have derived from the "peculiar" role played by the EU Commission in antitrust proceedings. It has in fact the double role as the advocate of a specific outcome (that the parent company should be liable) and as the entity deciding on that very outcome (by addressing the decision to and imposing a fine on the parent company).

A third strand of scholars[143] have then raised the further question as to whether the existing case law and Commission practice are sufficient to enable

140 Opinion of Advocate General Kokott delivered on 3 July 2007 in Case C-280/06, *Autorità Garante Della Concorrenza e del Mercato v. Ente Tabacchi Italiani- ETI SpA and Others*, para. 71: "*The consequence of the sanctionative nature of measures imposed by competition authorities for punishing cartel offences – in particular fines – is that the area is at least akin to criminal law. Therefore, what is decisive for the attribution of cartel offences is the principle of personal responsibility, which is founded in the rule of law and the principle of fault. Personal responsibility means that in principle a cartel offence is to be attributed to the natural or legal person who operates the undertaking which participates in the cartel; in other words the principal of the undertaking is liable*".

141 See in this sense , B. Leupold, *Effective enforcement of EU Competition law gone to far? Recent case law on the presumption of parental liability*, in 34 Eur. Comp. L. Rev., 2013, 579.

142 Article 6 ECHR provides, inter alia, the following: "In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within reasonable time by an independent and impartial tribunal established by law" (emphasis added).

143 See, among the others, Bronckers, Marco and Vallery, Anne, *No Longer Presumed Guilty: The Impact of Fundamental Rights on Certain Dogmas of EU Competition Law* (January 10, 2012). World Competition: Law and Economics Review, Vol. 34, No. 4, 2011; Ortiz Blanco, Luis, Givaja Sanz, Ángel and Lamadrid de Pablo, Alfonso, *Fine Arts in Brussels:*

a parent company to ascertain in advance whether it can be held liable for the purported conduct of its subsidiary. In their opinion, the unpredictable decisional practice of the EU Commission and courts would amount to a violation of Article 7 of the ECHR which enshrines, *inter alia*, the principle that an offence must be clearly defined in the law and that this requirement is only satisfied where the individual can know from the wording of the relevant provision and, if need be, with the assistance of the courts' interpretation of it, what acts and omissions will make him liable.[144]

Second, other scholars[145] have claimed that parental liability rule violates the principle of personal responsibility on which – as analyzed in Subsection 2.1.2 above – the same liability rule and the entire EU competition law system is grounded. They specifically contest the position of EU Courts which – in this specific context[146] –conceive the beneficiary of such principle as the "undertaking" as a whole (in the "antitrust" meaning, as explained in Subsection 2.1.2 above) and not the individual companies which have made the

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Punishment and Settlement of Cartel Cases under EC Competition Law. Antitrust: between EC Law and National Law, Bruylant, Bruxelles, 2008.

144 See for instance the Judgment of the European Court of Human Rights of 22 November 1995, *S.W. and C.R. v. United Kingdom*, Series A nos. 335-B and 335-C, para.35. As previously stated, when speaking of "law", Article 7 alludes to the same concept as that referred to by the Convention elsewhere when using that term, a concept which comprises both statute law and judge-made law, and implies qualitative requirements, including most notably those of accessibility and foreseeability.

145 See in this sense, B. Leupold, *Effective enforcement of EU Competition law gone to far? Recent case law on the presumption of parental liability*, in 34 Eur. Comp. L. Rev., 2013, 579; see S. Thomas, *Guilty of a Fault that one has not Committed. The Limits of the Group-Based Sanction Policy Carried out by the Commission and the European Courts in EU-Antitrust Law*, in Journal of Comp. Law & Pract., 2012, 11.

146 It is worth full to point out how the courts' interpretation of the principle of personal responsibility is diametrically different when used in the context of legal succession cases. See in this respect, Subsection 2.1.1 above.

infringement. In such a manner, the responsibility of violating competition law would be attributed to basically a legal concept, the “undertaking”, which lacks legal personality and cannot holds rights (an therefore cannot claim an infringement of its rights).

Lastly, it is worth full to remind and remark that all the repeated attempts to challenge the parental liability rule as such or the irrebuttable nature of the presumption as a violation of the fundamental rights have irremediably failed.

2.4 CONCLUSIONS: THE SERIOUSNESS OF THE RISK AND THE NEED FOR “EX ANTE” PROTECTIVE MEASURES

This Chapter has extensively demonstrated how the principles of successor and parental liability - as constantly applied by EU Commission and courts - generates a liability risk for the parties of an M&A deal. Should in fact the target company be sanctioned for a cartel wrongdoing after the transaction being made, the probability for the former (*i.e.* the seller) and the perspective (*i.e.* the buyer) parent companies to be held liable and fined jointly with the target are close to 100%.

Such statistical data confronted with the severity of the sanctions and the other collateral negative consequences, clearly revealed the importance such risk is going to assume for the parties of an M&A deal.

This is particularly true for financial buyers, such as private equity groups, given that such groups frequently buy and sell companies active in a wide range of industries.[147] Although portfolio companies are not typically integrated into a coherent group commercial policy, this fact may not suffice for a private equity buyer to escape liability, since private equity buyers often appoint one or more members to portfolio company boards and may become closely involved in restructuring a portfolio company's activities in anticipation of an exit. On the other hand, establishing which entities form part of the single economic unit can be difficult where there is no single common parent entity, but rather multiple parallel fund structures. Once group liability is established, the large combined group turnover of disparate portfolio companies can lead to a high cap on the amount of fines that can be imposed for a single infringement. Perhaps even more seriously, this approach can lead to significant increases as a result of deterrent multipliers. Once one portfolio company has been fined for an EU law infringement, moreover, fines imposed for any future violations by the same or other portfolio companies will be subject to potentially significant recidivism increases for an indefinite period.

This said and considering the limited availability of "ex post" legal defenses (as extensively discussed in Subsection 3.3.1 above), it is by then unavoidable

147 See, in this respect, the recent EU Commission decision of April 4, 2014 in case AT.39610 – *Power cables* ruling that Goldman Sachs was jointly liable with the former subsidiary of one of its funds, Prysmian, for the payment of the fine imposed on Prysmian for its involvement in the high voltage power cable cartel. This is because the EU Commission considers that Goldman Sachs exercised "decisive control" over its subsidiary during the period of its ownership. As a result, Goldman Sachs was jointly held liable for Euro 37. 303. 000 of a total amount of Euro 104.613. 000, i.e. for about a third of the fine imposed on its subsidiary. The remainder is shared between Prysmian and its other former parent, Italian tyre maker Pirelli.

that in addition to (typical) merger control issues also cartel liability risk is seriously tackled "ex ante" in any commercial transaction involving the transfer of a business.

This may be (and in some transactions has been already) done by recurring to the traditional measures of contractual nature. M&A agreements typically contain detailed provisions allocating liabilities through a combination of warranties and rights to indemnification for specific matters. In the antitrust context, the most relevant warranties are normally those regarding the target's compliance with law (including antitrust law) and the absence of undisclosed liabilities.

However, as it will be extensively confirmed by the following Chapter 3, such arrangements are valid and effective between the parties (only). This is a general principle of contract law that has been followed by EU courts in order to clarify that contractual arrangements by which a party intends to transfer liability for an infringement cannot be relied upon against the Commission to apportion liability between companies.[148]

This said, contractual arrangements seems insufficient to effectively secure M&A parties from the cartel risk of the transaction. The following Chapter 3 shows in more details the weaknesses of such traditional approach.

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[148] Case T-161/05, *Hoechst v Commission* [2009] E.C.R. II-3555 at [65].

3. THE CONTRACTUAL ALLOCATION OF THE RISK

M&A agreements typically contain detailed provisions allocating liabilities through a combination of representation, warranties and rights to indemnification for each specific matter. The relevant obligations are commonly subject to thresholds and caps, as well as to procedural requirements regarding how warranty and indemnity claims must be presented.

Making specific reference to the antitrust context, the most relevant representations and warranties are normally those regarding the target's compliance with law (including antitrust law) and the absence of undisclosed liabilities. These are all normally released by the seller.

Starting with a presentation of the typical structure of an M&A agreement, this Chapter focuses on the analysis of those provisions specifically aimed at allocating the liability of specific interest for this Thesis: the liability arising to the M&A parties from possible cartel wrongdoings committed by the target company.

Further, the Chapter discusses the legal effectiveness of the said contractual provisions with the aim of discovering whether they offer adequate and effective protection *vis à vis* cartel liability risk.

3.1 THE TYPICAL STRUCTURE OF AN M&A AGREEMENT

This Section extensively discusses the typical structure and contents of the agreements entered into between the parties of an M&A deal with the purpose of regulating the transfer of the target company.

This detailed description is aimed at giving the reader a comprehensive overview of the contractual context on which mechanisms and provisions intended to allocate liability risks (including antitrust risks), further discussed in this Chapter, are inserted in and operate.

3.1.1 The "Purchase Agreement"

Once the parties reach an agreement on the terms of a proposed acquisition, they will typically record their agreement in a legally binding contract. The form of the contract, the identity of the parties, and the extent to which it contains binding provisions vary significantly depending on the nature of the transaction, on the specific agreements of the parties, and on the applicable takeover and stock exchange regulations and securities and corporate laws. For instance, in a transaction involving the acquisition of a public company the prospective acquirer may launch a takeover or tender offer to purchase target shares from the public without any binding agreement, other than perhaps an agreement from the target's management to recommend that shareholders accept the offer and/or a commitment from key shareholders that they will accept the offer (subject to management's duties under applicable corporate and securities laws). Alternatively, an agreement to invest cash or contribute assets to an entity in return for shares may take the form of a subscription or contribution agreement and not involve any sale of assets or outstanding shares.

In view of the huge variety of agreements that may be entered into with respect to a proposed acquisition, this discussion focuses on the most typical terms of a binding agreement between two entities with respect to the investment in a business (the so called and here and after defined "*Purchase Agreement*").[149]

3.1.2 The essential elements

The essential elements of a Purchase Agreement, which are typically set forth as basic terms of the transaction, are the parties' representations and warranties, the pre-closing covenants (and any related indemnification rights), the conditions that must be satisfied prior to the closing or completion of the transaction, the mechanics of the closing, the circumstances in which the agreement may be terminated and any post-closing covenants.[150] Some of these provisions may be included in separate agreements rather than in the Purchase Agreement itself.

This said, the following paragraphs illustrate more in details such basic provisions of the Purchase Agreement.[151]

(1) *Terms of Transaction*. These provisions describe what is being purchased (*e.g.*, the shares or assets) or which entities are being merged, the purchase price or merger consideration, and any post-closing adjustment mechanisms (*e.g.*, earn-out provisions, under which the seller may be entitled to additional

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149 For a more complete overview of the various form of implementation of an M&A transaction see one of the most complete manuals in this respect, *LexisNexis M&A Practice Guide, 2014 Edition*, LexisNexis Electronic, ebook available at http://www.lexisnexis.com/store/catalog/booktemplate/productdetail.jsp?pageName=relatedProducts&prodId=prod-us-ebook-01514-epub .

150 For a more extensive treatment of the topic, see John B. Spitzer, *ALI-ABA's Practice Checklist Manual on Advising Business Clients III: Checklists, Forms and Advice from the Practical Lawyer*, American Law Institute, 2004 or also Eleanor M. Fox and Byron E. Fox, *Corporate Acquisitions And Mergers* (LexisNexis 2011).

151 For a more extensive treatment of such topic see ABA Association – Committee on Negotiated Acquisitions, *The M&A Process, A Practical Guide for the Business Lawyer*, Chicago, 2005.

consideration if the affected business meets pre-agreed financial targets after the closing, or net worth or working capital adjustments, under which a payment may be made by one party or the other based on the target's net worth or working capital as shown on a balance sheet prepared as of the closing date).

(2) *Representations and Warranties*. Representations and warranties are promises made by one party to the other that certain statements of fact are true and correct as of a particular time (typically at signing and again at closing). In the context of an acquisition of sole control over a business, the buyer may represent and warrant only with respect to formalities, such as its own existence, authority to enter into the agreement, and the binding nature of the agreement. The seller will typically give much more extensive representations and warranties with respect to the business being transferred. The purposes of the seller's representations and warranties include: (i) furthering disclosure by the seller (when coupled with disclosure schedules or a separate disclosure letter documenting such issues as the target's contracts, assets, financial information and liabilities); (ii) forming a basis for a condition precedent to the buyer's obligation to close the transaction; and (iii) forming a basis for the buyer to seek indemnification from the seller or even rescind the transaction if a representation or warranty turns out to be incorrect after closing. Representations and warranties, for instance those with respect to the affected businesses' compliance with laws, litigation, and absence of undisclosed liabilities, may deal expressly or implicitly with antitrust issues.

(3) *Pre-Closing Covenants*. Given the fact that the period between signing and

closing is complex and that, during this period each of the parties has legitimate interests in the conduct of the business concerned but the title to the business has not yet transferred, such a period needs a specific regulation of interests. Accordingly, both the buyer and the seller typically enters into covenants to take, or refrain from taking, certain actions during this period. These covenants may cover a wide array of subject matters, but many of them fall into three general categories: (i) covenants that restate certain provisions of the Confidentiality Agreement and/or the Letter of Intent; (ii) covenants aimed at ensuring that the parties take all necessary steps to consummate the transaction; and (iii) covenants aimed at maintaining the integrity of the acquired business and laying the groundwork for the later integration of the target and the buyer.

As just mentioned, the **first** category of pre-closing covenants may restate or supplement certain provisions of a Confidentiality Agreement or Letter of Intent (especially since Purchase Agreements commonly contain a "*merger clause*" providing that any prior agreement with respect to the proposed transaction is terminated and superseded by the Purchase Agreement). These include provisions for keeping confidential, in the period between signing and closing, the confidential information pertaining to the parties and due diligence information. Moreover, such agreements commonly include provisions regarding alternative transactions, as exclusivity clauses prohibiting the parties from pursuing alternative transactions ("*no shop*" clause). To reinforce these provisions or otherwise to try to ensure that the transaction is consummated as agreed, the buyer may seek a break-up fee (typically a fixed amount of cash and/or an amount equal to the buyer's out-of-pocket expenses related to the transaction) requiring the target or the seller to pay the buyer a fee if the transaction is not completed because of an unsatisfied condition precedent. The seller may also seek a break-up fee, termed a "*reverse break-up fee*" or "*forfeit indemnity*", if the transaction is not consummated (*e.g.*, because of the buyer's failure to obtain shareholder or antitrust approvals). This may be paid into escrow at the time of signing of the Purchase Agreement or effected simply by providing for payment of a non-refundable portion of the purchase price upon the execution of the Purchase Agreement. The amount of such a break-up fee is commonly highly debated and negotiated between the parties, and it sometimes leads to litigation. Applicable corporate laws may impose limits on the size of the break-up fees that may be payable, typically measured as a percentage of the value of the transaction.[152]

As to the **second** category of pre-closing covenants, both the seller and the buyer will typically enter into covenants to take actions to bring about satisfaction of the conditions precedent and to consummate the transaction.

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152 In the US market practice, this percentage typically ranges from 2 to 3.5% of the transaction's equity value. For a more specific study on this topic see Michael Weisser & Matthew Cammack, *Shepherding the Deal*, The Deal, Mar. 30, 2007 . See also Houlihan Lokey, 2005 *Transaction Termination Fee Study*, 7 (2006), http://www.directorsandboards.com/DBEBRIEFING/December2006/TerminationFeeStudy2005.pdf . However, it should be also considered that US Courts have indicated that excessive break-up fees are unreasonable and accordingly have recently deemed as such a termination fee of 6.3%. In this respect see, *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.*, Nos. CIV.A. 17398, 17383 & 17427, 1999 WL 1054255, at *2 (Del. Ch. Sept. 27, 1999). In this respect see also, Darren S. Tucker and Kevin L. Yingling, *Antitrust Risk-Shifting Provisions in Merger Agreements After the Financial Collapse*, 2009, electronic copy available at: www.antitrustsource.com; Scott A. Sher and Valarie Hogan, *Getting the Deal Done: Antitrust Risk – Shifting Provisions in Merger Agreements*, in *The Threshold*, Volume XII, Number 1, Fall 2011

Such "*best efforts*" covenants typically cover filing antitrust notifications and procuring antitrust approvals, either in a general covenant or in a separate covenant dealing specifically with antitrust filings and approvals.

The **third** category of pre-closing covenants typically protects the buyer against changes in the nature of the acquired businesses which might occur between the signing of the Purchase Agreement and the closing. The seller commonly undertakes to cause the affected business to continue to operate in the ordinary course of business consistent with past practice and applicable law, to use reasonable efforts to preserve the target's business operations and to refrain from taking certain actions during the pre-closing period without the buyer's consent. The degree of specificity of such "*ordinary-course covenants*" varies. For instance, the seller may be specifically required to continue to comply with applicable laws, pay taxes, perform material contracts (and not to enter into new material contracts) and to maintain existing insurance coverage, while being prohibited from incurring any new material liability, obligation or lien, entering into certain types of contracts, transferring any material assets, establishing any additional employee or retiree benefit plans, terminating any material employment agreement, changing any material accounting policy, entering into any related party transaction, declaring any dividends, issuing new securities (except pursuant to existing obligations), amending its organizational documents or commencing (or settling) any material litigation.

The buyer may also want to commence preparations for the integration of the target with its own business to permit it more quickly to gain the efficiencies or synergies expected from the transaction after closing. The buyer may try to negotiate provisions granting the buyer the right to direct the target's business or to work jointly with the buyer in taking certain actions (*e.g.*, selecting employees to be offered new employment contracts or employees to be fired, rationalizing the organizational structures of the two businesses, or communicating with employees generally to ensure that valued employees do not leave due to the uncertainty prior to closing). In addition, the buyer may want to approach customers together with the seller or even to get involved in setting the target's prices or selecting its customers or product lines. As a business matter, the seller might agree to a higher level of cooperation at this juncture than it would have accepted before the Purchase Agreement was signed, but such cooperation may still raise issues under applicable antitrust rules, especially if the parties are competitors.

(4) *Conditions Precedent*. Under general contract law, a condition precedent is an event which must take place before a party to a contract must perform or do their part. In a Purchase Agreement, there are typically three broad categories of conditions precedent: (i) conditions that the seller must satisfy (or that must be waived by the buyer) before the buyer can be required to close; (ii) conditions that the buyer must satisfy (or that must be waived by the seller) before the seller can be required to close; and (iii) conditions that must be satisfied or waived before either party can be required to close. In general, neither side is required to close the transaction if the other side's representations and warranties are not materially accurate as of the date of the

closing and/or the other side has not materially complied with all of its pre-closing covenants. In addition, the Purchase Agreement often contains additional conditions precedent to the buyer's obligation to close, such as the absence of a material adverse change with respect to the affected business (a "*MAC*" clause), the absence of any court order or injunction prohibiting the closing of the transaction or the existence of litigation challenging the transaction, and the obtaining of consents and approvals. Several of these conditions may have antitrust implications.

(5) *Closing Mechanics*. The Purchase Agreement normally specifies the practical modalities of the closing, which are typically straightforward, and contain an identification of the documentation to be exchanged at the closing (including any ancillary agreements, officers' and directors' certificates, legal opinions and so on) and the payment mechanics (*e.g.*, a wire transfer by the buyer to the seller's account).

(6) *Indemnification*. As a remedy for any breach of the representations, warranties and covenants in the Purchase Agreement, the parties may rely on breach of contract claims or they may (and typically do) negotiate indemnification provisions identifying the conditions under which each party is responsible for covering losses resulting to the other from such a breach by the first party. The parties will agree on the survival period of the representations and warranties and perhaps monetary limitations (such as "*caps*" and "*baskets*") on rights to indemnification.

(7) *Termination Provisions*. The Purchase Agreement will also address the

circumstances in which it may be terminated by each of the buyer and the seller. The parties may agree a deadline, or "*drop dead date*," after which either party may abandon the transaction if the conditions precedent to its obligations have not been satisfied or waived, in some cases subject to the possibility of extension, for instance because of a delay in obtaining antitrust approvals.

3.1.3 Conclusions

This Section examines in details the most typical provisions of the Purchase Agreement with a view of offering the reader an overview of the framework within which the contractual mechanisms and provisions aimed at allocating liability risks are inserted in and operate.

Following such brief introduction, the following Section is then specifically dedicated to explore and discuss, among the said contractual provisions, those which are specifically aimed at allocating cartel liability risk.

3.2 THE SPECIFIC PROVISIONS AIMED AT ALLOCATING CARTEL LIABILITY RISK

Most of the provisions of a Purchase Agreement normally do not relate with antitrust issues. However, Purchase Agreements typically contain few - but extremely important - provisions dealing with the parties' allocation of antitrust-related risks.[153]

153 For the sake of completeness, one of the most important antitrust risks typically dealt within M&A agreement is the parties responsibilities to make antitrust notifications and to obtain antitrust approvals. For example, the seller may seek a representation to the effect that only certain specified antitrust approvals are required. Such a representation works together with other provisions in the Purchase Agreement, such as pre-closing covenants, conditions precedent to closing, termination provisions and indemnification provisions, to allocate antitrust approval risks. With regards to this specific antitrust

This Section is however dedicated in examining the M&A contractual practice in allocating, among the antitrust risks, the one of specific interest for this Thesis, the cartel liability risk.

The first part of the Section analyzes the most common methods of contractual apportioning cartel liability risk. The so called "clean" or "plain vanilla" representation and the related indemnification provisions, both typically released by the seller which bears the risk of violation.

The second part enters more into the dynamics of M&A negotiations. It gives some valuable examples of how the seller may indeed try to mitigate the said allocation of liability and risk by negotiating more "friendly" covenants. Also the buyer side is analyzed since this latter, if conscious of the significance and probability of the risk at stake, may also try to negotiate more protective covenants.

3.2.1 The "clean" representations, warranties and indemnification provisions

In the usual M&A market practice, the cartel liability risk is not contemplated in any specific provisions. The seller's representations and warranties with respect to the target company may however contain express promises regarding – in general and more broadly - the absence or extent of general antitrust liabilities (thus including and covering liability deriving from cartel infringements). In addition, even in case antitrust issues are not expressly

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risk, see, among the others the following contributions from commentators, A. Scott and V. Hogan, *Getting the deal done: antitrust risk-shifting provisions in merger agreements*, accessible on http://www.wsgr.com/ PDFSearch/sher_fall11.pdf, p. 78; R. Steu, J. Simala and J. Roberti, *Competition law in merger transactions: managing and allocating risk in the new normal*, Competition Law International, Vol. 9, No. 1, April 2013, p. 42.

addressed, such issues may be also addressed indirectly, for instance in representations and warranties relating to the target's financial statements, compliance with laws, litigation and absence of undisclosed liabilities.[154]

However, in the recent years the sensitiveness of M&A parties to cartel liability issues has increased in a quasi-direct proportional manner with respect to the level of sanctions imposed by the EU Commission for cartel violations.[155]

As a result, it is not any more infrequent to find a Purchase Agreement which contains a specific provision dealing with cartel liability.[156] In the vast majority of cases, such provision is the so called "clean" or "plain vanilla" representation.[157] This is basically a representation issued by the seller through

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154 See in this same sense, J. R. Modrall, *Competition law issues in the M&A deal process*, in European Merger Control Law, Ch. 25, para. 25.03[1][a] (Matthew Bender 2012).

155 A good example of this increased sensitiveness may be given by the alarming tone with which some authors commented the recent condemnation of a private equity found, Goldman Sachs, in the recent case AT.39610 – Power Cables decided by the EU Commission on April 2, 2014. In this respect, see for example Kaye Scholer LLP Dr. Sebastian Jungermann and Jens Steger, *Parent companies remain rich targets as EC allocates antitrust liabilities in cartel case*, available at http://www.lexology.com/library/detail.aspx?g=3013e395-6730-4b8c-a8de-d932459fb6ec ; L. Lindberg and J. Kakela, *Buyer beware! : European Commission confirms private equity investors' potential cartel liability for portfolio companies*, available at http://www.krogerus.com/insights/archive/buyer-beware/ ; R. Vidal, L. Penny and R. Graig, *Private Equity and Competition Law Risks*, available at http://www.taylorwessing.com/fileadmin/files/docs/PEP_competition.pdf .

156 See for example what a very well-known international law firm publicly advises to its private equity clients following the EU Commission decision on the cited Power Cable case : Client Publication by Shearman and Sterling LLP, *Cartel Fines: Liability of Private Equity Funds, available* at http://www.shearman.com/~/media/Files/NewsInsights/Publications/2014/04/Cartel-Fines-Liability-of-Private-Equity-Funds-Antitrust-04072014.pdf .

157 See in this same sense, Karen Dykjaer-Hansen and Katja Hoegh, *Succession of liability for competition law infringements with special reference to due diligence and warranty claims*, European Competition Law Review, 24(5):203-212, 2003, p. 212.

which it represents and warrants to the buyer that the target company did not commit any cartel wrongdoing or – more broadly – that the target company is not a party to particular types of agreements with potential antitrust implications (such as non-compete covenants or restrictive agreements). Naturally enough, this is a representation which may be issued only by the seller and which protects only the buyer. The seller is in fact the party that has managed and controlled the target company for years. Hence, the seller is the party which had the chance to control cartel risk and consequently is the most appropriate party by which such risk shall be borne.

Moreover, another instrument which is used in order to allocate cartel risk is by indemnification provisions.[158] The parties to a transaction often negotiate indemnification provisions identifying the conditions under which each party is responsible for covering losses resulting from the inaccuracy, breach or violation of representations, warranties or covenants. For example, if the seller failed to disclose existing antitrust (or cartel) liabilities that later come to light, the buyer might be able to claim indemnification from the seller for any losses it suffered as a result.

Indemnification provisions usually contain negotiated conditions relating to the procedure for making claims, including time limits and monetary thresholds. The time limit for making claims under these provisions is typically one to two years, with longer periods for certain types of liability, such as tax or

158 *Id.*

environmental liabilities. In these cases, indemnification provisions in a Purchase Agreement may survive for the entire applicable statute of limitations. However, determining the appropriate time limits for making claims with respect to antitrust-related liabilities may be complex. If the acquired business has taken part in a cartel, the statute of limitations for actions by the Commission is normally five years, although this period may be interrupted or suspended.[159]

3.2.2 Juridical nature of representations, warranties and indemnification provisions

The system of contractual representations, warranties and indemnification provision have been imported into M&A practice from US legal system.[160] Differently, in the civil law systems, such contractual provisions are not generally and specifically regulated by black letter law. So, the relevant legal status and remedies available in the event of an infringement have long been debated by academics and case-law.[161]

Two main theories have been advanced on the legal nature of representations and warranties. According to the first, the acquisition of

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159 Article 25 (1), Regulation 1/2003, 2003 O.J. L1/1.

160 See in this respect, S. MacKenzie, *Acquisitions: Look Before You Buy*, in Compliance Monitor 18, 3, 2005.

161 To definitively resolve such dispute about the legal nature of representation and warranties in the ambit of the transfer of a business, the Italian Government has recently presented to the Lower Chamber a project of law (n. 1610) aimed at "Introducing Section IV-bis od Chapter I of Title III of the Fourth Book concerning the sale of business and shareholdings". Here, the project fixes a uniform statutory limitation period of 5 years for the claims deriving from the breach of representation and warranties.

interests in the corporate capital of a target constitutes an indirect purchase of the target's business and assets. Consequently, representations and warranties should be regarded as promises about the qualities and characteristics of the target's assets. On this interpretation, the rules on the sale of goods apply.

Under the second theory, representations and warranties are not deemed to be promises given by the vendor to the acquirer, as the acquisition of the target's interests is not an indirect sale of goods. Rather, the sole purpose of the acquisition agreement is to acquire interests in the target; the representations and warranties are merely a contractual obligation; more specifically an insurance obligation of the party which release the representation or warranty to indemnify the other should a certain negative event occur.[162]

In terms of the legal remedies available to the buyer in the event of infringement, the two theories lead to different conclusions and have indeed different litigation implications.

If the sale of goods rules are deemed to apply, they entitle the acquirer to sue the vendor in the event of misrepresentation by the vendor. This would give the acquirer the right to seek compensation for damages, termination of the agreement or a reduction in purchase price within a short-term statutory limitation period.[163]

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162 See John B. Spitzer, *ALI-ABA's Practice Checklist Manual on Advising Business Clients III: Checklists, Forms and Advice from the Practical Lawyer*, American Law Institute, 2004 or also Eleanor M. Fox and Byron E. Fox, *Corporate Acquisitions And Mergers* (LexisNexis 2011).

163 For example, in Italy this circumstance would be regulated by Article 1495 of the Italian Civil Code pursuant to which the buyer would have the right to seek compensation for

Under the second theory, the short-term statutory limitation period do not apply. On this analysis, in the event of a breach or misrepresentation, the acquirer may sue the vendor within the ordinary long term limitation period (as in the case of any other breach of obligation).[164]

Therefore, the buyer typically adopts certain precautions when drafting the Purchase Agreement, taking into consideration the possibility of future litigation in the event that the representations and warranties are infringed. In this respect, the Purchase Agreement specifically states that the purchase of the interests and assets to which the representations and warranties relate is only a partial performance of the deal. Such a provision seeks to prevent the representations and warranties from being characterized as qualities of the target's goods. The aim of such a provision is indeed to clarify the intention to identify the representations and warranties as contractual obligations (rather than promises about the qualities of the target's assets), and to make any subsequent legal action by the potential acquirer subject to the long-term statutory limitation period (rather than the shorter one provided by the discipline of the promises about the qualities of goods). In addition, the Purchase Agreement provide also a contractual indemnity procedure, other than the legal remedies set forth by the applicable law, as a basis for the

damages, termination of the agreement or a reduction in purchase price within the statutory limitation period (*i.e.* one year from closing), provided that the acquirer informed the vendor of the misrepresentation within eight days of becoming aware of it. Although the parties may extend the eight-day term, the one-year statutory limitation cannot be modified by agreement.

164 *Id.* In Italy, the statutory limitation period for the breach of contractual covenants is 10 years pursuant to 2946 of the Italian Civil Code.

application of the ordinary, long-term, statutory limitation period.

3.2.3 Typical Seller's "friendly" covenants

As noted, under a typical Purchase Agreement, the seller is required to compensate the buyer for liabilities of the target company arising from a breach of warranty, including for the target's breach of competition law to the extent such liabilities are not disclosed against the warranties. These obligations often apply for a negotiated number of years, but, in the case of violation of law, they may apply for the entire statute of limitations. Caps and other limitations may be negotiated on the amount of liabilities to be covered. The seller often has the right to control the conduct of litigation against the target that may give rise to liabilities covered by the warranties under the acquisition agreement.

From the seller's perspective, a number of modifications to traditional Purchase Agreement clauses may be appropriate to take account of the EU antitrust law issues discussed above. Potentially affected provisions include those relating to (i) the period for which the warranties will survive closing, (ii) the amount of liabilities covered by the warranties, and (iii) the seller's procedural rights in respect to proceedings giving rise to warranty claims.

As regards the survival period of the warranties, Purchase Agreements often limit the seller's obligations to a relatively short period after closing (typically one to three years), but in the case of liabilities arising from a violation of law, a Purchase Agreement may provide that the seller's obligations will survive for the entire statute of limitations applicable to the breach. Although – as already mentioned - the EU statute of limitations is five years, this period only begins to run for the target from termination of the violation whilst for the seller, this period begins to run from the closing of the sale. If the target continues to participate in a cartel post-closing, therefore, the seller's exposure can be prolonged indefinitely. To avoid this risk, if no shorter period applies, the seller may want to limit its obligations for EU antitrust infringements to the statute of limitations or five years, whichever is shorter.

The issues discussed above may raise issues concerning the amount of the seller's exposure from at least two perspectives. First, if the seller has negotiated a cap on its liability, the seller will want to ensure that fines imposed directly on the seller, and not only on the target or members of the buyer's group, are included in the cap. The seller may also want to negotiate requirements for the buyer and/or the target to indemnify the seller for "excessive" fines imposed on the seller. Such a provision may be appropriate, for example, where the seller is not making extensive warranties about the target's business, for instance in the case of a private equity seller that purchased the target as a financial investment and is selling the target "as it is". Similarly, the seller may want to confirm that the sale agreement adequately deals with joint and several liability where the buyer may be liable for the target's fine but claim reimbursement for all or part of that fine (or *vice versa*).

Second, the seller may want to protect itself against the risk that its exposure may be increased by the buyer's group turnover (which may affect the entry fee and deterrence multiplier) or the target's continued participation in the cartel (which may result in application of a larger duration multiplier). Although a

Purchase Agreement would typically limit the seller's exposure to liability that arose as a result of the target's conduct on or before closing, in view of the complexity of the Commission's approach to fines, determining the seller's liability may not be straightforward. The seller may seek a more specific provision, for instance that it will not be required to compensate the buyer or the target for any amount in excess of the fine to which it would have been subject in the absence of the sale assuming the infringement terminated as of the closing date.

A seller may also want to customize in a protective way the procedures applicable to warranty claims in light of the possibility to obtain reductions of EU fines by cooperating with the Commission. Purchase Agreements typically require buyers to notify the seller promptly if a third party asserts a claim for which the buyer may make a warranty claim. As discussed above, such provisions are insufficient for the seller to benefit from a reduction in its own fine, and the seller may be unable to influence conduct that could be expected to reduce the target's fine. To increase the possibility that the target may benefit from a fine reduction or even a total immunity under the Leniency Program, however, a seller may require the buyer or the target to notify the seller immediately upon becoming aware of facts that could make an internal investigation appropriate aimed at discovering possible cartel activities. It might be also the case that the seller requires to review the typical provisions giving it the right to control third-party claims to ensure that they are broad enough to cover internal investigations by the target and cooperation by both the target and the buyer with the EU Commission.

3.2.4 Buyer's "friendly" covenants

The buyer's concerns about typical Purchase Agreement provisions are indeed to a large extent the mirror image of the those of the seller. From the buyer's perspective, it is useful to distinguish between the treatment of liability imposed directly on the buyer and the treatment of the target's liability.

As discussed above, an instrument that a seller - concerned about exposure to antitrust fines - could use is negotiating an exception to warranty obligations lasting for the entire statute of limitations applicable to the target. In order for such an exception to be useful and powerful, it should last and continue to be valid indefinitely if the target continues to participate in a cartel after closing. In order to face such an exception, the buyer may resist such a limitation on the basis that the extension of the EU statute of limitations in cartel cases reflects the fact that cartels can continue undetected for many years, and the seller should not escape liability for an infringement that began when the seller controlled the target and of which the buyer may have been completely unaware. A financial purchaser with no prior involvement in the relevant markets and no reason to suspect that a violation is occurring may have better chances to defend this position on the negotiations table than an industrial buyer, particularly if other members of the industrial buyer's group are also involved in the cartel (in which case, the buyer arguably should have known about the infringements of existing subsidiaries and have anticipated that the target might also have been involved).

The buyer may also argue that the seller's warranty obligations should cover not only fines imposed on the target but also fines imposed on the buyer as a result of the target's conduct, following the parental liability rule established under EU completion law (as extensively discussed in Chapter 2). Since the buyer will only be exposed to fines in respect of infringements that continued after the buyer acquired control, the seller is likely strongly to resist such an argument. As already analyzed, if the target continues to participate in a cartel after closing, however, the buyer may be exposed to fines even though it was not involved in or even aware of the infringement. Thus, the buyer may argue that it should at least be protected against liability resulting from target infringements that continue post-closing, at least during a reasonable transition period. Again, a financial buyer that could not be considered to be "on notice" of the violation may be better placed to defend this position than an industrial buyer whose other subsidiaries may also be involved in the cartel.

Even assuming that the buyer is compensated only for fines imposed directly on the target for violations that occurred before closing, the buyer will want to ensure that the seller's warranty obligations cover the entire fine, including increases due to the turnover of the buyer's group (assuming the buyer is larger than the seller). Although the seller may argue that its exposure should not be increased by factors that have nothing to do with it, the buyer can respond that it should not be required to bear any fine as a result of a legal violation that occurred when the seller controlled the target.

The buyer may also be concerned about the implications of the Commission's recidivism increases, both in respect of the target's infringement and in respect of possible future infringements by the target or other members of the buyer's group. As extensively discussed in Chapter 2, with regard to the target's infringement, the fines imposed on the target and on the buyer could be significantly increased if other members of the buyer's group have infringed EU competition law and if the target's participation continued post-closing. Sellers are unlikely to agree, however, given the unpredictable amount involved and the fact that any recidivism increase would be attributable in part to conduct with no connection to the seller.

The recidivism implications of a target infringement that continues past closing are even more unpredictable as regards fines that may be imposed on the buyer group for possible future violations. Again, the buyer may seek protection from the seller in respect of recidivism increases due to infringements by the target that continue past closing where the buyer was not aware of or otherwise involved in the cartel. A seller would be even more likely to refuse to accept liability for any such increase given that the fine would be based on an infringement unrelated to the conduct of the target when it belonged to the seller's group, and the size of any such increase would be based largely on factors (such as the volume of sales of the affected commerce) having nothing to do with the target.

3.2.5 Conclusions

This Section describes and analyses the specific provisions aimed at allocating cartel liability risk between M&A parties. To this extent, the classical "clean" representation and the relevant indemnification provision are analyzed. The last part of the Section is then dedicated to give an example of the negotiations that may develop between the parties around cartel liability risk.

3.3 LIMITED EFFECTIVENESS OF CONTRACTUAL ARRANGEMENTS

Following customary rules of contract law, the provisions of a Purchase Agreement – including the ones aimed at allocating cartel liability risk – have effectiveness only between the parties.

The purpose of this Section is thus to analyze such "inter partes" effectiveness with the aim of exploring the possibility to extend it, at least to certain significant third parties, such as – in the case of cartel liability in the M&A context – an antitrust authority possibly opening a cartel procedure and fining the target company.

In this respect, two of the most significant cases in which such "ultra-effectiveness" argument has been proposed by the relevant claimants and challenged by EU Courts are analyzed in the paragraphs below.

3.3.1 The Hoechst case[165]

By decision of 19 January 2005,[166] the Commission imposed fines on Akzo Nobel NV and on its Dutch and Swedish subsidiaries, on Elf Aquitaine SA and

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165 Case T-161/05, *Hoechst v Commission*, [2009] E.C.R. II-3555 at [51].

on its subsidiary Arkema SA, and on Hoechst AG for the participation of one of its chemicals divisions in a cartel on the monochloroacetic acid ("MCAA") market. That substance is used as a chemical intermediate, in particular, in the manufacture of detergents, adhesives, textile auxiliaries and thickeners used in foods, pharmaceuticals and cosmetics.

From 1984 to 1999, the said undertakings participated in a cartel to maintain market shares through a volume and customer allocation system. They also exchanged price information and reviewed the actual sales volumes, as well as price information, at regular multilateral meetings so as to monitor the implementation of the arrangements.

The Commission imposed fines totaling Euro 216,91 million on the undertakings concerned. The Akzo and Hoechst Groups were handed fines of Euro 84,38 million and 74,03 million respectively. Elf Aquitaine and Arkema were ordered jointly and severally to pay the sum of Euro 45 million. Arkema was also ordered in its own right to pay the sum of Euro 13,50 million.

On April 25, 2005, Hoechst AG filed an action for annulment of the Commission decision *vis à vis* the General Court. One of the pleas supporting such action concerned the fact that Hoechst AG could not have been held liable for the infringement committed by the formerly owned MCAA business since the responsibility for such infringement (ceased, in any event, before the transfer) have been allocated on an unlimited basis to Virteon GmbH, the

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[166] Commission decision C(2004) 4876 final of 19 January 2005 relating to a proceeding pursuant to Article 81 [EC] and Article 53 of the EEA Agreement (Case COMP/E-1/37.773 – MCAA).

controlled company which acquired the MCAA business. Such transfer of responsibility was set out in the relevant transfer agreement in which the parties have expressly acknowledge that Virteon released Hoechst from any liability. Later on, the same Virteon and the relevant MCAA business were then acquired by Clariant, a third party *vis à vis* the Hoechst Group.

The General Court rejected such specific claim stating that "*a contract cannot be relied upon against the Commission order to escape the penalties incurred under competition law inasmuch as it seeks to apportion liability between the companies for participating in a cartel*"[167].

In any event but on different grounds, it should be noted that Hoechst AG obtained its fine reduced of 10% By the General Court to Euro 66,63 million.

3.3.2 The Thyssen Krupp case

In 1994 the Commission imposed fines on the companies that had participated in a cartel in the steel beams market, including ArcelorMittal

167 Id. [65]. This is also confirmed by the Judgment of the General Court of March 3 2011, in Cases T-117/07 *Areva v European Commission* and T-121/07 *Alstom v European Commission*, at [229]. Here the Court confirmed the general rule that when a wholly-owned subsidiary that has infringed competition law is sold to a new owner, that subsidiary remains liable for any infringement that it commits before the sale and the previous owner is jointly and severally liable with that subsidiary for that infringement relating to behavior up until the sale. However, since the claimants (buyer and seller of the M&A transaction) drew the Court's attention to their contractual agreement of a guarantee at the time of the sale of the subsidiaries under which Alstom should be solely liable for any cartel fine prior to the transfer of its subsidiaries to Areva. However, the Court confirmed that liability resulting from breach of the European competition rules cannot be affected by what may be privately agreed between the parties. This was also upheld in the recent decision of the Court of Justice on the appeal bought by Areva. See Judgment of the Court (Fourth Chamber) of 10 April 2014. *Areva SA* (C-247/11 P) *v European Commission and Alstom SA and Others* (C-253/11 P) v European Commission, unpublished.

Luxembourg (formerly ARBED). The Commission adopted that decision[168] under the European Coal and Steel Community Treaty (ECSC), which laid down special rules on competition in the steel sector.

Also on the basis of that Treaty, the Commission, by a decision adopted in 1998,[169] found that eight stainless steel producers, including Thyssen Stahl GmbH, had agreed on a general price increase in the stainless steel sector, known as the "alloy surcharge". The alloy surcharge was calculated on the basis of the prices of alloys (nickel, chromium and molybdenum) and was added to the basic price for stainless steel. The cost of the alloys used by stainless steel producers formed a very large proportion of the total production costs.

The uniqueness and peculiarity of this decisions consists in the fact that the Commission did not impose a fine on the direct infringer Thyssen Stahl GmbH but it did it on its successor in law ThyssenKrupp Stainless AG (by which it was acquired) on the basis of a written declaration filed from this latter to the Commission according to which it took over the liability deriving from the cartel to which the acquired company Thyssen Stahl GmbH took part.

The Commission decision was challenged in EU Courts[170] and also re-adopted in 2006,[171] however, the said peculiar manner of apportioning the fine

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168 Decision 94/215/ECSC of 16 February 1994 relating to a proceeding pursuant to Article 65 of the ECSC Treaty concerning agreements and concerted practices engaged in by European producers of beams.

169 Decision 98/247/ECSC of 21 January 1998 relating to a proceeding pursuant to Article 65 of the ECSC Treaty (Case IV/35.814 – Alloy surcharge).

170 Case T-45/98 and T-47/98, *Krupp Thyssen Stainless and Acciai speciali Terni v Commission* [2001] E.C.R. II-3757, upheld on appeal in Joined Cases C-65/02 P and C-73/02 P [2005] E.C.R. I-6773.

and liability following a written statement made by a third party (*rectius* the acquirer of one of the infringers) remained untouched.

On this specific point, the General Court upheld the Commission decision stating that, by derogation from the principle that penalties should be personal, the acquirer could voluntarily undertake to support the liability of the infringement, taking into account "*economic considerations specific to concentrations of undertakings*". In such a case, the Commission is entitled to impute the liability of the infringement directly to the acquirer rather than to the offender.[172]

In addition, the Court of Justice reinforced and reaffirmed the said interpretation later on by rejecting the tentative of ThyssenKrupp Stainless AG (today ThyssenKrupp Nirosta AG) of revoking the said statement. In this context, it concluded stating that "*the acquirer will not then be able to revoke such a statement after the Commission has actually imposed a fine in reliance on the statement*".[173]

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171 The Commission thereupon decided to bring fresh proceedings in respect of those infringements of the ECSC Treaty. Thus, by decision of 8 November 2006.

172 See Joined Cases T-45 and 47/98, *Stainless Steel Flat Products*, para 62: "*It must be emphasized that it is undisputed that, in view of the statement made by* [ThyssenKrupp Stainless AG] *on 23 July 1997, the Commission was, by way of exception, entitled to impute to* [ThyssenKrupp Stainless AG] *liability for the unlawful conduct of which Thyssen Stahl was accused between December 1993 and 1 January 1995. It must be concluded that such a statement, which in particular takes account of economic considerations specific to concentrations of undertakings, implies that the legal person within whose sphere of responsibility the business of another legal person was brought after the date of the infringement deriving from that business should be required to be answerable for it, even though, in principle, it is incumbent upon the natural or legal person running the undertaking concerned at the time of the infringement to answer for it*" (emphasis added).

173 Case C-352/09 P, *ThyssenKrupp Nirosta GmbH v Commission*, judgment March 29, 2011 at [153]–[154].

3.3.3 Conclusions

This Section demonstrates how EU Commission and Courts have strongly and consistently refused to attribute "ultra-effectiveness" to contractual covenants apportioning cartel liability. This has been done on the basis of the fact that private arrangements cannot alter the position of the addressee of a public authority decision, which flows directly from primary law and which does not have effects in relation to either substantive or procedural law, because it is incompatible with the rules relating to fines in cartel cases. Those rules fall indisputably within public law, in particular penal law and the law of sanctions. Independent private arrangements made by private-law individuals cannot alter the legal consequences arising under public law, particularly penal law and the law of sanctions. That principle dates from Roman law (*jus publicum privatorum pactis mutari non potest*) and is applied in the legal systems of the Member States, thus constituting a legal tradition common to the Member States which must be respected by the Commission and the EU Courts.[174]

However and without prejudice to the above, this Section has also underlined how EU Commission and EU Courts have recognized a certain value to unilateral private statements aimed at transferring liability between companies involved in the same cartel proceeding. In the *Krupp Thyssen* case, the Commission considered - in apportioning the fine among the infringing companies - the express written statement made by the acquirer (also involved

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174 See Case T-161/05, *Hoechst v Commission*, [2009] E.C.R. II-3555 at [51]; and, in the same sense, the Judgment of the General Court of March 3 2011, in Cases T-117/07 *Areva v European Commission* and T-121/07 *Alstom v European Commission*, at [229].

in the proceeding) that liability for the past infringements of the former owner of the transferred business should be attributed to it. In such a way, the EU Commission introduced an exception to the principle of personal responsibility in order to take account of "*the economic considerations specific to concentrations of undertakings*".[175]

3.4 CONCLUSION: THE CONTRACT IS ENOUGHT?

This Chapter has extensively discussed the contractual allocation of cartel liability which is largely the most common method used by the parties to tackle such liability in the context of an M&A deal. This is mainly due to the fact that cartel liability is generally perceived on an equal foot with other liabilities and it is generally inserted in the "catch all" basket containing the objects of representations, warranties and indemnification provisions released by the seller.

This Chapter has also confirmed, making reference to customary rules of contract law and the *Hoechst* case, the "inter partes" limitedness of contractual protections which renders such measures insufficient to adequately protect M&A parties from cartel risk.

A chance to obtain the effect of extending the effectiveness and, at the same time, the protection offered by private documents apportioning cartel liability has been instead underlined by the examination of *Thyssen Krupp* case.

[175] *Id.* at [62]

On the basis of this precedent, and by applying it analogically, it has been argued that the EU Commission, when investigating the existence of a cartel, might be willing to accept a statement of “discharge of responsibility” issued by one of the parties of the M&A deal in favor of the other. As a result, the EU Commission – acting as described - could give effect to a private document which would represent the result of the negotiations of the parties in apportioning cartel liability.

However, if, on the one side, this interpretation would arguably allow to obtain a limited “ultra partes” effectiveness of the said private statements; on the other side, the relevant allocation of liability contained therein would still and unavoidably leave one of the parties unprotected.

As a result, the next challenge of this Thesis would be to seek to identify a tool which could ensure a more complete protection against cartel liability risk. An extended protection possibly covering both parties of the M&A transaction.

The performance of an audit specifically aimed at discovering cartel activities carried out by the target company is analyzed in this respect in the following Chapter 4.

4. THE PRE-ACQUISITION AUDIT

An audit may be a very intrusive tool which implies a deep dive analysis on the business involved. However, an audit properly done may effectively surface conducts that would remain otherwise hidden. This is especially so when the audit includes extensive reviews of records and interviews with a broad range of company's personnel.

With reference to antitrust matters, audits are generally performed within the context of compliance programs.[176]

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176 See for example Section 8 (e) of the *ICC Antitrust Compliance Toolkit* available at http://www.iccwbo.org/Advocacy-Codes-and-Rules/Areas-of-work/Competition/ICC-Antitrust-Compliance-Toolkit/ ; the French Autorité de la Concurrence, Framework document of 10 February 2012 on Antitrust Compliance Programmes, available at http://www.autoritedelaconcurrence.fr/doc/framework_document_compliance_10february2012.pdf ; or also, for a comparative analysis, Section 8.B.2.1 of *United States Sentencing Commission, Guidelines Manual*, para.3E1.1 (Nov. 2013) which set out the minimum standards that must be met in order for the business to be regarded as having exercised due diligence and promoted an organizational culture that encourages ethical conduct and a commitment to compliance See also in this respect, Ghosal, Vivek and Sokol, D. Daniel, *Compliance, Detection, and Mergers and Acquisitions* (May 1, 2013). Managerial and Decision Economics 34(7) 2013; Minnesota Legal Studies Research Paper No. 13-21. Available at SSRN: http://ssrn.com/abstract=2259039 or http://dx.doi.org/10.2139/ssrn.2259039; Geradin, Damien, Antitrust *Compliance Programmes & Optimal Antitrust Enforcement: A Reply to Wouter Wils* (March 29, 2013). Journal of Antitrust Enforcement (2013) (Forthcoming). Available at SSRN: http://ssrn.com/abstract=2241452; Wils, Wouter P. J., *Antitrust Compliance Programmes & Optimal Antitrust Enforcement* (October 31, 2012). Journal of Antitrust Enforcement, Volume 1, Issue 1, April 2013, Forthcoming. Available at SSRN: http://ssrn.com/abstract=2176309; Sokol, D. Daniel, *Policing the Firm* (March 7, 2013). Notre Dame Law Review, 82(2):785-848; Minnesota Legal Studies Research Paper No. 13-13. Available at SSRN: http://ssrn.com/abstract=2230121; Sokol, D. Daniel, Cartels, *Corporate Compliance and What Practitioners Really Think About Enforcement* (June 6, 2012). Antitrust Law Journal, Vol. 78, 2012. Available at SSRN: http://ssrn.com/abstract=2079336; Sokol, D. Daniel, *Detection and Compliance in Cartel Policy* (September 30, 2011). CPI Antitrust Chronicle, Vol. 2, September 2011. Available at SSRN: http://ssrn.com/abstract=1935907; Hofstetter, Karl and Ludescher, Melanie, *Fines Against Parent Companies in EU Antitrust Law - Setting Incentives for 'Best Practice Compliance'* (December 22, 2009). World Competition: Law and Economics Review, Vol. 33, No. 1, March 2010. Available at SSRN: http://ssrn.com/abstract=1502769; J. Murphy and W. Kolawsky, *The Role of Anti-Cartel Compliance Programs In Preventing Cartel Behavior*, Antitrust, Vol. 26, No. 2, Spring 2012.

The idea underlying the present Chapter is to enquire the possibility (and effectiveness) of using such tool outside its normal context. More precisely, this Chapter seeks to demonstrate how audits might be also usefully performed in the context of M&A deals to protect the parties from cartel risk (hereinafter also, the "anti-cartel" audit).

The Chapter firstly discusses the juridical nature of audits. A comparative analysis of the discipline regulating pre-contractual negotiations in both common and civil law's systems reveals a possible legal qualification of audits. Then the specific "anti-cartel" purpose to which the audit should be targeted at is analyzed. This encompasses the description of the peculiarities of cartel wrongdoings together with the examination of the high level of costs and legal boundaries generally connected with the conduction of an audit.

Being audits intrusive, complex and expensive by their nature, the Chapter proceeds by explaining the need for a preliminary cartel risk assessment to be performed with a view of evaluating the opportunity of a full audit.

Further, it is proposed a possible structure for an effective and efficient conduction of the "anti-cartel" audit considering the specific context of M&A transactions. The incentives of the parties and their respective position *vis à vis* the target entity are examined in this respect. The seller is then identified as the most appropriate party under which responsibility the audit shall be conducted.

The composition of the audit team is also discussed. A mixed composition of outside and in-house counsel is proposed as the preferable solution. The focus is then drawn on presenting a possible structure for the investigation. The audit shall be properly and internally announced and then interviews and document review may follow. A report of the relevant findings, if any, shall be lastly addressed to the seller, as conclusion of the exercise.

Lastly, the crucial issue of the use of the audit results to secure the M&A parties from cartel risk is ultimately tackled. Should the result be "positive" and reveal a cartel activity of the target entity, the possibility to eliminate cartel risk by successfully launching a leniency application is discussed. Should instead the result be "negative" and not ascertain any finding, a peculiar method of allocating cartel liability risk is proposed. The peculiarity is due to the empirical solution adopted to extend the effectiveness of such method *vis à vis* a qualified third parties such as a proceeding antitrust authority.

By way of conclusion, the proposed method of using pre-acquisition audits to secure M&A parties from cartel liability risk is confronted with a similar solution adopted by the US legislator to address the effects of environmental liability risk in commercial real estate transactions.

4.1 NATURE AND JURIDICAL QUALIFICATION OF AUDITS

An audit (also known as due diligence exercise) is generally defined in the M&A context as the process of evaluating and investigating a perspective business decision by getting information about the financial, legal, intellectual and other material information from the other party. The ultimate goal of such activities is to make sure that there are no hidden drawbacks or traps associated with the business transaction under consideration.[177]

Audits are not disciplined by any specific provision. Consequently, there is a clear need to define the juridical aspects and legal background of such exercise. In fact, if from one side, the business community has developed an unanimous consensus about the role and the meaning of audits in the context of M&A transactions, from the other side, legal academia and practitioners is not on the same page.

It is thus of essence, on the one side, to analyze the possible juridical qualification attributable to the concept of audit (which, in principle, could coincide with the one attributed to it by the business community) and, on the other hand, to study the legal effects and implications of its performance. Considering the transnational origin of audits, such analysis will be conducted with the method of comparative law. Without prejudice to the differences and peculiarities the audit assume in the different juridical systems, it is doubtless that it presents a common core of principles. In this respect, the business market practice usually collocates the audit exercise in the pre-contractual phase of the M&A deal and entrust the relevant performance to the buyer (so called "buyer audit") or to the seller ("vendor audit"), as the case may be. The exercise and the relevant results serve the parties to basically assist them in the negotiation process and in drafting of definitive agreements (*i.e.* the "Purchase

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177 See in this sense C. Davis, *Due Diligence Under Different Sales Processes*, in *Ad Bus* 2.4 (19) (2003).

Agreement”), particularly with regard to the set of representations and warranties to be released.

The following paragraphs analyze the juridical reasons behind the performance of an audit in the M&A context with the aim of proposing a possible juridical qualification to such exercise in both the civil and common law systems.[178]

4.1.1 Juridical aspects of the audit in the common law systems

The common law systems generally exclude the existence of a (reciprocal) pre-contractual duty of information for the parties of a sale and purchase transaction. This is expressed by the theory of the “caveat emptor”.[179] Such theory basically allocates on the buyer the responsibility of autonomously examining, evaluating and verifying the object of purchase. Accordingly, there is no information duty on the seller which – in principle - cannot be held responsible *tout court* for the possible defects of the object of purchase, always with the limit of fraud.

Such theory has been progressively limited in the U.S. by the introduction of several exceptions which were due to the affirmation of “moral standards” in

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178 With regards to the relationship between audit and pre-contractual duty of information, see, among the other, H.P. Westermann, *Due Diligence beim Unternehmenskauf*, in ZHR, 2005, 248 ss. .

179 The *Black Law Dictionary* translates the full Latin expression “*caveat emptor, qui ignorare non debuit quod jus alienum emit*” with “let the buyer be aware”. It also explains the relevant theory which allocates on the buyer the responsibility of examining, evaluating and verifying the object of transaction. See also in this respect, B. Goldfarb, *Fraud and Non-disclosure in the Vendor-Purchaser Relation*, in 8 West. Res. L. Rev. 5, 13 (1956).

the business market[180] such as: (i) the extensive use of the "promissory estoppel"[181] and the related concept of "reliance"[182]; (ii) the tendency to qualify an increasing number of relationships between two or more parties as "fiduciary" or "confidential relationship" (to which a strictest discipline in terms of duty of information applies);[183] (iii) the primary role played by the concept of "unconscionability"[184] both in the Restatement 2nd of Contracts (§ 208) and the Uniform Commercial Code (§ 2-302); (iv) the implicit acceptance and the progressive diffusion of the principle of good faith in contracts law.[185]

Another important exception to the principle of "caveat emptor" is the one that the courts deemed applicable with specific reference to real property

180 See in this sense, G. Shell, *Substituting Ethical Standards For Common Law Rules In Commercial Cases: An Emerging Statutory Trend*, in 82 Nw. U. L. Rev. 1198, 1206 (1988); D. Farber and J Matheson, *Beyond the Promissory Estoppel: Contract Law and the "Invisible Handshake"*, in 52 U. Chi. L. Rev. 903, 906 (1985).

181 The "promissory estoppel" is an equitable doctrine declaring that "a promise which the promissor should reasonably expect [will] induce actions or forebearance on the part of the promisee or a third person and which does not induce such action or forebearance is binding if injustice can be avoided only by enforcement of the promise". See Restatement (Second), Contracts para. 90.

182 The concept of "reliance" with reference to the "promissory estoppel" refers to reliance that the promissor have induced on the other party that is said to be "estopped" from denying the existence of a contract, though in fact one has not been made.

183 The strictest discipline concerns, among the others, a reciprocal duty of pre-contractual (full) information between the parties. See in this respect, E. M. Holmes, *A Contextual Study of Commercial Good Faith; Good Faith Disclosure in Contract Formation*, in 39 U. Pitt. L. Rev. 381, 452 (1978).

184 The concept of "unconscionability" refers to the situation in which something is so unreasonably detrimental to the interest of a contracting party as to render the contract unenforceable. The common law rule rendering unconscionable contracts unenforceable was codified in the Uniform Commercial Code in para. 2-3012. The basic test is whether, in the light of the general commercial back-ground and commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable at the time of the making of the contract.

185 The concept has been finally codified under the Uniform Commercial Code para.2-103 (1)(b) referring to the total absence of any intention to seek an unfair advantage or to defraud another party, an honest and sincere intention to fulfill one's obligations.

transactions. In this context, it has been affirmed that the seller has a specific duty of information to the benefit of the buyer.[186] Hence, the seller is obliged to disclose the buyer any hidden flaw or liability related to the property title which cannot be remedied within the date of execution of the agreement. The violation of this disclosure obligation is then remedied by recurring to the general rules applicable for torts of misrepresentation. As a result, the misrepresentation discipline represents another element which may drive the pre-contractual relationships of the parties.[187] In this context, there are two instances in which the seller can be deemed responsible of misrepresentation. First, an incorrect representation (accompanied by a related warranty) inserted in the purchase agreement or in a related annex containing the audit report.[188] Second, any other incorrect declaration or information rendered outside the audit process.[189]

Similar principles related to misrepresentation are also applicable in the English legal system. More specifically, there is a duty of the seller to verify the adequacy of the information provided to the buyer and promptly notify this latter with any modification in this context.[190]

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186 This duty has been developed by English courts with reference to the specific characteristics of real property transactions in which the seller usually represents the only source of information for the buyer.

187 See in this respect, P. S. Atiyah, J. N. Adams, the sale of goods, Pearson Ed. Ltd., Harlow, X ed., 2001.

188 See, S. Willston, *Representation and Warranty in Sales – Heilbut v. Buckelton*, in 27 Harvard Law review 1 (1913); P. S. Atyiah, *Essays on contract law*, Oxford-New York, 1986.

189 S. MacKenzie, *Acquisitions: Look Before You Buy*, in Compliance Monitor 18, 3, 2005.

190 See in this respect, R. Bigwood, *Pre-contractual Misrepresentation and the Limits of the Principle in With v. O'Flanagan*, Cambridge Law Journal, 64(1), 2005, 94.

This said, it should be noted that neither the US[191] nor English[192] legal systems explicitly recognize the applicability of such exceptions to business transactions such as M&A deals. This means that in this context the parties are not charged with a general (and reciprocal) duty of information. Each party is basically responsible to safeguard its interests. From buyer's perspective, this would imply a sort of duty of diligence to procure itself an adequate set of information to successful complete the transaction (also known as "duty to investigate" of the buyer).[193] As a result, the audit represents, in the common law context, the tool through which the seller may satisfy such specific legal duty. This legal framework causes a twofold effect. First, it increases the level of diligence required to the buyer in acquiring the information. Second, it limits the liability of the seller with regards the information provided upon request to the buyer.

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191 The leading case in the US is Barnard v. Kellogg, 77 US (10 Wall. 383, 388 (1871). See also in this context, T. Le Vines, *Caveat Emptor Versus Caveat Venditor*, in 7 Md. L. Rev. 177, 182 (1943); H. Hamilton, The Ancient Maxim Caveat Emptor, in 40 Yale L. J. 1133 (1931); D. P. Rothschild, *The Magnusson-Moss Warranty Act: Does it Balance Warrantor and Consumer Interest?*, in 44 Geo. Wash. L. Rev. 335, 337 (1976).

192 The leading case in England is still Bell v. Lever Bros Lts. [1932] A.C. 161; more recently, in this same sense, Clarion Ltd. vs National Provident Institutions [2000] 1 W.L.R. 1888, 1905 where it is stated that "*there is no general duty imposed upon them in the nature of a duty of disclosure. The negotiations are in the nature of an arm's length commercial bargaining. Each party has took after his own interests and neither owes a duty of care to the other*". See on this topic also, P. Gilijer, Regulating contract behavior: the duty to disclose in English and French law, in Eur. Rev. priv. law., 2005, 5, 621 ss, 625 where according to the author "[In English law] … *party autonomy is therefore seen in terms of maximizing self-reliance*".

193 It should be noted that some US Scholars have argued that such duty to investigate of the buyer would cease to exist when this latter made justifiable reliance on the representation voluntary made by the seller. See in this specific respect, S. Gorny, *Caveat Emptor or Justifiable Reliance?*, in 25 Wash L. Rev. & St. B. J. 180 (1950).

4.1.2 Juridical aspects of the audit in the civil law systems: the Italian experience

The notion of good faith has strongly influenced contract law in civil legal systems, particularly with reference the relevant pre-contractual phase. The following paragraphs provide a general overview of the jurisdictions which have embraced good faith as a central principal of their contractual systems. Then the focus is drawn on the Italian experience.

In the Republic of Germany, contractual obligations are subject to the standard of good faith. It is linked with the notion of "Treu und Glauben" and is set forth in § 242 of the Bürgherliches Gesetzbuch (BGB) which sets forth in general terms that the debtor is bound to perform according to the requirements of good faith, taking into consideration general practice in commerce.[194]

In France also, according to article 1134, para. 3 of the French Civil Code, contracts must be performed in good faith. Though the French courts have not given the notion of "bonne foi" the same importance as the German courts, similar results were obtained by the application of a general theory of "abus de droit" which was developed at the end of the 19th century and was based on

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194 Whittaker and Zimmermann explain this notion thus: "*Treue…signifies faithfulness, loyalty, fidelity, reliability; Glaube means belief in the sense of faith or reliance. The combination of 'Treu und Glauben' is sometimes seen to transcend the sum of its component and is widely understood as a conceptual entity. It suggests a standard of honest, loyal and considerate behaviour, of acting with due regard for the interests of the other party, and it implies and comprises the protection of a reasonable reliance. Thus is not a legal rule with specific requirements that have to checked but may be called an 'open' norm. Its content cannot be established in an abstract manner but takes shape only by the way in which it is applied*". See Whittaker and Zimmermann, *Good Faith in European Contract Law*, Cambridge Un. Press, 2000, pp.18-30.

good faith. Performance of contracts in good faith has been interpreted by French jurists as implying two duties on the contracting parties (i) a duty to act loyally (“obligation de loyaute”) and (ii) a duty to cooperate (“devoir de cooperation”).

As far as the European Union is concerned, it must be noted that the Principles of European Contract Law impose a duty of good faith in the formation, performance and enforcement of the parties’ duties under a contract. Article 1:201 provides that “*(i) Each party must act in accordance with good faith and fair dealing. (ii) The parties may not exclude or limit this duty*.” The UNIDROIT Principles of International Commercial Contracts (Unidroit, 1994) have a similar provision to article 1:201.[195] As a corollary of good faith, article 1:202 of the Principles of European Contract Law imposes on each party “*a duty to co-operate in order to give full effect to the contract*”.[196] These Principles do not have the binding force of either national law or international treaties or conventions, they aim to achieve a modern European “lex mercatoria” an d to help bring harmonization of general contract law within the European Union.

Finally, under Italian law, good faith plays an important role, such that it is considered a fundamental pillar of the system. Noteworthy is the fact that the Italian 1942 Civil Code had been drafted in an epoch when Italian jurists were

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195 See also in this respect some commentators, E. A. Farnsworth, *Duties of Good Faith and Fair Dealing under the UNIDROIT Principles, Relevant International Conventions, and National Laws*, in 3 Tul. J. Int’l & Comp. L. 47 (1995); M. J. Bonell, *An International restatement of Contract Law: The UNIDROIT Principles of International Commercial Contracts*, II ed., 1997 Transnational Publishers Inc., Invirgton-on-Hudson, New York.

196 See in this respect, *Principles of European Contract Law*, Parts I and II, edited by O. Lando and H. Beale, Kluwer Law International, The Hague, London-Boston, 2000.

fully conscious of German case law on § 242 of the BGB. The good faith principle shall also "inspire" the conduct of the parties in the pre-contractual phase of a sale and purchase transaction. Article 1337 of the Italian Civil Code, provides that "*parties must behave in provides that parties must behave in good faith during the pre-contractual bargaining and contract drafting*". A breach of that duty of reasonable behavior gives rise to the so-called pre-contractual liability or "culpa in contrahendo", so-called to be distinguishable from contractual liability which arises in cases of breach of a contract already concluded.

This however does not imply a general and absolute duty for the seller to provide its counterparty with the adequate information to successful complete a transaction.[197] Contrarily and more similarly to the common law experience, the Italian case-law have clarified that instead on the buyer a duty to investigate with diligence the target of its perspective acquisition by acquiring and requesting all the necessary information (particularly when the buyer has the professional expertise to adequately request and assess the relevant information).[198] As a result, also in the Italian system the audit exercise represents again the tool through which the buyer may satisfy a duty to acquire information from the seller which the law explicitly attribute to it.[199]

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197 See in this sense R. Sacco in R. Sacco and G. De Nova, *Il Contratto*, in Trattato di Diritto Civile, edited by R. Sacco, III ed. Torino, 2004.

198 See, among the others, Cass. Civ. Sez. III, July 19 2007, n. 16031, Ircoss S.r.l. vs Iritech S.p.A. .

199 See in this sense, U. Tombari, *Problemi in tema di alienazione della partecipazione azionaria e attività di due diligence*, in Banca, borsa, tit. cr., 2008, 1, 65; S. Tersilla, *La due diligence per l'acquisizione di un pacchetto di controllo di un a società non quotata in borsa: obblighi di informazione e responsabilità dei soggetti coinvolti*, in Dir. Comm. Int., 2002, 4, 969; F. Ricci,

4.1.3 Conclusions

Both the common law and civil law systems charges the buyer with an explicit or implicit duty to autonomously investigate the relevant object of purchase. Translating this statement in the specific context of an M&A transactions, the buyer is incentivized to proactively acquire (mainly from the seller) all the adequate information to successful complete the transaction. Should in fact the buyer fail to do it or does it without the due care or diligence, the legal system would not offer any protection to it. The effective and complete acquisition of the necessary information is also very important for the buyer since, considering the said legal framework, the seller would not normally be available to release any representation or warranty in relation with the documents or information provided to the buyer and on which this latter has been allowed to make its own assessments.[200]

As a result, the performance of an audit on the target entity clearly represents the most comprehensive and effective mean for the buyer to satisfy the duty to investigate conferred by the law.

However, pursuant to the freedom to contract principle, the parties are also free to revert the said legal duty agreeing to conversely attribute the seller the duty to inform the buyer of all the elements for successful complete the

Due diligence e reponsabilità, Bari, 2008; F. Gambaro, *Brevi considerazioni in tema di cosiddetta due diligence*, in Riv. Dir. Priv., 2006, 5, 897.

200 See in this respect, C. Parr, *Due diligence: worth a look?*, in Bus. L. Rev., Oct. 2006; S. MacKenzie, *Acquisitions: look before you buy*, in Compliance Monitor, 18, 3, 12, (2005); J. O. Fiet, *Reliance upon informants in the venture capital industry*, in Journ. Bus. Venturing, 1995.

transaction. It may happen when the seller is particularly willing to rapidly complete the sale or when, as the case for cartels, the buyer is particularly best placed to detect a certain hidden liability. Here, the seller performs the so called "vendor audit".[201]

Such inversion of the duty of information generates indeed a twofold effects. First, it increases the diligence due by the seller in performing the audit exercise. Second, it renders the reliance made by buyer on the results of the audit legally enforceable. Should such result reveal to be untrue at a later stage, the buyer would be entitled to recover damages from the buyer, at least, on extra-contractual liability grounds.

4.2 THE "ANTI-CARTEL" PURPOSE

An antitrust audit is a general exercise aimed at investigating the existence of antitrust violations committed by a certain business or company. The scope of the antitrust audit's analysis is therefore extremely broad and covers both collusive and abusive conducts.[202]

Differently, the "anti-cartel" audit would be instead a specific exercise focused in discovering past or ongoing cartel activities.

There is also a practical reason why an "anti-cartel" audit of the target entity is so important in the context of an M&A transaction:[203] cartels are the only antitrust wrongdoing which are hidden by definition.[204]

201 *Id.*

202 Under EU competition law, collusive and abusive conducts are respectively forbidden

203 Other reasons in support of the importance of anti-cartel audits are the severity and frequency of cartel risk. In this respect, see Chapter 2 of this Thesis.

This Subsection discusses in detail the secrecy elements which distinguish cartels from the other antitrust general violations. Following this brief digression, the high level of costs and legal boundaries generally connected to the conduction of an audit are assessed and taken into account.

All those elements allows then to conclude that when an antitrust audit is performed in the context of an M&A deal it shall have a specific "anti-cartel" purpose.

4.2.1 The peculiarity of cartels and the secrecy element

Cartels are agreements and/or concerted practices between two or more competitors aimed at coordinating their competitive behavior on the market and/or influencing the relevant parameters of competition through practices such as the fixing of purchase or selling prices or other trading conditions, the allocation of production or sales quotas, the sharing of markets including bid-rigging, restrictions of imports or exports and/or anti-competitive actions against other competitors.[205] Such practices are among the most serious violations of Article 101 TFEU.

Cartels are by their very nature secret. They are therefore difficult to detect and investigate. Cartel activity, because it is clearly illegal, it is conducted in

[204] Other antitrust violations, such as abusive conducts or anticompetitive contract clauses, are in fact more evident and easily detectable also through the careful examination of the corporate documents which are customary object of the due diligence exercise usually performed in the context of an M&A transaction.

[205] See, among the other, A. Jones, B. Sufrin, *EU Competition Law: Text, Cases & Materials*, Oxford University Press, 2014.

great secrecy. Conspiracy meetings might occur in a hotel room during a trade show, for example, or simply over the phone. Evidence is hidden away.

Because of this secrecy element and the related difficulties in prosecuting them, cartels are also considered and fined by authorities as the most serious violations of antitrust law.[206]

4.2.2 Costs and legal boundaries

Economic costs and legal boundaries represent two important elements to be considered in defining the scope and extension of the audit. Companies operate in fact with limited resources and their audit efforts shall be concentrated on the most risky areas.

The following paragraphs offer an overview of the most relevant factors which would affect the course of an audit both from the economic and legal point of view.

4.2.2(i) Costs

An audit is costly both in terms of time and resources. Expenses are incurred throughout the process and due diligence is going to disrupt daily business operations of the targeted company.

Indeed, the most significant expenses are represented by the legal fees of outside specialized counsels, should the conduct of the audit be entrusted to them (as envisaged in Subsection 4.3.2 below).

206 See, for example, the speech held in Berlin on 14 April 2011 by Joaquín Almunia Vice President of the European Commission responsible for Competition Policy, *Cartels: the priority in competition enforcement,* at 15th International Conference on Competition: A Spotlight on Cartel Prosecution and available at http://europa.eu/rapid/press-release_SPEECH-11-268_en.htm?locale=en .

However, it should be always remembered that the costs of an audit will only amount to a small fraction of the amount of any potential fine.[207] Therefore, it might be preferable to bear the costs of such an audit rather than risking to incur in a very high fine.

4.2.2(ii) Legal boundaries

When conducting an audit, legal issues may arise in respect of every phase[208] of the investigation.[209] These issues mainly depend on national laws and vary from jurisdiction to jurisdiction. The paragraphs below give a general overview in this respect. Reference is made to the applicable rules within the main jurisdictions of the European Union.[210]

Legal aspects related to the announcement of the audit

There is no jurisdiction that requires general *advance approval* of the announcement of the audit by a work council—where one exists. However, both in France[211] and the Netherlands a work council has to be *informed* beforehand in case the audit is conducted in connection with an intended

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207 See the statistics published by the EU Commission at http://ec.europa.eu/competition/cartels/statistics/statistics.pdf . In this respect see also the quantification of cartel liability risk conducted under Subchapter 2.2 of this Thesis.

208 For the purpose of this Thesis, 3 main phases of the investigation have been detected and explored: announcement, document review and interviews. In this respect, see Subchapter 4.3.4 below.

209 See also in this respect, Hummer and L. Leitner, *Antitrust Audit: Motives and Key Practical Aspects*, Journal of European Competition Law & Practice, 2012, Vol. 3, No. 3.

210 The comparative data exposed and commented in such section have been taken from the ICC comprehensive study, Promoting Antitrust Compliance: the Various Approaches of National Antitrust Authorities, available at […].

211 Article L 2323–6 Code du travail, Article L. 2323–32.

decision to transfer control of one company to another.[212] A Danish work council should also be informed and the permission from the Danish Data Protection Agency may be required. In some very special circumstances a duty to inform the work council may arise also in Austria,[213] Belgium,[214] Estonia,[215] Germany,[216] Hungary,[217] Malta,[218] and Slovenia.[219] In addition, a company of course may enter into voluntarily arrangements with its employees covering such duty to inform.

Actually, only in Germany a work council has the right to co-determinate launch of an audit insofar as the implementation of the audit affects the companies' internal constitution or the employees' conduct.[220]

In France, a breach of a statutory information requirement may even trigger criminal sanctions by imposing a fine of up to Euro 3.750 and/or imprisonment

212 The obligation is based upon a general duty for the company to inform the works council about business matters of the company.

213 Where the information required concerns the economic, social, health, or cultural interests of the employees.

214 An information requirement exists in cases where the information requested is considered 'economic and financial information relating to the undertaking'.

215 Such information requirement only exists if explicitly provided for in a collective bargaining agreement.

216 Para. 80(1) Nr 1 BetrVG.

217 Only if an antitrust audit affects a larger group of employees or the employer's economic situation.

218 In case an employee should disclose information not being subject to the employment contract or in case of a breach of data protection laws.

219 If an audit is considered as a 'system of rules' relating to disciplinary liability of employees.

220 Works council can apply to the labor law courts for injunctive relief prohibiting further implementation until the works council's rights have been complied with. Further measures imposed on employees in violation of the works council's co-determination rights are illegal and void.

of up to one year.[221] French courts have the power to order to immediately stop the audit process, they can award damages to employees and to the work council, and declare the measures null and void. Fines can also be imposed on the company for breach of statutory information duties in Denmark, Malta, and Slovenia. The work council can also request the withdrawal of the employer's decision to conduct an audit in Slovenia.

Data protection issues related to the document review

In addition to the above mentioned labor law issues, the document review which constitutes a crucial phase of the "anti-cartel" audit (as extensively explained in Subchapter 4.2.4 below) may then specifically rise other legal issues connected with data protection law. In Germany, the review of electronic correspondence might require prior approval from the work council. A search of hard copy business files and correspondence is instead admissible without any particular restrictions. If the work e-mail account is prohibited for private use, e-mails may be then searched without the employee's consent. If it is instead permitted for private use, the search normally requires consent, but even then reviewing the content of private e-mails is in most cases prohibited, even if the employer concludes a general agreement with the works council.[222]

In France, it is irrelevant whether the use of the work e-mail is allowed or prohibited for personal purposes. Although the employer has the right to

221 Article L.2328—1 du Code du travail.

222 Para. 88(3) TKG.

examine the employee's electronic files,[223] under no circumstances the employer is allowed to read the e-mails identified as private correspondence.

In the UK, there is a limited right for privacy.[224] Employers usually advise employees to mark e-mails personal if they are using the company e-mail address for private purposes. If they do so, employer may not review e-mails correspondence marked as "personal".[225]

In the Czech Republic, Slovakia, and Slovenia the private use of work devices (including the electronic ones) is generally prohibited. Hence, there is no need to differentiate between working and private e-mails. All of them may be indeed object of scrutiny by the employee.

In addition to the issues related to files and e-mails, in some countries personal calendars can be reviewed only with the consent of the employee,[226] for example only if there is a reason to believe that the employee has committed a criminal offence.

Legal issued related to the interviews

Employees are to a certain extent obliged to cooperate during interviews held in the course of an "anti-cartel" audit. The legal bases for this are

223 Under the conditions that the employee is present and unless there is a 'risk or a particular event' (suspicion of a breach of duties, or when an employee denounces another employee for antitrust practices) that justifies not having informed the employee.

224 Data Protection Act 1998.

225 The Employment Practices Data Protection Code deals with the impact of Data Protection laws on the employment relationship. Part 3 of the Code recommends that employers are proactive in obtaining approval from an employee for any search of his e-mails.

226 Belgium, Czech Republic, Finland, France, Hungary, Italy, Latvia, Lithuania, the Netherlands, Poland, Portugal, Slovakia, and Slovenia.

principles of good faith, fidelity and sometimes also the employment contract itself. In various countries, depending on the seniority of the employee[227] and the level of responsibility and loyalty,[228] it may or may not be appropriate to carry out interviews.[229] Only Estonia,[230] Greece, and Belgium[231] do not have any such a duty.

In the United Kingdom, a refusal to cooperate with the audit may constitute a breach of any or all of three[232] duties of employees. However, employees are not under an implied obligation to disclose their own wrongdoings to an employer, but only those of other employees. Directors and senior employees in fiduciary positions have more onerous duties than lower employees and consequently have to answer all questions addressed to them in the context of an audit, even in case, doing so, the director would disclose his own wrongdoings.

In Germany, a general '*talk or walk*' policy exists under which employees are *per se* threatened with dismissal unless they fully cooperate. Such a policy may constitute undue pressure and is prohibited. Information obtained under

227 Czech Republic, Malta.

228 Austria, Finland, Greece, Malta, and the UK. [ins legge]

229 Denmark.

230 In Estonia, such duty only arises out of a separate agreement between the employer and employee.

231 Even a current employee cannot be forced to answer such questions, unless they are ordered to do so by a court or official order.

232 The duty of good faith and fidelity, the duty to obey the lawful and reasonable instructions of their employers, the duty of mutual trust and confidence.

inappropriate pressure is often considered inadmissible evidence in any later action for dismissal or damages against the employee.

Moreover, companies can require a written declaration from their employees that no wrong or incomplete information was provided during the interviews. In the Czech Republic, Denmark, Estonia, France, Greece, Hungary, Ireland, Latvia, Malta, Portugal, Slovakia, Slovenia and the UK such a declaration can even be used as the basis for a warning, dismissal, termination, etc. In Finland and the Netherlands, in giving such a wrong declaration or by refusing to sign it, the employee could infringe the standard required from the statutes or may be in breach of loyalty obligations. In Austria, Italy, and Belgium an employee cannot be forced to sign such a declaration and if he does so, there are no consequences based on a wrong declaration. In Bulgaria the employer cannot require such a declaration.

Legal consequences are also possible in case an employee does not disclose all the relevant facts during such interviews. Possible consequences are redress,[233] if there are resulting damages for employers, damage claims[234] and disciplinary sanctions,[235] which may result in dismissal or termination of the employment. In Ireland and Romania there exist no sanctions for not disclosing all relevant facts during an interview.

4.2.3 Conclusions

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233 Czech Republic.

234 Estonia.

235 Austria, Denmark, Finland, France, Germany, Hungary, Latvia, Lithuania, Italy, the Netherlands, Poland, Portugal, Slovakia, Slovenia, and the UK.

In the context of an M&A transaction, should the target entity be committing a cartel wrongdoing the probability of the parties to be exposed to cartel risk is close to 100%. The sanctions possibly deriving from the concretization of such risk are very severe, both in terms of monetary damages and reputational terms.[236] In addition, cartel are secret by nature and so difficult to investigate and detect. Hence, the liability potentially deriving from cartel infringements of the target entity represent one of the most risky areas for the parties of an M&A transaction.

It should be also noted that audit are costly and subject to a series of legal constraints which requires the relevant scope to be carefully targeted.

As a results, an audit performed in the context of an M&A transaction to protect the parties from cartel risk shall necessary have a specific "anti-cartel" purpose.

4.3 PRELIMINARY CARTEL RISK ASSESSMENT

As discussed, audit are not free of charge. The relevant conduction implies costs to be incurred and legal boundaries to be respected. As a result, it is more than advisable the performance of a preliminary cartel risk assessment to evaluate the general need to proceed with a full "anti-cartel" audit on the target entity. Not all the companies are in fact equally exposed to the risk of anticompetitive or – more precisely – collusive behavior. It depends from the industry in which it operates, the markets on which it is active but also a

[236] For a detailed description of cartel risk in the context of an M&A transaction see Chapter 2 of this Thesis.

possible history of antitrust wrongdoings or the implementation of preemptive measures, such as compliance programs.

The preliminary cartel risk assessment consists of a market / behavioral analysis possibly accompanied by an empirical screen. Such twofold analysis may reveal in advance whether the target entity is likely to have been involved in collusive conduct or not.[237]

On the basis of the outcome of this preliminary risk assessment, the parties of an M&A transaction may then decide (*rectius* negotiate, being the M&A deal a contentious scenario) whether to proceed with the "anti-cartel" audit or not.

4.3.1 The market and behavioral analysis

The first step of the cartel risk assessment consists in the analysis of the market (or markets) in which the target entity operates. More precisely, the analysis of the affected market shall focus on the following areas:

(i) the characteristics of the products produced by the target (*e.g.* homogenous products more often support collusive arrangements);[238]

(ii) the procurement markets in which the undertaking operates, if any;

(iii) the level of concentration of the markets which depends on the number of players being active therein. In fact, concentrated markets enhance cartel

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[237] See in this sense, C. Hummer and L. Leitner, *Antitrust Audit: Motives and Key Practical Aspects*, Journal of European Competition Law & Practice, 2012, Vol. 3, No. 3.

[238] In particular, undertakings producing homogenous bulk goods such as paper, cement, concrete, building materials, or chemical goods are also likely to be involved in collusive conduct. See Stadler, *Compliance Programme. Vorbeugung gegen Kartellversto¨ße im Unternehmen in Schwerpunkte des Kartellrechts 2004*, Heft 206 der FIW Schriftenreihe, 75.

infringements[239]. As a general rule, anticompetitive arrangements are most likely on stable, highly concentrated markets.

(iv) the development of the price level on the relevant market[240]. Should it be flat, there are in fact far higher chances that collusion may develop.

As a second step, the decision to conduct an audit may depend also on the specific "behavioral" circumstances of the target entity. Some companies in fact may already autonomously decide to conduct (for example in the ambit of their antitrust compliance programs) a comprehensive audit every few years; other may decide periodically to audit only certain operations; still others may decide to rely principally on other antitrust compliance measures and to reserve audits for special situations (like M&A transactions, as argued in this Thesis). In addition, the target entity may also use other methods of measuring its antitrust compliance, including the continuous involvement of antitrust counsels, internal procedures that ensure review of all matters of antitrust significance on an on-going basis, and unannounced spot-checks.

As a result, in deciding whether an antitrust audit is needed, the following factors may also be relevant: (i) whether the target entity has ever conducted an antitrust audit (or has not conducted an audit for several years); (ii) whether a

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239 The likelihood of collusion is generally higher among a small number of competitors for the following reasons: first, it is easier to reach consensus over the collusive conduct; and second, it is easier to monitor compliance with the collusive conduct. Also, high barriers to market entry increase the likelihood of collusion as low barriers to entry generally attract new competitors, which decreases the attraction of collusion. See Grout, *Structural Approaches in Cartel Detection, Grout: European Competition Law Annual 2006: Enforcement of Prohibition of Cartels* (Hart Publishing, Oxford, Oregon), 2.

240 Beninca/Zschocke, Kartellrecht in der Praxis—Ein Leitfaden, (C.F. Muller, Heidelberg, 2007) 261.

prior audit revealed antitrust problems; (iii) whether the target entity have been sued or threatened with suit for antitrust reasons; (iv) whether the target entity or the relevant industry has an history of antitrust problems.[241]

In this respect, anticompetitive arrangements are most likely when indeed no precautionary antitrust measures have been implemented by the target entity and / or the target entity or the industry in which it operates has experienced antitrust problems.

4.3.2 Econometric Screens

The second tool through which the preliminary cartel risk assessment may be conducted is the so called "econometric screen".

This is a statistical test based on an econometric model designed to identify industries where competition problems exist and, in such industries, where the companies are involved in a conspiracy. Screens apply statistical tools to commonly available data, such as prices or bids, costs, or market shares to identify patterns in the data that are either highly improbable or anomalous.[242]

It should be noted that econometric screening do also trigger antitrust cases, as happened in the Italian cartel case in baby milk.[243]

Screens employ a quantitative analysis which generally follows one of the two main strategies available. The first type of strategy aims at researches the

241 See in this sense, C. Hummer and L. Leitner, *Antitrust Audit: Motives and Key Practical Aspects*, Journal of European Competition Law & Practice, 2012, Vol. 3, No. 3.

242 Abrantes-Metz/Bajari, '*Screens for Conspiracies and their Multiple Applications*', (2009) American Bar Association–Antitrust Magazine 66. [Ins. Riferimento a caso AGCM]

243 *Beyond Leniency: Empirical Methods of Cartel Detection*, American Bar Association Brown Bag Series, (December 15, 2011). Presentations, slides, and audio available at www.americanbar.org .

improbable events that would not occur unless companies have concluded collusive arrangements. Differently, the other type of strategy uses, as reference, the statistical concept of a "control group" in order to identify anomalous patterns in the data. By comparing prices in markets suspected of collusion with prices in markets where there is competition, these methods try to identify the problems relating to competition.

From a more practical point of view, there are six requirements for properly develop and implement a screen: (i) an understanding of the relevant market, including its key drivers, the nature of competition, and the potential incentives to cheat—both internally and externally—to the corporation; (ii) a theory on the nature of the cheating; (iii) a theory on how such cheating will affect market outcomes; (iv) the design of a statistic capable of capturing the key factors of the theory of collusion, fraud, or the relevant type of cheating; (v) empirical or theoretical support for the screen; and (vi) the identification of an appropriate non-tainted benchmark against which the evidence of collusion or relevant cheating can be compared.[244]

As a result, econometric screens can provide extremely valuable circumstantial evidence for or against a possible cartel violation.

4.3.3 Conclusions

An "anti-cartel" audit, like every audit, implies the incurrence of high costs (also in terms of business disruption) and the respect of several legal

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[244] Abrantes-Metz, Rosa M. and Bajari, Patrick and Murphy, Joe, *Antitrust Screening: Making Compliance Programs Robust* (July 26, 2010). Available at SSRN: http://ssrn.com/abstract=1648948 or http://dx.doi.org/10.2139/ssrn.1648948 .

requirements. Audits are thus intrusive, complex and expensive tools to be managed.

A preliminary cartel risk assessment may allow the parties to make a more informed, and motivated, choice about the possibility to proceed with the full "anti-cartel" audit. Both market/behavioral analysis and econometric screens may in fact help not only to determine if cartel risk is likely to occur but also to better target the relevant subsequent audit, when needed.

As a result, it is highly advisable to launch an "anti-cartel" audit if the preliminary cartel risk analysis shows that the target entity is in a high risk market and it has never, or very rarely implemented any antitrust preemptive measure,

4.4 THE STRUCTURE OF THE AUDIT

Considering the secrecy element which renders cartels detection particularly difficult and the costs and legal constraints related to audits, a proper structure of the investigation is of essence for an effective and efficient conduction of the exercise.[245]

This Section firstly seeks to identify the party of the M&A deal under which responsibility the audit shall be conducted. The incentives of the parties and their respective position *vis à vis* the target entity are taken into account to argue

245 With reference to the structure of a general audit (not specifically aimed at discovering cartels), see, among the others, W.F. Schmitz, *Due Diligence for Corporate Acquisitions*, London-Boston, 1996; G. Bing, *Due diligence: planning, questions, issues*, Westport-London, 2008; P. Hawson, *Commercial due diligence: the key to understanding value in an acquisition*, Aldershot, 2006; A. H. Rosenbloom (ed. by), *Due diligence for global deal marketing: the definitive guide to cross-border merger and acquisitions, joint ventures, financing, and strategic alliances*, Princeton, 2002; L. S. Spedding, *The due diligence handbook: corporate governance, risk management and business planning*, Amsterdam, 2009.

that seller is the most appropriate party to which the conduction of the audit shall be entrusted.

The composition of the audit team is also examined. Legal professional privilege of outside counsels and the necessity for antitrust expertise are discussed and taken in due consideration. The solution advised is a mixed team of outside and in-house lawyers. Those latters should be involved given their particular proximity and confidence with the company's personnel and business.

Further, the Section enters more into the merits of the structure of the investigation. A three parts configuration is proposed. The audit shall be first properly announced within the company. Then the investigative phases of interviews and document review can follow. A report with the relevant findings, if any, is then eventually addressed to the seller.

4.4.1 The responsibility of conducting the audit

Both the parties of an M&A deal have in principle strong incentives in performing an "anti-cartel" audit.[246] As shown in Subchapter 2.2., both the seller and the buyer are in fact equally exposed to the cartel risk of the target entity, that is to say the risk of being called liable for cartel infringements. More

246 See in this sense also ; Wils, Wouter P. J., Antitrust Compliance Programmes & Optimal Antitrust Enforcement (October 31, 2012). Journal of Antitrust Enforcement, Volume 1, Issue 1, April 2013, Forthcoming. Available at SSRN: http://ssrn.com/abstract=2176309; Hoffsetter and Ludescher, *Fines Against Parent Companies in EU Antitrust Law - Setting Incentives for 'Best Practice Compliance'* (December 22, 2009). World Competition: Law and Economics Review, Vol. 33, No. 1, March 2010. Available at SSRN: http://ssrn.com/abstract=1502769; J. Murphy and W. Kolawsky, *The Role of Anti-Cartel Compliance Programs In Preventing Cartel Behavior*, Antitrust, Vol. 26, No. 2, Spring 2012.

specifically, on one side, the buyer has the incentive of performing the audit in order to protect itself from a liability risk that – differently from the seller – is simply "inherited" as a result of the transaction being made and without any possibility to control or prevent such risk before.

On the other side, the seller has a specific[247] interest in performing the audit in the context of an M&A deal in order to avoid – should a cartel be unveiled after the transfer being made – the very uncomfortable situation of not being able any more to provide the necessary/sufficient evidences to apply for leniency[248] (or in a later stage to defend itself in courts). The seller would be in fact prevented from having access to the employees and documents of its former subsidiary.

As a result, although both parties hold strong incentives for performing the "anti-cartel" audit, they cannot be considered on an equal footing when it comes to discuss their attitude in practically conducting it.

As it will be further analyzed in Subchapter 4.3.1, should the audit reveal that the target entity is involved in cartel activities, such result may be used as a trigger for leniency application.

Since - following the *Hoechst* case[249] - only one company may benefit from immunity and may support its application with the same evidences, it goes

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247 The primary incentive for the seller should be represented by the deterrent effect of the high level of fines imposed by the EU Commission (as extensively discussed in Chapter 2 of this Thesis).

248 For a more extensive analysis of leniency program in the EU see Subchapter 4.2.1 below.

249 *Id.*

without saying that leaving the possibility to conduct the audit (having access to the relevant results and collected evidences) to the buyer, which is very likely to be a competitor of the seller (and even a co-cartelist), may expose the seller to very unpleasant consequences. The seller may in fact be involved in a cartel proceeding triggered by a leniency application launched by the buyer and supported by the evidences collected during the audit, with the aggravating factor of not being any more able to run for immunity nor (very likely) for any other kind of discount. In such case in fact, the collected evidences regarding the target entity would have already been provided to the proceeding authority by the buyer in order to support its own immunity application. This would be an application from which the seller would not and could not benefit[250] and as a result of which only the applicant[251] (*i.e.* the buyer) would be exempted from the fine.

Last but not least, the seller is by definition the party that has better chances to detect a wrongdoing because it has owned and managed the target entity since years and it perfectly knows, or should know, how and where researching the necessary information and evidences, if any.

As a result, the seller is unequivocally the best placed party to materially conduct the audit. As a logical consequence, the relevant responsibility should fall on it.

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250 See Case T-161/05, Hoechst v Commission, [2009] OJ C155, para. 63.

251 Meaning the economic unit applying for leniency. Hence, both a parent company and its subsidiary will benefit.

The management of the results of the audit aimed at obtaining a beneficial effect on the M&A deal shall be then also treated with care. Subchapter 4.3 will provide a thorough analysis in this respect.

4.4.2 The selection of the "audit team"

4.4.2(i) The necessity of antitrust expertise

First of all, people entrusted with conducting the audit shall have effective working knowledge of antitrust principles (in particular, with specific reference to collusive conducts). Antitrust expertise is indeed necessary to recognize more subtle (but still serious) anticompetitive conducts that rarely, if ever, will be labeled as such in corporate documents.[252]

If using antitrust lawyers to conduct an audit is not feasible, supervisory responsibility of the audit should at least be assigned to a lawyer possessing reasonable antitrust expertise. Barring that, an experienced antitrust lawyer should be readily available and consulted throughout the audit process in order to provide general guidance and answer specific questions. Without such expert input, the audit may produce little more than unnecessary disruption and a false sense of security or, even worse, may result in unprivileged communications that could actually (also *vis à vis* the counterparty) increase the

252 See in this sense the ICC Antitrust Compliance Toolkit available at http://www.iccwbo.org/Advocacy-Codes-and-Rules/Areas-of-work/Competition/ICC-Antitrust-Compliance-Toolkit/ ; or also, for a comparative analysis, Section 8.B.2.1 of United States Sentencing Commission, Guidelines Manual, para.3E1.1 (Nov. 2013). For a valid comment see Sokol, D. Daniel, *Detection and Compliance in Cartel Policy* (September 30, 2011). CPI Antitrust Chronicle, Vol. 2, September 2011. Available at SSRN: http://ssrn.com/abstract=1935907 .

risk of entangling the company in antitrust litigation (or even worse in a leniency application launched by the buyer of by another competitor).

In selecting the audit team, the company can turn to: (i) in-house legal counsels (if they hold antitrust expertise); (ii) regular outside legal counsels (holding antitrust expertise); (iii) special outside legal counsels specifically and newly appointed to conduct the antitrust audit. Depending on the specific situation, each type of counsel has advantages and disadvantages.[253]

In-house counsels generally know the most about the company and its documents and have established close working relationships with company's employees and staff (*i.e.* their colleagues). In addition, use of in-house counsels will reduce the cost of the audit. On the other hand, in-house counsels typically have many responsibilities, and may be hard pressed to carry out an audit on their own. In-house counsels may also conclude that investigatory aspects of the audit would undermine their counseling role, or potentially jeopardize their ongoing amicable relations with staff members.

Outside counsels should be in a position to structure the audit so it may be conducted efficiently, and with the least possible disruption to company's ongoing activities. Outside counsels also may be in a better position to handle the investigatory aspects of the audit; staff employees may feel more comfortable talking about a possible anticompetitive collusion to an "outsider", especially if the company has adequately explained in advance why the audit is

253 *Id.*

taking place and what counsel's role is. On the other hand, as noted, outside counsels generally know less than in-house counsels about the company and will be more expensive than in-house counsels.

The third option is to involve special and newly appointed outside counsels who can conduct a thorough investigation without compromising ongoing relationships. But special (and newly appointed) counsels will know the least about the company and their activities, thus this may be the most expensive option. Because by definition they lack any ongoing relationship with the company, special counsels may find it relatively more difficult to gain the complete trust of those staff members who will be interviewed and whose company and "personal" files need to be reviewed.

4.4.2(ii) The Legal Professional Privilege ("LPP") enjoyed by outside legal counsels

Last but not least, in choosing who should be entrusted with the conduction of the audit the preservation of legal professional privilege (also known as "LPP") in respect of the information gained and documented during the audit shall be also taken into account.[254]

That some documents are covered by legal professional privilege under EU law was clearly established by the Court of Justice in *AM & Europe Ltd v Commission*[255], where it acknowledged that the maintenance of confidentiality as regards certain communications between lawyer and client constitutes a general

254 In the UK in-house counsels also have legal privilege.

255 Case 155/79 [1982] ECR 1575, [1982] 2 CMLR 264.

principle of law common to the laws of all Member States and, as such, a fundamental right protected by EU law. The Court held that "*any person must be able, without constraint, to consult a lawyer whose profession entails the giving of independent legal advice to all those in need of it*", and that, therefore, the confidentiality of certain lawyer-client communications must be protected.[256]

In *AM&S* the Court of Justice defined the scope of LPP in the EU system, on the basis of the legal traditions common to the Member States. It interpreted Regulation 17/62[257] as protecting the confidentiality of written communications between a lawyer and his or her clients, subject to two conditions, namely that such communications (i) are made for the purposes and in the interests of the client's rights of defense, and (ii) emanate from independent lawyers who are qualified to practice in an EEA country.[258] With regard to the first requirement, the Court recognized that all written lawyer-client communications exchanged after the initiation of the proceedings and any earlier written communications that have a relationship to the subject-matter of that procedure must be protected.[259] Moreover, in *Hilti v Commission* the general Court established that

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256 *Ibid.* Although AM&S was concerned with inspections, it has been generally acknowledged that the principles established in that case also apply to Commission's requests for information.

257 Regulation 17/62 implementing Articles 85 and 86 of the Treaty [1956-1960] OJ Spec. Ed. .

258 Case 155/79 "Zinc", para 21. These principles were also confirmed in the most recent case *Akzo*: Joined Cases T-125 and 253/03 and Case 550/07 P "Heat Stabilisers".

259 Case 155/79 "Zinc", para 23. See also Kerse & Khan at 145 and 146. It follows that also advice given by legal counsel prior to the initiation of cartel proceedings, concerning the legal assessment of a cartel agreement or practice under Article 101 TFEU, including the likelihood of prosecution and fines, or advice given in relation to potential interim measures, should be covered by LPP.

any internal documents of the undertaking being investigated, which reported the content of communications and legal advice received by independent external lawyers and were distributed within the undertaking for consideration by managerial staff, are still covered by LPP, too.[260]

Pursuant to the second requirement established in *AM&S*, LPP applies only to written communications emanating from independent lawyers who are entitled to practice their profession in one of the Member States, regardless of whether this is the same Member State in which the client resides.[261] The notion of "*independent lawyer*" does not encompass, in the Court's view, any legal expert who is bound to his or her client by a relationship of employment (*i.e.* in-house lawyers).[262] Moreover, it should be also noted that correspondence between an undertaking's external lawyer and a lawyer acting for a third party does not enjoy privilege.[263]

4.4.2(iii) The advisable solution: a mixed team

In light of the above and being the LLP principle established by EU Courts, the preferable and advisable solution for the entrustment of conducting the

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260 Case T-30/89 Hilti/Commission 1990 ECR II-163, para 18 (stating that "*the principle of the protection of written communications between lawyer and client must, in view of its purpose, be regarded as extending also to the internal notes, which are confined to reporting the text or the content of those communications*").

261 Case 155/79 "Zinc", para 25. The limits of this protection are to be determined by reference to the rules on the practice of the legal profession as set forth in Council Directive 77/249/EEC of March 22, 1977, to facilitate the effective exercise by lawyers of freedom to provide services (OJ L 78/17) and Directive 98/5/EC of the European Parliament and of the Council of February 16, 1998, to facilitate practice of the profession of lawyer on a permanent basis in a Member State other than that in which the qualification was obtained (OJ L 77/36).

262 Case 155/79 "Zinc", para 27.

263 *Perindopril (Servier)*, Commission Decision of July 23, 2010.

audit is to engage an outside counsel with antitrust expertise. This said and considering the difficulties an outside counsel may encounter in investigating the target entity, the best option is to make the outside counsel be supported by in-house lawyers of the seller (or of the same target entity) as well.[264]

4.4.3 The possible structure of the audit

For an effective cartel detection, it is of essence to properly structure the "anti-cartel" audit so it may be conducted with the least possible disruption to target entity's ongoing activities and in a manner which minimizes the costs and the risk that evidence may be hidden or destroyed.[265] This Subsection presents a possible structure of audit, which develops in two phases. The audit shall start with a "*preparatory phase*" during which the characteristics of the target entity and the relevant markets and industry shall be studied. A properly announced and prepared "*investigatory phase*" shall then follow during which document review and interviews shall be performed.

4.4.3(i) The Preparatory Phase

The analysis of many (but by no means all) cartel issues partially depends on the structure of the industry or industries in which the target entity operates. Consequently, it may be appropriate for the counsel performing the audit to first gather as much basic information as possible with respect to each relevant industry early in the audit process. At a minimum, counsel should preliminary

264 This conclusion is shared also by Sokol, D. Daniel, Detection and Compliance in Cartel Policy (September 30, 2011). CPI Antitrust Chronicle, Vol. 2, September 2011. Available at SSRN: http://ssrn.com/abstract=1935907 .

265 See in this sense, C. Hummer and L. Leitner, *Antitrust Audit: Motives and Key Practical Aspects*, Journal of European Competition Law & Practice, 2012, Vol. 3, No. 3.

identify: (i) the relevant products and geographic markets in which members of the association compete; (ii) the levels of concentration in those markets, and (iii) the approximate market shares of the largest competitors, whether they are association members or not.

In addition, it is also useful to inquire (iv) whether the industry has experienced any serious antitrust problems in the past years, and (v) whether the industry exhibits any apparent pattern of price stability or price leadership.[266]

At the same time, counsel should also review the target entity's history of antitrust litigation and investigations.

Moreover, it may be also advisable for counsel to conduct an initial series of relatively brief interviews with high level executives, and perhaps some lower level personnel, to provide background information and identify specific areas deserving closer attention. The following check-list includes some recurring areas of antitrust risk for companies: (i) prior antitrust litigation or investigation, outstanding decrees, decisions or orders issued by antitrust

[266] The importance of acquiring a basic knowledge of the industry and the markets in which the interested company operates as a precondition to conduct an effective antitrust audit (and *rectius* any antitrust assessment) is also stressed by the following authors: Ghosal, Vivek and Sokol, D. Daniel, *Compliance, Detection, and Mergers and Acquisitions* (May 1, 2013). Managerial and Decision Economics 34(7) 2013; Minnesota Legal Studies Research Paper No. 13-21. Available at SSRN: http://ssrn.com/abstract=2259039 or http://dx.doi.org/10.2139/ssrn.2259039 , Sokol, D. Daniel, *Detection and Compliance in Cartel Policy* (September 30, 2011). CPI Antitrust Chronicle, Vol. 2, September 2011. Available at SSRN: http://ssrn.com/abstract=1935907 ; J. Murphy and W. Kolawsky, *The Role of Anti-Cartel Compliance Programs In Preventing Cartel Behavior, Antitrust*, Vol. 26, No. 2, Spring 2012; C. Hummer and L. Leitner, *Antitrust Audit: Motives and Key Practical Aspects*, Journal of European Competition Law & Practice, 2012, Vol. 3, No. 3.

authorities; (ii) litigation threats; (iii) price-fixing agreements; (iv) customer, territorial, or product allocation agreements; (v) product standardization or certification programs; (vi) statistical programs and other exchange of competitive information between competitors (also through trade associations); (vii) codes of ethics and similar industry "self-policing" measures; (viii) credit reporting systems; (ix) compensation surveys; (x) trade show activities.[267]

Once acquired these preliminary information and backed up also by the data collected during the preliminary risk assessment performed (see Section 4.1. above), the counsel has all the necessary elements to better define the scope and objectives of the core part of the audit: the investigative phase.

4.4.3(ii) The Investigative Phase

In the course of an "anti-cartel" audit several investigative measures must be taken. However, the first advisable step is to inform the employees, and

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[267] These elements are usually listed in almost all the interview's check-list provided by the compliance manuals drafted by competition authorities and independent institutions dealing with antitrust compliance matters. See for example, ICC Antitrust Compliance Toolkit available at http://www.iccwbo.org/Advocacy-Codes-and-Rules/Areas-of-work/Competition/ICC-Antitrust-Compliance-Toolkit/ ; or the UK Office of Fair Trade Guide, How your business can achieve compliance with competition law, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284402/oft1341.pdf; also, for a comparative analysis, the *United States Sentencing Commission, Guidelines Manual*, para.3E1.1 (Nov. 2013); The Australian Competition and Consumer Commission's 2005 guidance, *Corporate trade practices and compliance programmes*, available at 1http://www.accc.gov.au/content/item.phtml?itemId=717078&nodeId=0de4ca0a69fe9dde037bf81391b2cdab&fn =Corporate%20trade%20practices%20compliance%20programs.pdf ; the Canadian Competition Bureau enforcement Bulletin, *Corporate Compliance Programs*, available at http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/CorporateCompliancePrograms-sept-2010 e.pdf/$FILE/CorporateCompliancePrograms-sept-2010-e.pdf

possibly the relevant trade unions and work councils, about the intention of the company to perform an audit aimed at detection of cartel wrongdoings.

Voluntarily informing employee of the audit, in particular before conducting personal interviews and/or reviewing e-mails and documents and regardless any form of mandatory disclosure,[268] might in fact be considered good practice and also contribute in general to a better working environment which could enhance a more fruitful detection.

The decision of announcing an audit is fundamental for two straightforward reasons. On the one hand, the cooperation of employees facilitates the execution of the audit.[269] On the other hand, reviewing documents without the employees' consent is limited by labor, data protection and criminal law. Therefore, it is recommended to obtain in advance the explicit written approval from the employees to review their documents in the course of an audit.[270]

The announcement of the audit

With regards to the approach to be taken in announcing the audit, the most simple and advisable method is to obtain the endorsement of the target's

[268] Those cases of compulsory disclosure already analyzed in Subsection 4.2.1 above.

[269] In this respect, in all the Member States of the European Union, there exists an obligation for current employees to cooperate during an antitrust audit, except in Belgium. This obligation derives either from employment contracts or the principles of good faith and loyalty.

[270] Such strategic use of the announcement of the audit is also shared by the following authors: J. Murphy and W. Kolawsky, The Role of Anti-Cartel Compliance Programs In Preventing Cartel Behavior, Antitrust, Vol. 26, No. 2, Spring 2012; C. Hummer and L. Leitner, Antitrust Audit: Motives and Key Practical Aspects, Journal of European Competition Law & Practice, 2012, Vol. 3, No. 3.

company senior full-time executive (usually the President) signing an internal memorandum announcing and illustrating the audit.

The announcing memorandum should however carefully avoid stating the explicit "anti-cartel" purposes. It should instead be broader about the purposes, stating few generic information, amongst which: (i) the target entity has engaged outside counsels for the purpose of obtaining legal advice concerning the company's compliance with antitrust law; (ii) the audit is being undertaken for the continued well-being of the company and company's staff; (iii) the audit is not being conducted because of any specific antitrust problems or suspicions; (iv) staff should cooperate fully with counsel in making their files available for examination and in making themselves available for interviews; (v) staff should avoid discussing the audit with anyone else than outside counsels performing the audit (or those working directly for such counsel, *e.g.* in-house counsels); and (vi) the employees involved will be protected against disciplinary measures.

The memorandum serves several functions. First, it authorizes outside counsels to proceed with the audit. Second, it conveys the message that the top executives of the company are fully committed to the audit. Third, it helps also establishing that communications during the audit are subject to the LLP. Fourth, it lets the entire company's staff knowing that the audit is for their members' benefit and that no specific staff members are under suspicion of having committed wrongdoings. Lastly, it limits the possible information leakages.

It could be advisable to distribute the memorandum during a meeting of key company's personnel in which the chief executive introduces the lawyers who will conduct the audit and describes the purpose and scope of the audit and the role of the external lawyer or lawyers involved.

Document review

After the audit be announced and a first round of preliminary and high level interviews be performed, the counsels may choose to proceed with the document review. Document review is usually the most time-consuming and expensive phase of an audit. It is nevertheless essential, because many antitrust problems come to light only through such a review, including e-mail messages, which, naturally enough, would be at the center of any future antitrust investigation or litigation.[271]

In this respect, it is equally obvious that anyone involved in a cartel is anxious not to leave any traces behind and to avoid producing incriminating evidence. Accordingly, there is less and less written communication between cartel members, but, in the majority of cartels, written evidence of collusive conduct can still be found in e-mails and other documents. In particular the e-mails of employees in antitrust-sensitive positions can help to identify cartel infringements.[272] The most common method to detect such evidences is then the use specific forensic software allowing the filtering of electronic documents in

[271] As it will be better explained in Subchapter 4.3.1 below, if collected during the audit, such "incriminating evidences may be then used by the seller to launch and support a leniency application for immunity from fines".

[272] More specifically, minutes of trade association meetings, travel expenses, quotation documents, or price calculations also often contain indications or illegal conduct.

order to assess their (potential) relevance regarding indications of anticompetitive conduct.[273]

Moreover, the document review process needs to be properly structured in order to be efficiently and effectively implemented.[274] In this respect, it is of the essence to identify two subsequent process milestones: what documents should be reviewed and who should review them.

To have an example of the documents to be reviewed, the following list includes categories of documents that often will be reviewed in "anti-cartel" audits: (i) files concerning non-antitrust litigation and litigation threats (to determine whether an antitrust claim may be added); (ii) written opinions of antitrust counsels concerning present or past practices of the target entity; (iii) minutes of the meetings of the board of directors and other important committees or groups (counsels may also wish to review some agendas, to verify that meetings follow the agenda); (iv) files of key company executives, including all "personal" files that relates to company's activities; (v) files

273 The forensic software works by searching documents on the base of specific "search words" inserted by the operator. To this extent, it is of essence to draft beforehand a list of "search words" to be used by the software. Examples include references to "partnering" with powerful customers, preserving "Italian market for Italians", "unfair" pricing practices, not being a "team player", various chest-thumping utterances, notations such as "destroy after reading", and so forth. Forensic software are commonly and extensively used to help external lawyers in the context of the audit performed with the aim of finding evidences to support leniency application. In the majority of cases IT companies specialized in this field are involved.

274 Then is also important to modify the scope and implementation of the document-review process to maximize efficiency and effectiveness. If reviewers discover that certain categories of documents are voluminous and insignificant, reviewers should quickly spot-check those documents or ignore them entirely. On the other hand, if the document review turns up unexpected problems, the review program should be expanded accordingly.

relating to substantive topics of inquiry, *i.e.*, membership requirements, industry self-regulation, pricing, statistics, marketing, standardization and certification programs, patents, and patent licensing agreements; (vi) antitrust compliance manuals and guides; and (vii) documents relating to any joint venture or any other collaborative arrangements with other organizations.[275]

With regards to the composition of the audit team, if the audit is limited in scope, or the target entity a small-sized one, counsel may be able to review documents by themselves, without other people involved. For larger audits, counsel may instead decide to assemble a document-review team that includes also in-house lawyers. The team approach speeds up the document review process and reduces costs. But should in-house reviewers lack substantial antitrust expertise, they cannot be expected to recognize antitrust issues simply by reading the documents. Consequently, it is advisable that non-experts members of the team receive precise instructions and guidelines from antitrust

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[275] Such illustrative list is the result of a summary of the most common documents identified as important to review by the most important compliance manuals drafted by competition authorities and independent institutions dealing with antitrust compliance matters. See for example, ICC Antitrust Compliance Toolkit available at http://www.iccwbo.org/Advocacy-Codes-and-Rules/Areas-of-work/Competition/ICC-Antitrust-Compliance-Toolkit/ ; or the UK Office of Fair Trade Guide, How your business can achieve compliance with competition law, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284402/oft1341.pdf; also, for a comparative analysis, the United States Sentencing Commission, Guidelines Manual, para.3E1.1 (Nov. 2013); The Australian Competition and Consumer Commission's 2005 guidance, Corporate trade practices and compliance programmes, available at 1http://www.accc.gov.au/content/item.phtml?itemId=717078&nodeId=0de4ca0a69fe9dde037bf81391b2cdab&fn =Corporate%20trade%20practices%20compliance%20programs.pdf ; the Canadian Competition Bureau enforcement Bulletin, Corporate Compliance Programs, available at http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/CorporateCompliancePrograms-sept-2010 e.pdf/$FILE/CorporateCompliancePrograms-sept-2010-e.pdf

counsel about what to look for (*e.g.* references to prices, costs, profits, discussion of how to deal with specific competitors or customers; use of colorful language, etc.). Properly instructed non-expert reviewers can then perform a "first cut" review, leaving a smaller group of documents for a more careful review by outside counsels.[276]

<u>*Interviews*</u>

Usually the most effective way of uncovering illegal conducts is by interviewing executives and sales managers which are the most exposed employees to be potentially involved in collusive conducts. However, as not everybody is inclined to confess his wrongdoings, interviews should be preceded by the document review and the relevant results may be used to confront employees during the interviews.

As a result, it is advisable to defer interviews until the document-review process is reasonably completed, so that the interviewer can (also) explore ambiguous or problematic documents. In addition, interviews may autonomously reveal cartel problems that are not reflected in company's documents.[277]

With regards to the practical aspects of conducting the interviews, the company's top executives contribution is key. In addition, it might also be important that lower-level staff members with responsibility for specific

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[276] Such guidelines for the composition of the audit team advised by Timothy J. Waters and Robert H. Morse, *Antitrust & Trade Associations*, in *How Trade Regulations Laws apply to Trade and Professional Associations*, Section of Antitrust Law of ABA, 2011.

[277] *Id.*

industry groups or markets are interviewed. Moreover, the document-review process usually identifies the other staff personnel who should be interviewed, including those involved in potentially high-risk activities, those who are found to have authored problematic or ambiguous documents, also by using suspicious "colorful" language.[278]

In addition, to establish that the interviews are protected by the legal professional privilege (explained in Subchapter 4.2.3 above), counsel should clearly state since the beginning of each interview that it is confidential and it is being conducted for the purpose of giving legal advice to the target entity. It is also advisable for counsel to expressly specify it represents the company and not any of its employees individually.[279]

The following list includes some of the topics that counsel may wish to cover in the interviews: (i) discussions with competitors concerning prices or any element of price (*i.e.*, discounts, credit terms, delivery charges, accessories, warranties, profits, costs), bidding processes, customers or territorial allocation (ii) derogatory comments about competitors, suppliers, or customers; (iii) whether company executives conduct "rump sessions" before or after trade

278 Examples of such language include references to "partnering" with powerful customers, preserving "Italian market for Italians", "unfair" pricing practices, not being a "team player", various chest-thumping utterances, notations such as "destroy after reading", and so forth.

279 See in this respect DLA and Piper, Legal Privilege Handbook 2012, available at http://www.dlapiper.com/~/media/Files/Insights/Publications/2012/03/Europe%20DLA%20Pipers%20Legal%20Privilege%20Handbook%202012/Files/Legal_Privilige_Handbook_2012_v2/FileAttachment/Legal_Privilige_Handbook_2012_v2.pdf .

association meetings; (iv) whether the employees are aware of departures from the company's antitrust policy (if and when implemented).[280]

4.4.3(iii) The audit report

After completing the audit, counsel must analyze the information collected and draft a report to be addressed to the seller (*i.e.* the party under which responsibility the audit is conducted). The report should conclude by identify or excluding past or ongoing violations of anti-cartel laws carried on by the target entity.

Such "positive" or "negative" results may be then profitably used by the parties to adapt accordingly their approach to the deal and secure themselves form cartel risk. In this respect, a suggested approach is proposed in the following Section 4.3.

4.4.4 Conclusions

This Section proposes a possible structure for an efficient and effective conduction of the "anti-cartel" audit in the context of an M&A deal.

The seller is identified as the most appropriate party under which responsibility the audit shall be conducted. The practical conduction of the exercise shall instead be entrusted by this latter to a mixed team of outside and in-house counsels. This would ensure the more appropriate and efficient combination between necessary antitrust expertise and proximity to the company's personnel and business.

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280 Such list is an extract of the advices for conducting interviews contained in the ICC Antitrust Compliance Toolkit available at http://www.iccwbo.org/Advocacy-Codes-and-Rules/Areas-of-work/Competition/ICC-Antitrust-Compliance-Toolkit/ .

Further, a three parts organization is proposed. First, the audit shall be properly and internally announced. Then the instigative phase of interviews and document review may follow. Eventually, a report with the relevant findings, if any, shall be addressed to the seller.

4.5 THE BENEFICIAL EXPLOITATION OF THE AUDIT RESULTS

As said, the "anti-cartel" audit may have twofold results. It may reveal the existence of past or ongoing cartel activities perpetuated by the target entity ("positive result") or differently conclude without any findings of cartel activities ("negative result"). However, the simple obtainment of such results is not in itself beneficial to secure the M&A parties from cartel risk related to the transaction.

This Section discusses the further actions required to the parties in this respect.

On one side, the elimination of cartel risk through the use of the "positive" result as a trigger for leniency will be analyzed. On the other side, an empirical approach to more effectively allocate cartel liability which still residues following a "negative" result obtained is discussed.

4.5.1 Positive result and leniency programs

Should the audit be concluded with a "positive result" detecting a cartel activity going on, the evidences collected therein may be then used by the seller to support a leniency application and be awarded by the relevant immunity. In this manner, the cartel risk is completely eliminated from the transaction. The parties may go on with the deal without considering any more cartel liability as an issue.[281]

The following paragraphs will offer a brief introduction to EU leniency program with a view of discussing the possibility to use an audit's result detecting a cartel as a trigger of an immunity application.

4.5.1(i) The EU leniency program in a nutshell

The Commission's cartel leniency policy encourages cartel participants to come forward and "whistleblow" on their co-conspirators in return for immunity from fines or a reduction in the fines that would otherwise be imposed.[282]

In 1996 the Commission published the first Leniency Notice (the "Leniency Notice").[283] Such Notice stated that, in the event of participants in cartels giving information to the Commission and cooperating with it in the investigation, they could expect a reduction in the fine which would otherwise be imposed, or even no fine at all.

281 The only "side effect" of this approach may be generated when the buyer is a co-cartelist of the seller. In such a case, the buyer may in fact be involved in the proceeding triggered by the leniency application launched by the seller in the context of the M&A deal.

282 See A. Stephan, "*An Empirical Assessment of the European Leniency Notice*" [2009], Journal of Competition Law and Economics 5 (3) 517.

283 Commission Notice on the non-imposition or reduction of fines in cartel cases [1996] OJ C204/14.

The Commission amended the Leniency Notice in February 2002.[284] Amongst the other improvements, the 2002 Notice did guarantee immunity to the first undertaking to submit evidence which met certain criteria.[285]

The 2002 Notice was then replaced by the current one in 2006. The key features of the 2006 Notice[286] which are indeed of interest for this Thesis are briefly discussed in the following paragraphs.

Immunity is guaranteed only to the first undertaking to submit evidence sufficient for the Commission either to mount a targeted inspection pursuant to Article 20(4) of Regulation 1/2003 or to enable the Commission to find an infringement, if certain other conditions (*i.e.* full, continuous and expeditious cooperation with the Commission, as set out in paragraph 12 of the Notice) are fulfilled.[287]

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284 Commission Notice on immunity from fines in cartel cases [2002] OJ C45/3, For comments on the Notice, see, e.g. N. Levy and R. O'Donghue, "*The EU Leniency Programme Comes of Age*", [2004], World Competition Law and Economics Review 75-99 [92].

285 See B. van Barlingen and M. Barennes, "*The European Commission's 2002 Leniency Notice in Practice*", Competition Policy Newsletter Number 3, Autumn 2005, 6.

286 Commission Notice on Immunity from fines and reduction of fines in cartel cases [2006] OJ C 298/11; Commission press release IP/06/1705, 7 December 2006. See S. Suurnäkki and M.L. Tierno Centella, "*Commission Adopts Revised Leniency Notice to Reward Companies that Report Hardcore Cartels*", (2007), EC Competition Policy Newsletter 7.

287 Paragraph 12 of the 2006 Leniency Notice: "*In addition to the conditions set out in points (8)(a), (9) and (10) or in points (8)(b) and 11, all the following conditions must be met in any case to qualify for any immunity from a fine: (a) The undertaking cooperates genuinely (5), fully, on a continuous basis and expeditiously from the time it submits its application throughout the Commission's administrative procedure. This includes: (i) providing the Commission promptly with all relevant information and evidence relating to the alleged cartel that comes into its possession or is available to it; (ii) remaining at the Commission's disposal to answer promptly to any request that may contribute to the establishment of the facts; (iii) making current (and, if possible, former) employees and directors available for interviews with the Commission; (iv) not destroying, falsifying or concealing relevant information or evidence relating to the alleged cartel; and (v) not disclosing the fact or any of the content of its application before the Commission has issued a statement of objections in the case, unless otherwise agreed; (b) The undertaking ended its involvement in the alleged cartel immediately following its application,*

The Notice sets out what type of information and evidences applicants need to submit to qualify for immunity: it links the threshold for immunity to what the Commission needs in order to carry out a “targeted inspection”; it explains what applicants are and are not required to produce in their initial application; and it states explicitly that applicants need to disclose their participation in the cartel.

Another relevant provision detailed in the Notice is that the undertaking has to end its involvement in the cartel.

The immunity is firstly granted through a so called “conditional immunity” decision. This decision remains unpublished and provides that, at the end of the administrative procedure, the Commission‘s final decision will grant the applicant immunity from fines, provided that the applicant has met the conditions set out the Notice to be granted immunity.

Undertakings which approach the Commission later are eligible for a reduction in the fine that would otherwise have been imposed, subject to the same ongoing cooperation as from immunity applicants. However, nothing is guaranteed to them.

With the tool of the discretionary “*marker system*”, introduced in 2006, the Commission grants to the first immunity applicant the possibility to reserve the

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except for what would, in the Commission's view, be reasonably necessary to preserve the integrity of the inspections; (c) When contemplating making its application to the Commission, the undertaking must not have destroyed, falsified or concealed evidence of the alleged cartel nor disclosed the fact or any of the content of its contemplated application, except to other competition authorities.”

first place in the queue by initially providing only limited information. The Commission grants then a period of time (at its discretion)[288] to perfection the application with the additional evidence required to reach the immunity threshold.

The greatest problem for undertakings contemplating immunity application is still that, at the time of the submission, the Commission must not already have sufficient evidence to carry out the inspection or find an infringement, and the undertaking has to be the first to provide it. So there is no immunity if the Commission has already gathered the necessary evidence, or if the undertaking has not approached the Commission first.

Undertakings which do not meet the criteria for immunity can get a reduction of the fine. Undertakings willing to participate in the leniency program are required to produce information of "*significant added value*" to the Commission. There is no "*marker system*" in respect of reductions.

For the sake of completeness and taking to account that the analysis of the EU Member States' leniency programs is outside the scope of this Thesis, it must be nonetheless specified that the EU Leniency Program co-exists with the national leniency programs implemented – as of the date – by each Member State of the EU save for Malta and Croatia.[289] Although such programs have more or less the same characteristics of the EU one, it should be pointed out that

288 In "Competition: revised Leniency Notice – frequently asked questions", Commission MEMO/06/469 the Commission expressly refrained from giving any indication about the length of time; it "*will need to be decided based on the circumstances of each case*".

289 See official report of the EU Commission updated as of November 22, 2012 and available at http://ec.europa.eu/competition/ecn/leniency_programme_nca.pdf.

there is no EU-wide leniency system and "*an application for leniency to a given authority is not to be considered as an application for leniency to any other authority*".[290]

4.5.1(ii) Positive result as a trigger for leniency

As anticipated, the mere fact that the audit ends up by detecting a cartel carried out by the target entity is not in itself beneficial to the secure the M&A transaction from cartel risk. If not disclosed in a proper manner, this type of result may instead not only jeopardize the deal by causing the withdrawal of the buyer but also may motivate this latter (and even other co-cartelists) to blow the "leniency" whistle to the competent antitrust authority (even before the same seller).

Having obtained a positive result from the audit it is indeed beneficial to the deal in so far as such result is used in a manner that has the effect of eliminating the cartel risk from the transaction.

In this respect, the most reasonable and advisable solution is that the seller stops the illegal conduct and immediately blows the whistle by cooperating with the competent competition authority in order to apply for leniency and, hopefully, get immunity.

Only and once obtained a conditional immunity or even – at the latest – a "*marker*" (certifying to be the first in the queue) it may be then advisable for the seller to disclose the perspective buyer, but still on a strict confidential basis, both the result of the audit and the consequent immunity application made.

290 Cooperation Notice [2004] OJ C 101/43, para. 37.

This approach has a positive effect on both the buyer and the seller. It completely secures the M&A transaction by eliminating the relevant cartel risk. The relevant wrongdoing made by the target entity is in fact detected, ceased and properly denounced before the execution of the transaction being made.

4.5.2 "Extra-contractual" value of the negative result: an empirical approach

The audit may indeed also be completed without discovering any wrongdoing committed by the target entity (*i.e.* "negative result"). Intuitively, such type of result could appear the most suitable result to be achieved. It in fact basically ascertains the absence of cartel risk from the transaction.

However, a residual risk remains. Differently from the hypothesis of an audit discovering a cartel which is then denounced through a successful leniency, the "negative result" scenario does not exclude the possibility, maybe remote, of an antitrust authority opening anyhow a cartel proceeding against the target entity and fining it jointly and severally with its present and past parent companies (that is to say, the buyer and the seller).

As a result, the beneficial use of the negative result is, again, essentially linked to possibility of eliminating also such residual cartel risk from the transaction.

In this case, the most immediate solution is to make the seller be contractually bound *vis à vis* the buyer by the result obtained by the audit conducted under its responsibility. On the basis of such result, the seller is in a position to represent and warrant to the buyer that the target entity has not committed any cartel wrongdoing. This specific representation and warrant shall be released in the ambit of the customary set of seller's representations and warranties in the Purchase Agreement (as extensively discussed in Chapter 3).

However, such representation and warranties mechanism is still insufficient to completely clear out cartel risk from the transactions. Being in fact a contractual remedy,[291] it does not offer protection *vis à vis* third parties, such as a proceeding antitrust authority. In addition, it does not extend protection to the seller.

A possible empirical solution to extend the effectiveness of the said contractual remedy is proposed in the paragraphs below. The reasons for not extending the protection also to the seller are also discussed.

4.5.2(i) "Ultra partes" effectiveness of the contractual "rep&war" mechanism

By making the seller represent (and warrant) that the target entity has not engaged in any cartel wrongdoing, the buyer enjoys contractual protection *vis à vis* cartel risk. Should in fact the seller's representation reveal to be untrue at a later stage and an antitrust authority impose a fine over the buyer for cartel infringement of the target, the buyer may claim contractual damages against the seller for breach of representations and warranties released in the Purchase Agreement. However, as already discussed in Subchapter 3.3, contractual covenants do not offer any protection *vis à vis* third parties, including antitrust authorities.

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291 The ineffectiveness of contractual remedies *vis à vis* cartel risk is extensively treated in Chapter 3 of this Thesis.

As a result, in order to completely erase the cartel risk from the transaction at least for the buyer, it is of essence attributing an *ultra partes* effectiveness to representation and warranties released by the seller on basis of the "negative result" of the audit.

A possible solution in this respect could be offered by the well-known *Thyssen Krupp* case.[292] As extensively described in Subchapter 3.3 above, in the *Thyssen Krupp* case the Commission apportioned a fine among the infringing companies on the basis of the fact that the buyer explicitly consented (by a written statement) that liability for the past infringements of the target business should be attributed to it. On the basis of this precedent, and by applying it analogically, it could be argued that the EU Commission, when investigating the existence of a cartel, may be willing to accept a statement of "discharge of responsibility" with an analogous content issued by the seller (instead of the buyer as in *Thyssen Krupp*). More specifically, it could be argued that the EU Commission – acting as described - could give effect to any seller's written statements by which, on the basis of the "negative result" obtained by the audit, it assumes any liabilities of the fines potentially incurred by the buyer as a consequence of cartel infringements committed by the target entity.

From a more practical point of view and following the above described approach, the said "statement of discharge" shall be object of a specific condition precedent in the Purchase Agreements. The statement shall be then

[292] Case T-45/98 and T-47/98 *Krupp Thyssen Stainless and Acciai speciali Terni v Commission* [2001] E.C.R. II-3757, upheld on appeal in Joined Cases C-65/02 P and C-73/02 P [2005] E.C.R. I-6773.

signed by the seller and handed out in original copy to buyer on the day of the closing of the transaction. In this manner, should a proceeding for cartel infringement be opened with respect to the target entity, the buyer may provide the statement to the Commission (or other proceeding authority). Consequently, all the potential liabilities arising from the conclusion of the proceeding would be borne by the seller.

In such a manner, the cartel risk of the transaction is completely eliminated, at least for the weakest contractual part, that is to say the buyer.

This approach finds however no support in the case law, and it is exclusively based on the analogical interpretation of the *Thyssen Krupp* case, which is the only case dealing with the value of written statements in the context of cartel liability.

In sum, such an analogical interpretation constitutes an empirical attempt to extend the effectiveness of a private statement but it didn't find any practical application until now.

4.5.2(ii) The lack of protection for the seller

Should the audit conclude without any findings of cartel wrongdoings, the sellers remains anyhow devoid of any protection against the further risk that such "negative result" reveals to be untrue at a later stage. Such untruthfulness possibly could be set forth, as a matter of fact, by a competent antitrust authority opening a cartel proceeding and fining the cartel company.

This lack of protection for the seller represents the only leak in the system of protection against cartel risk granted by the performance of the "anti-cartel" audit structured as suggested in the present Thesis.

The seller is in fact identified as the most appropriate party under the responsibility of which the audit has to be conducted. Should a competent antitrust authority open anyhow a cartel proceeding and fine the target entity, it would mean that the audit has been wrongly performed. Naturally enough, the risk of a wrong analysis should fall on the party under the responsibility of which it has been conducted it.

More important, the seller has also controlled and managed the target entity since years. It have had not only the time to prevent and eventually detect the cartel activity going on (*e.g.* through the implementation of an effective compliance program) but also had benefitted for years from the extra profits[293] derived from the cartel. As a results, it is fair to charge the seller with risks connected to the only possible leak of the system.

Lastly, the buyer can rightly be considered the weakest contractual part *vis à vis* cartel risk. Differently from the seller, the buyer in fact simply "inherits"

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293 Cartel infringements (but in general all antitrust infringements) are beneficial to the company, in that they increase profits or reduce losses, or, in some cases of marginal companies, prevent the company having to lay off staff or even going out of business. See more extensively in this respect Levenstein, Margaret C. and Suslow, Valerie Y., *Cartels and Collusion - Empirical Evidence* (November 2012). Ross School of Business Paper No. 1182. Available at SSRN: http://ssrn.com/abstract=2182565 or http://dx.doi.org/10.2139/ssrn.2182565; OECD, "*Report on the Nature and Impact of Hard Core Cartels and Sanctions under National Competition Laws*", DAFFE/COMP(2002)7 (9 April 2002), at 9 (median overcharge in 14 price-fixing cases between 15 and 20 per cent); L.M. Froeb, R.A. Koyak and G.J. Werden, "*What is the effect of bid-rigging on prices?*" (1993) 42 Economics Letters 419 (finding that a fairly typical bid-rigging scheme had raised prices by over 20 % for over 4 years).

such liability risk as a result of the transaction being made without no means to control and/or prevent it. Moreover, it has also statistically a higher probability of exposure to cartel risk (87,5%) than the seller (75%).[294] This weakness thus fully justifies the grant of the most extensive and complete protection to it.

4.5.3 Conclusions

The management and use of the audit results, reveals to be the most crucial phase for the pursuing of the aim at which the “anti-cartel” audit may be beneficially performed in the context of M&A transaction: the protection of the parties *vis à vis* cartel risk.

This Section demonstrates how, depending from the result obtained, the parties are required to act in a certain manner in order to be secured.

On one side, the elimination of cartel risk through the use of the “positive” result as a trigger for leniency is proposed. On the other side, it is suggested an empirical approach to (further) secure, at least the buyer, from the cartel risk potentially arising from the “negative result” possibly revealed untrue at a later stage.

4.6 ENVIRONMENTAL LIABILITY RISK AND THE ROLE OF AUDITS IN THE US SYSTEM

The previous paragraphs have analyzed the “anti-cartel” audit and have proposed a possible structure for its performance and the beneficial use of the relevant results in the context of an M&A transaction.

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[294] See, in this respect, the statistical data exposed in Subsection 2.2.1 of Chapter 2.

This Section will support and confirm the empirical conclusions drawn therein by comparing them with those currently adopted within the US legal system with respect to environmental liability risk in the context of commercial real estate transactions.

On one side, the characteristics of environmental liability under US legal system are analyzed and the several similarities with cartel liability under EU law will emerge.

On the other side, the legal incentives enhancing a widespread use of pre-acquisition audits aimed at tackling environmental liability risk are also discussed. A solution this latter which will is not dissimilar to the one proposed by the present Thesis with reference to cartel liability risk.

4.6.1 Environmental liability risk in the context of real estate transactions

In the US, environmental law has had a significant impact upon real estate transactions in recent years. Increasingly, parties involved in both commercial and residential real estate transactions are finding that environmental issues can easily undermine proposed deals or, at a minimum, such issues have the capacity to substantially change the economics of the deal.[295]

4.6.1(i) The origin of the risk: the environmental liability under CERCLA

[295] See, *e.g.*, Dave Lenckus, *Cigna Plan Scrutinized; Regulators in Several States Await Pennsylvania Action*, BUS. INS., Jan. 8, 1996, at 6, available in LEXIS, NEWS Library, BUSINS File; Centromin Auction Fails, PRIVATISATION INT'L, June 1, 1994, available in WESTLAW, PRVINT Database.

The Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA")[296] authorizes the Environmental Protection Agency ("EPA") to remediate sites contaminated with hazardous substances.[297] CERCLA also provides for reimbursement of EPA's cleanup costs from certain persons covered by the statute, known as potentially responsible parties ("PRPs").[298] Under CERCLA section 107(a), PRPs are liable for costs of removal and remedial action incurred by the government, and response costs incurred by any other person. In addition, PRPs are liable for damages associated with the destruction or loss of natural resources.[299] The four categories of PRPs under CERCLA include: (i) the current owner and operator, who are liable for their own disposal practices as well as those of past owners (*i.e.* the buyer);[300] (ii) any party who owned or operated the facility at the time of disposal of a hazardous substance (*i.e.* the seller);[301] (iii) generators of hazardous substances, who, by contract, agreement or otherwise, arranged for the disposal or treatment of such

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296 42 U.S.C. paras. 9601-9675.

297 42 U.S.C. para. 9604.

298 *Id.* para. 9607(a).

299 *Id.* para. 9611(b)(1).

300 *Id.* para. 9607(a)(1).

301 *Id.* para. 9607(a)(2). As a result, liability may be imposed retroactively on past owners and operators of a facility if disposal of a hazardous substance occurred during their tenure, even if the disposal was lawful. See, *United States v. Kramer*, 757 F. Supp. 397, 428-30 (D.N.J. 1991); *United States v. Hooker Chem. & Plastics Corp.*, 680 F. Supp. 546, 556-57 (W.D.N.Y. 1988).

substances;[302] and (iv) transporters who disposed of hazardous substances at the site from which there is a release.[303]

The liability possibly arising from CERCLA also presents very peculiar and harsh characteristics which renders the treatment of relevant environmental liabilities undoubtedly one of the top priorities for the parties of a commercial real estate transaction.[304] The following paragraphs present a quick overview of such characteristics.

Contingent and hidden liability (at least for a perspective purchaser)

Courts have clarified that the liability in question shall be qualified as a contingent and hidden liability since the relevant possible harm at the real estate sites (*i.e.*, the contamination and its resulting environmental hazards) represents an indivisible harm as between the landowner and the other PRPs.[305]

Joint and several liability (of buyer and seller)

302 *Id.* para. 9607(a)(3).

303 *Id.* para. 9607(a)(4).

304 Thomas O'Brien, *Successor Liability -- Are You Buying Trouble?*, METRO. CORP. COUNS., Jan. 1996, at 16, available in LEXIS, NEWS Library, MCC File.

305 See, *Chesapeake & Potomac Tel. Co. of Virginia v. Peck Iron & Metal Co.*, 814 F. Supp. 1269, 1278-79, 1281 (E.D. Va. 1992); *United States v. Monsanto Co.*, 858 F.2d 160, 171-72 (4th Cir. 1988); *United States v. R.W. Meyer, Inc.*, 889 F.2d 1497, 150708 (6th Cir. 1989); *New Castle County v. Halliburton NUS Corp.*, 111 F.3d 1116, 1121 n.4 (3d Cir. 1997); *United States v. Stringfellow*, 661 F. Supp. 1053, 1060 (C.D. Cal. 1987); *United States v. Mottolo*, 695 F. Supp. 615, 629 (D.N.H. 1988), aff'd, 26 F.3d 261 (1st Cir. 1994) (all involving owners at the time of disposal). Cf. *United States v. Township of Brighton*, 153 F.3d 307, 314 (6th Cir. 1998) (in the context of operator liability).

CERCLA provides for joint and several liability,[306] so that any one of several PRPs (including buyer and seller in the context of commercial transactions) can be held liable for the entire cleanup.

<u>*Parental liability*</u>

The issue of corporate parental liability has been analyzed by the US courts also in cases arising under CERCLA.[307] Parent corporations may be held liable for their subsidiary's environmental cleanup costs on either of two theories: (i) the corporate parent is found to be directly liable as an operator of the contaminated site,[308] or (ii) the court may pierce the corporate veil so as to find the parent indirectly liable for the actions of its subsidiary. [309]

The leading case concerning corporate parent liability in the environmental context is *United States v. Kayser-Roth Corp*.[310] Here, the parent corporation was held liable as an operator for the cleanup costs of its subsidiary.[311] The Court of Appeals for the First Circuit noted that "*a fair reading of CERCLA allows a parent corporation to be held liable as an operator of a subsidiary corporation.*"[312] Without deciding the exact standard necessary for a parent to be an operator, the court

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306 See, *United States v. Lang*, 864 F. Supp. 610, 613-14 (E.D. Tex. 1994); *Shell Oil*, 841 F. Supp. at 968.

307 See, e.g., *United States v. Kayser-Roth Corp.*, 910 F.2d 24 (1st Cir. 1990), cert. denied, 498 U.S. 1084 (1991); *Joslyn Mfg. Co. v. T.L. James & Co.*, 893 F.2d 80 (5th Cir. 1990), cert. denied, 498 U.S. 1108 (1991).

308 See, e.g., *Jacksonville Elec. Auth. v. Bernuth Corp.*, 996 F.2d 1107, 1109-10 (11th Cir. 1988); Kayser-Roth, 910 F.2d at 26-27.

309 See, e.g., *New York v. Shore Realty Corp.*, 759 F.2d 1032 (2d Cir. 1985).

310 910 F.2d 24 (1st Cir. 1990), cert. denied, 498 U.S. 1084 (1991).

311 *Kayser-Roth*, 910 F.2d at 27-28.

312 *Id.* at 27.

indicated that not only was a showing of complete ownership required, combined with general authority or the ability to control that comes with ownership, but that, at a minimum, there must be a showing of active involvement in the activities of the subsidiary.[313]

To some extent, the decision in *Kayser-Roth* provide "guidelines" that parent corporations can follow to avoid liability arising from the activities of their subsidiaries. The problem, however, is that the relationship between a parent corporation and its subsidiary, by its very nature, is often based upon a certain measure of control.[314] For example, the corporate parent frequently causes the incorporation of its subsidiary.[315] In addition, it is not uncommon for the corporate parent to finance its subsidiary, or for it to have some active involvement in the business of its subsidiary.[316] In short, the guidelines provided by current case law are not clear and offer little reassurance to the corporate parent who seeks to protect itself against environmental liability resulting from the actions of its subsidiary.

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313 The following factors were considered by the *Kayser-Roth* court in holding the parent liable as an operator: (i) the parent corporation had total monetary control over its subsidiary, including collection of accounts payable; (ii) the parent corporation restricted its subsidiary's financial budget; (iii) the parent corporation directed that all governmental matters, including environmental matters, be funneled through the parent; (iv) the parent's approval was required before the subsidiary could lease, buy, or sell real property; (v) the parent's approval was required for any capital transfer or expenditure greater than $ 5,000; and (vi) the parent placed its personnel in almost all of its subsidiary's directorship and officer positions as a means of ensuring that the parent's corporate policy was implemented and precisely carried out. Id. (citing *United States v. Kayser-Roth Corp.*, 724 F. Supp. 15, 18 (D.R.I. 1989)).

314 See PHILLIP A. BLUMBERG, *The Law Of Corporate Groups: Problems Of Parent And Subsidiary Corporations Under Statutory Law Of General Application* para. 2.02.3 (1989).

315 See, e.g., Jon-T, 768 F.2d at 689.

316 *Id.*

Successor liability

The issue of successor liability under CERCLA has not been specifically addressed by the US Congress when enacted the law.[317] The courts, however, have tried to create a rule which is consistent with the broad remedial goals of CERCLA, and also takes into account traditional concerns of corporate law.[318]

In substance, if the buyer acquires all of the seller's stock in the target company, or even if the transaction is limited to a sale of certain assets of the target company and the buyer (i) retains the same employees and production facilities; (ii) produces the same products; (iii) maintains the same assets and business operations; (iv) retains the same business name; and (v) holds itself out to the public as a continuation of the previous enterprise, under the "continuity of enterprise" theory, the buyer at become responsible for the seller's liabilities.[319]

The voluntary environmental self-policing and self-disclosure program

On April 3, 1995, EPA issued an interim policy statement on voluntary environmental self-policing and self-disclosure (hereinafter the "Voluntary Disclosure Program").[320] This statement was intended to promote

317 See, *Louisiana-Pacific Corp. v. ASARCO, Inc.*, 909 F.2d 1260, 1262 (9th Cir. 1990); *Smith Land & Improvement Corp. v. Celotex Corp.*, 851 F.2d 86, 91 (3d Cir. 1988), cert. denied, 488 U.S. 1029 (1989).

318 See, e.g., *United States v. Carolina Transformer Co.*, 978 F.2d 832, 837-38 (4th Cir. 1992); *United States v. Mexico Feed and Seed Co.*, 980 F.2d 478, 487 (8th Cir. 1992); Louisiana-Pacific Corp., 909 F.2d at 1263.

319 See, *United States v. Carolina Transformer Co.*, 978 F.2d 832, 838 (4th Cir. 1992); *Atlantic Richfield Co. v. Blosenski*, 847 F. Supp. 1261, 1284 (E.D. Pa. 1994).

320 Voluntary Environmental Self-Policing and Self-Disclosure Interim Policy Statement, 60 Fed. Reg. 16,875-879 (1995) (stating that the policy seeks "*to provide incentives for*

environmental compliance by providing greater certainty as to the agency's enforcement response to voluntary self-evaluations, voluntary disclosure, and the prompt correction of violations.[321] EPA's Voluntary Disclosure Program favors incentives over privileges.[322] As such, environmental audits are not treated as privileged.[323] As such, environmental audits are not treated as privileged.[324] Instead, the Voluntary Disclosure Program provides that EPA will reduce civil penalties and refrain from making criminal referrals under certain conditions.[325] Essentially, the program requires regulated entities which discover a violation through a voluntary environmental audit to disclose the violation to the appropriate agency when discovered[326] and to correct the violation within sixty days of such discovery.[327] The other conditions which must be satisfied are: (i) the entity must act expeditiously in remedying a condition that creates an imminent danger to human health and the environment; [328] (ii) the entity must implement appropriate measures to prevent

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regulated entities that conduct voluntary compliance evaluations and also disclose and correct violations").

321 *Id.* at 16,876.

322 *Id.* at 16,878.

323 *Id.* at 16,876-878.

324 *Id.* at 16,876-878.

325 *Id.* at 16,876-878.

326 *Id.* at 16,877. Additionally, the violation must be reported "*prior to (1) the commencement of a federal, state or local agency inspection, investigation or information request; (2) notice of a citizen suit; (3) legal complaint by a third party; or (4) the regulated entity's knowledge that the discovery of the violation by a regulated agency or third party was imminent.*"

327 *Id.*

328 *Id.*

a recurrence of the violation;[329] (iii) the violation does not indicate that the entity failed to take appropriate steps to avoid repeat or recurring violations;[330]and (iv) the entity cooperates with EPA by providing requested documents, as well as access to employees during the investigation of the violation.[331]

4.6.1(ii) The approach to the risk incentivized by the law: the "innocent purchaser defense" and the central role of audits

Other than being the origin of environmental liability risk, CERCLA provides also some limited defenses. Among them, the one applicable for commercial transactions is the "*innocent landowner defense*" (alternatively called the "*innocent purchaser defense*")[332] which absolves the buyer from liability when certain conditions are met.[333] In order to prevail under this defense, the buyer must have acquired the facility in question after the disposal of the hazardous substances.[334] Additionally, the buyer must demonstrate that there was no reason to know of such disposal, that due care with respect to the hazardous substance was exercised, and that precautions against foreseeable acts or

329 *Id.*

330 *Id.*

331 *Id.*

332 See id. para. 9601(35)(B), 9607(b)(3). Alternatively called the "*innocent purchaser defense*" this exclusion is referred to by courts and commentators alike. *Westwood Pharmaceuticals, Inc. v. Nat'l Fuel Gas Distribution Corp.*, 964 F.2d 85, 89 (2d Cir. 1992); *United States v. Peterson Sand & Gravel, Inc.*, 806 F. Supp. 1346, 1352 (N.D. Ill. 1992);

333 42 U.S.C. para. 9607(b)(3).

334 *Id.*

omissions of any third party were taken.[335] In this context, it should be also specified that if the seller is liable under the CERCLA (having polluted the site with hazardous substances) it cannot rely on this defense,[336] and previous owners who transfer ownership with knowledge of the release of polluted substances, without disclosing such information are fully liable under the CERCLA and precluded form asserting the landowner defense.[337]

As a result, the said stringent requirements illustrate the importance of conducting a thorough audit inquiry in the context of a commercial transaction involving the transfer of real estate.

The described approach has then inevitably influenced real estate commercial transactions in the US, conferring the audit a central role in tackling and allocating environmental liability risk. This regime thus obliges the seller to disclose the release of polluted substances in advance (contractually assuming the relevant risks and liabilities) or accept the buyer to perform a pre-acquisition environmental audit on the site at stake. An audit which in turn

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335 *Id.*

336 CERCLA para. 101(35)(C), 42 U.S.C.A. para. 9601(35)(C). The statute provides: "(C) <u>Nothing in this paragraph or in section 9607(b)(3) of this title shall diminish the liability of any previous owner or operator of such facility who would otherwise be liable under this chapter</u>. Notwithstanding this paragraph, if the defendant obtained actual knowledge of the release or threatened release of a hazardous substance at such facility when the defendant owned the real property and then subsequently transferred ownership of the property to another person without disclosing such knowledge, such defendant shall be treated as liable under section 9607(a)(1) of this title and no defense under section 9607(b)(3) of this title shall be available to such defendant." (emphasis added).

337 *Id.*

may or may not reveal pollution but will protect, in any event, the buyer from possible liabilities following the said "innocent purchaser defense".

The described liability mechanism under CERCLA has also caused a distinct public policy benefit. This approach has indeed generated a significant amount of audits being performed. Most business transactions involving the transfer of land have been preceded by pre-purchase investigations designed to determine whether contamination may be present. In turn, this audit has frequently generated significant levels of private cleanup, often without any direct governmental prodding or involvement.

It should be noted that this was a specific public policy aim which the US legislator had clear in mind when enacted CERCLA. Such aspect has been constantly remarked by the courts.[338] For example, in *Foster v. United States* the court explicitly opined that "*the nature of the CERCLA's liability scheme,* […] *was intended to not only ensure that those who were responsible for, and who profited from, activities leading to property contamination, rather than the public at large, should be responsible for the costs of the problems that they had caused,* […] *but also to provide*

338 See *Carlyle Piermont Corp. v. Federal Paper Bd. Co.*, 742 F. Supp. 814, 817 (S.D.N.Y. 1990) (quoting *City of New York v. Exxon Corp.*, 633 F. Supp. 609, 617 (S.D.N.Y. 1986)) ("*One of the major objectives of the private recovery provisions of CERCLA is to 'assure an incentive for private parties, including those who may themselves be subject to liability under the statute, to take a leading role in cleaning up hazardous waste facilities as rapidly and completely as possible.*" (emphasis added)); *Cadillac Fairview/California, Inc. v. Dow Chem. Co.*, 840 F.2d 691, 694 (9th Cir. 1988) ("*one of CERCLA's purposes is to promote private enforcement actions independent of government actions funded by Superfund*"); *Solid State Circuits, Inc. v. EPA*, 812 F.2d 383, 386 (8th Cir. 1987) ("*Since superfund money is limited, Congress clearly intended private parties to assume cleanup responsibility.*"); *Chem-Dyne Corp.*, 572 F. Supp. at 805 ("*CERCLA passed, in part, to induce voluntary private responses at contaminated sites*" (emphasis added)).

incentives for private parties to investigate potential sources of contamination and to initiate remediation efforts" (emphasis added).[339]

4.6.2 Cartel liability risk in Europe v. environmental liability risk in the US: a comparative analysis

Environmental liability under CERCLA and cartel liability under EU competition law clearly presents analogous characteristics.

The liability arising from possible cartel wrongdoings is hidden and contingent. This is basically due to the secret nature of cartels which are normally conducted in great secrecy and the fact that relevant evidences are hidden away. Consequently, cartel's investigation and detection results very difficult. With the aim of enhancing and incentivizing detection and deterrence, both the EU and the Member States have enacted specific programs awarding self-denouncing in exchange of immunity or fine reductions (the so called "Leniency Programs"). Further, such liability is transmissible to both parent companies and successors in law of the infringer pursuant to successor and parental liability rules established by EU courts and the derived liability is joint and several with the infringer.

Similarly, the environmental liability arising under CERCLA has been explicitly qualified by US courts as contingent and hidden as well. The relevant possible harm at the real estate sites (*i.e.*, the contamination and its resulting environmental hazards) would in fact represent an indivisible harm as between the landowner and the other PRPs. As a result, also the US Government have

339 See Foster v. United States, 922 F. Supp. 642, 656 (D.D.C. 1996).

enacted a program which enhance detection by awarding self-disclosure in exchange of reduction of civil penalties and refraining from making criminal referrals (the so called "Voluntary Disclosure Program"). Moreover, the points of contacts with cartel liability do not limit to those aspects. Successor and parental liability rules have also been established by US courts in cases related to liability under CERCLA. Also in this cases, parent companies and successors in law of the infringer have been held jointly and severally liable with the infringer.

Considering the underlined similarities, both environmental liability under CERCLA and cartel liability under EU competition law are able, as a matter of fact, to significantly affect commercial transactions. The allocation between the parties of the risks and responsibilities associated with such liabilities would be indeed an issue that must be addressed. This in fact would significantly impact several aspects of the transactions, such as the manner in which transactions are structured, the due diligence that is performed on behalf of the purchaser, the subsequent negotiations that inevitably follow the due diligence investigation, and the form of purchase agreement ultimately executed by the parties.

Being conscious of such effects on the circulation of goods, the US legislator explicitly decided to address this issue by providing the parties of a real estate transaction with the default rule of the "innocent purchaser defense". Such rule, which substantially favors the buyer, creates a strong incentive on the originator of the risk (*i.e.* the seller) to disclose and timely remedy the possible sources of environmental liability, if known, or fully cooperate with the buyer in performing an audit aimed at detecting them.[340]

This liability mechanism generates several positive effects. This firstly establishes a default rule which represents a clear guide for the possible bargaining of the parties around the allocation of environmental liability. Second, the said default rule allocates the burden of the liability on the seller. On one side, this punishes the origination and the originator of the risk and, on the other side, protects the weakest contractual party of the transaction (*i.e.* the buyer) which would simply inherit the liability without having contributed to the causation. Third, this legal framework also generates a public benefit creating an incentive on both the seller and the buyer to investigate and possibly clean up properties prior to a possible intervention of the EPA and, consequently, shifting the costs and responsibility for detection and clean-up of polluted sites from the Government to the parties of the transaction.[341]

Differently, the EU legislator has not provided any solution to address the effects of cartel liability on M&A transaction.

In the absence of this legislative contribution, the present Thesis has proposed a solution to address this issue which logics are not dissimilar to those considered by the US legislator in regulating the effects of environmental liability on real estate transaction.

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340 See in this sense, S. Turner, *Superfund and the Innocent Landowner, The Impact of Environmental Law on Real Estate and Commercial Transactions* ((N.Y.S.B.A. Course Materials) at 3 (Dec. 15, 1988).

341 Berz & Spracker, *The Impact of Superfund on Real Estate Transactions*, Prob. And Prop., (March/April 1988) at 49.

Based on the analogical interpretation of the *Thyssen Krupp* case,[342] this Thesis argues in fact that the parties of an M&A transaction would be allowed to address the EU Commission a private statement allocating cartel liability exclusively on the seller. This interpretation would in substance create a sort of default rule based on case-law which may guide the parties in bargaining around the allocation of cartel liability. The simple possibility of addressing a similar statement to the Commission would in fact offer to the buyer the legal grounds to ask the seller to disclose the existence of a cartel, if known, (and advisably file an immediate leniency) or set-up an "anti-cartel" audit in line with the structure suggested by the present Thesis.

As a result, the central role of the audit supported by the present Thesis with respect to cartel liability risk in the context of M&A transactions appears reinforced and confirmed by the analogous solution adopted by the US legislator with respect to the environmental liability.

4.7 CONCLUSIONS

This Chapter extensively inquired the possibility of using the audit (*rectius* the results of the audit) as a tool to secure the parties of an M&A transaction from the relevant cartel risk.

The Chapter firstly discussed the juridical nature of audits. A comparative analysis of the discipline regulating pre-contractual negotiations in both

342 Case T-45/98 and T-47/98 *Krupp Thyssen Stainless and Acciai speciali Terni v Commission* [2001] E.C.R. II-3757, upheld on appeal in Joined Cases C-65/02 P and C-73/02 P [2005] E.C.R. I-6773.

common and civil law's systems revealed an important legal value of audits for buyers.

Then, the specific "anti-cartel" purpose to which the audit should be targeted at has been also analyzed. In the context of an M&A transaction, should the target entity be committing a cartel wrongdoing the probability of the parties to be exposed to cartel risk is close to 100%. The sanctions possibly deriving from the concretization of such risk are also very severe, both in terms of monetary damages and of reputational terms.[343] In addition, cartels are secret by nature and therefore difficult to investigate and detect. Hence, the liability potentially deriving from cartel infringements of the target entity represent one of the most risky areas for the parties of an M&A transaction.

Being shown that audits are intrusive, legally complex and expensive by their nature, it has been moreover advised to proceed with a preliminary cartel risk assessment to evaluate the opportunity to perform the full audit.

Further, a possible structure for an effective and efficient conduction of the "anti-cartel" audit has been proposed. The incentives of the parties and their respective positions *vis à vis* the target entity have been examined and explained. The seller has been then identified as the most appropriate party under which responsibility the audit shall be conducted. The composition of the audit team has also been discussed. A mixed composition of outside and in-house counsel has been proposed as the preferable solution. This would ensure

343 For a detailed description of cartel risk in the context of an M&A transaction see Chapter 2 of this Thesis.

the appropriate combination between necessary antitrust expertise and proximity to the company's personnel and business.

The focus has been then drawn on presenting a possible tripartite structure of the investigation. Fist the audit shall be properly and internally announced. Then interviews to the personnel and document review may follow. A report of the relevant findings, if any, addressed to the seller concludes the exercise.

In light of the above, the crucial issue of demonstrating how the audit results may be beneficially used to eliminate cartel risk from the transaction has been ultimately tackled.

In this context, it has been underlined that the audit may have a twofold result. It may reveal the existence of past or ongoing cartel activities perpetuated by the target entity ("positive result") or differently conclude without any findings of cartel activities ("negative result"). However, the simple obtainment of such results is not in itself beneficial to secure the M&A transaction from cartel risk. Further actions are required to obtain such result.

Should the audit be concluded with a "positive result" detecting a past or ongoing cartel activity, the advisable solution is to have the seller using the evidences collected therein to support a leniency application and be awarded by the relevant immunity. In this manner, both parties would benefit from such initiative and the cartel risk would be completely eliminated from the transaction.

The situation is instead more complicated when the audit ends up without discovering any cartel wrongdoing (*i.e.* "negative result"). Intuitively, such type of result could appear the most suitable result to be achieved. It would apparently ascertain the absence of cartel risk from the transaction. However, a residual risk remains. The "negative result" scenario does not in fact exclude the possibility, maybe remote, of an antitrust authority opening anyhow a cartel proceeding against the target entity and fining it jointly and severally with its present and past parent companies (that is to say, the buyer and the seller).

As a result, the beneficial use of the "negative result" in the context of the M&A deal is, again, essentially linked to the possibility of eliminating also such residual cartel risk from the transaction. In this case, the most immediate solution would be to make the seller be contractually bound *vis à vis* the buyer by the same "negative result" obtained by the audit it has performed. However, such contractual mechanism would be still insufficient to clear out completely the cartel risk from the transactions because, as pointed out when discussing the weaknesses of contractual remedies, it has a limited "inter partes" effectiveness and it is unenforceable *vis à vis* third parties, such as a proceeding antitrust authority.

The possible empirical solution suggested in the present Thesis is to obtain a sort of "ultra partes" effectiveness of the said contractual remedy on the basis of a possible analogical interpretation and application of the *Thyssen Krupp* case. Following such precedent, it has been argued that the EU Commission, may be willing to accept any seller's written statements by which, on the basis of the "negative result" obtained by the audit, it would assume the liabilities and fines potentially incurred by the buyer as a consequence of a cartel wrongdoing possibly committed by the target entity. In this manner, the cartel risk of the transaction is completely eliminated, at least for the buyer, also in the "negative result" scenario.

In light of the above, it can be concluded that an audit specifically aimed at detecting cartels wrongdoings of the target entity and structured as described may be beneficially and effectively used in the context of an M&A transaction in order to secure the parties from cartel risk.[344]

This solution appears also reinforced and confirmed after the comparison made with the analogous approach adopted by the US legislator to address the effects of environmental liability on commercial real estate transactions. Considering the similarities between cartel and environmental liability, the US legislator has in fact tackled the allocation of environmental liability among the parties basically by providing a legislative incentive in performing a pre-acquisition environmental audit. A choice that appears not dissimilar with the one proposed by the present Thesis to address cartel liability risk in the context of M&A transactions.

344 By way of reminder, the proposed system of protection presents however a leak. When the audit concludes without any findings, the sellers remains anyhow devoid of any protection against the further risk that such "negative result" is revealed, as a matter of fact, untrue by a competition authority opening a proceeding against the target entity. However, should the system have a leak it appears fair enough that the party that has conducted the audit and managed the target companies for years bears the risks connected to such leak.

5. CONCLUSIONS

This Thesis has analyzed cartel liability risk and the relevant effects on M&A deals with the aim of identifying and proposing an innovative approach to it, protecting M&A parties more effectively than the traditional contractual remedies.

In this context, successor and parental liability rules under EU competition law have been identified as the sources of the risk. Should in fact the target entity be sanctioned for a cartel wrongdoing after the transaction being made, the probability for the former (*i.e.* the seller) and the current (*i.e.* the buyer) parent companies to be held liable and fined jointly with the target are close to 100%. Such statistical data coupled with the severity of the relevant sanctions and the other collateral negative consequences (*e.g.* reputational damages, risk of private redress, etc.), clearly revealed the importance such assumes for M&A parties.

The study of the EU case law, showing the limited availability of "ex post" legal arguments and defenses, added further elements to confirm the need for tackling "ex ante" cartel liability risk in any commercial transaction involving the transfer of a business.

This preemptive treatment of cartel liability risk it is customarily done by recurring to the traditional measures of contractual nature. M&A agreements normally contain detailed provisions allocating liabilities between the parties through a combination of representations, warranties and rights to indemnification. In this context, cartel liability risk may result to be covered by the specific representations and indemnification clauses classically released by the seller with regards to the target's compliance with law (including antitrust law) and the absence of undisclosed liabilities. However, pursuant to common principles of contract law, as consistently applied by EU courts, it has been shown as such measures present the weakness of having a limited "inter partes" effectiveness which leaves M&A parties completely unprotected against any possible third party claim (*e.g.* from an antitrust authority opening an infringement procedure and fining the target entity).

This Thesis has proposed an innovative approach to cartel liability risk grounded on two pillars: (i) the central role of pre-acquisition audits in detecting cartels and / or allocating cartel liability risk and (ii) the empirical extension of the effectiveness and, at the same time, the protection offered by private documents apportioning cartel liability risk.

As a result, the possibility of using an audit as a tool to secure the M&A parties from cartel risk has been firstly deeply inquired.

The need for a specific "anti-cartel" purpose of the audit has been underlined. The peculiarity of cartel wrongdoings which are secrets by nature (and difficult to detect), the severity of the relevant sanctions and the very high probability of exposure have underlined how the liability in question represents one of the most risky areas for the M&A parties.

It has also been shown as audits are intrusive, disruptive, costly and subject to a series of legal constraints which require the relevant scope and structure to be carefully targeted.

As a result, first the performance of a cartel risk assessment to evaluate the actual opportunity to perform the full audit has been advised as a preliminary step to be taken. Second, a possible structure for an effective and efficient conduction of the "anti-cartel" audit has been concretely proposed.

The incentives of the parties and their respective positions *vis à vis* the target entity have been examined and explained. The seller has been then identified as the most appropriate party under which responsibility the audit shall be conducted. The composition of the audit team has been also discussed. A mixed composition of outside and in-house counsel has been proposed as the preferable solution. This would ensure the appropriate combination between necessary antitrust expertise and proximity to the company's personnel and business. The focus has been then drawn on presenting a possible structure of the investigation. A tripartite configuration has been proposed. First, the audit shall be properly and internally announced. Then interviews to the personnel and document review may follow. At the end of the investigation, a report of the relevant findings, if any, shall be addressed to the seller to conclude the exercise.

Further, the crucial issue of demonstrating how the audit results may be beneficially used to eliminate cartel risk from the transaction has been tackled.

Naturally enough, the audit may have a twofold result. It may reveal the existence of past or ongoing cartel activities carried on by the target entity ("positive result") or differently conclude without any findings of cartel activities ("negative result"). However, the simple obtainment of such results is not in itself beneficial to secure the M&A parties.

Should the audit be concluded with a "positive result" detecting a past or on-going cartel activity, the evidences collected therein may be then used by the seller to support a leniency application and be awarded by the relevant immunity. In this manner, both parties benefit from such initiative and the cartel risk is completely eliminated from the transaction.

The situation is instead more complicated when the audit ends up without discovering any cartel wrongdoing committed by the target entity (*i.e.* "negative result"). Intuitively, such type of result could appear the most suitable result to be achieved. It would apparently ascertain the absence of cartel risk from the transaction.

However, a residual risk remains. The "negative result" scenario does not in fact exclude the possibility, maybe remote, of an antitrust authority opening anyhow a cartel proceeding against the target entity and fining it jointly and severally with its current and past parent companies (i.e. the buyer and the seller).

As a result, the beneficial use of the "negative result" is, again, essentially linked to the possibility of eliminating also such residual cartel risk from the transaction. In this case, the most immediate solution would be to make the seller contractually bound, *vis à vis* the buyer, by the same "negative result" obtained by the audit it has performed. However, the effectiveness of such contractual mechanism would be limited "inter partes" and would be accordingly unenforceable *vis à vis* third parties, such as a proceeding antitrust authority.

This Thesis presents an empirical solution to extend "ultra partes" the effectiveness of the said contractual remedy based on a possible analogical application of the *Thyssen Krupp* case. On the basis of this precedent it could in fact be argued that should the EU Commission fine anyhow the target entity after the transaction being made, it may be willing to accept a written statement from the seller pursuant to which it assumes the relevant cartel liability and fines. Such written statement shall be drafted on the basis of the "negative result" obtained by the audit and released to buyer at the closing of the transaction. In this manner, the cartel risk of the transaction would be completely eliminated, at least for the buyer,[345] also in the "negative result" scenario.

In light of the above, this Thesis demonstrated how an audit specifically aimed at detecting cartels wrongdoings of the target entity and structured as described above may be beneficially and effectively used in the context of an M&A transaction in order to secure the parties from cartel risk.

345 A leak of such system has been ultimately identified. When the audit concludes without any findings, the sellers remains anyhow devoid of any protection against the further risk that such "negative result" is revealed, as a matter of fact, to be untrue by a competition authority opening a proceeding against the target entity. However, should the system have a leak it appears fair enough that the party that has conducted the audit and managed the target companies for years bears the risks connected to such leak.

To further support this conclusion, this final Chapter 5 is also dedicated to prospectively analyze the effects that the performance of "anti-cartel" audits in the context of M&A deals would produce in the real world.

On one side, one of the most recent cases of imputation of cartel liability in the ambit of an M&A transactions will be examined. The *Power Cables* case[346] is used to simulate the effects that a pre-acquisition "anti-cartel" audit performed on the target entity would have produced on the parties involved and on the overall outcome of the deal.

On the other side, the widespread use of "anti-cartel" audits in M&A transactions, as a public policy tool aimed increasing detection and deterrence of cartel wrongdoings, will be examined. To this extent, some amendments to the current legislation enhancing the use of "anti-cartel" audits will be discussed and proposed.

5.1 CASE STUDY: THE POWER CABLE CARTEL

This Subchapter seek to simulate the application to a real word case of the solution suggested by the present Thesis to clear out cartel risk from M&A transactions. In this context, the Power Cables case which represent one of the most recent cases in which the Commission has applied successor and parental liability rules to held liable the parties of an M&A transaction for the cartel wrongdoings of the target entity will be taken into consideration. The effects a

[346] Commission Decision of April 4, 2014 in Case AT.39610 Power Cables, provisional summary of the decision in available at […].

pre-acquisition "anti-cartel" audit would have produced on the parties and on the outcome of the deal will be then briefly analyzed and discussed.

5.1.1 Factual background

On April 4, 2014, the European Commission adopted a decision imposing fines of over Euro 300 million on 11 producers of high voltage cables who were found to have engaged in cartel activity for a ten year period between 1999 and 2009. The cartel arrangements covered all types of underground power cables of 110 kV and above and submarine power cables of 33 kV and above including all products, works and services sold to the customer related to a sale of power cables when such sales are part of a power cable project.

What was particularly significant about this decision is that the Commission found Goldman Sachs to be liable for the behavior of one of its portfolio companies, Prysmian, through the investment of its private equity arm, GS Capital Partners. Prysmian was fined for about Euro 104.600.000 and the Commission found that Goldman Sachs was jointly and severally liable for around Euro 37.000.000.

By applying the successor and parental liability rules, the Commission imputed liability and fines to Goldman Sachs since in 2005, GS Capital Partners, acquired 100% of Prysmian through one of its funds, GS Capital Partners V Fund LP. After an IPO in 2007, GS Capital Partners retained 54% and then divested its remaining interest in stages between then and 2010. As a result, the Commission found that GS Capital Partners had "decisive influence" over Prysmian through its varying degrees of investments between 2005 and 2009.

As a result, Goldman Sachs was ultimately responsible and liable for Prysmian's behavior during this time. The joint and several liability of Goldman Sachs covered approximately one-third of the fine. The previous owner, Pirelli, was held similarly liable for the rest of the fine which corresponded to the period of its ownership over Prysmian (1999 – 2005).

5.1.2 The application of a pre-acquisition "anti-cartel" audit

As mentioned, Goldman Sachs, through its private equity arm GS Capital Partners, acquired Prysmian from Pirelli.

Before entering into any definitive agreement, Goldman Sachs could have asked Pirelli to perform an "anti-cartel" audit on Prysmian or, as an alternative, directly release, in addition to a specific contractual representation and warranty, an "ad hoc" statement discharging the buyer for any cartel liability it could have incurred for possible cartel wrongdoings of the target entity.

Should Pirelli have resisted to Goldman Sachs request, it would have been obliged to draft the said statement and deliver it to Goldman Sachs at the closing of the transaction. Later on, when in 2005 the Commission opened the cartel proceeding, among the others, against Prysmian, Goldman Sachs would have able to send the Commission the statement of discharged obtained by Pirelli and go exempted from any liability pursuant to the analogical application of the *Thyssen Krupp* case supported by the present Thesis.

Differently, should Pirelli have acceded to Goldman Sachs request, it would have discovered the cartel as a result of the performance of the audit: Coherently, Pirelli would have also been able to launch a leniency application and realistically be awarded with the immunity since the leniency application which gave birth to the case was launched by the co-cartelist ABB only in 2008 (2 years later the execution of the M&A transaction between Pirelli and Goldman Sachs).

As a result, the performance of a pre-acquisition "anti-cartel" audit, structured as presented in this Thesis, would have effectively saved the M&A parties, Pirelli and Goldman Sachs, from the cartel risk of the transaction which then, some years later, turned into an actual cartel liability, following the issuance of the Commission Decision in 2014.

5.2 SOCIAL VALUE OF "ANTI-CARTEL" AUDITS AND POSSIBLE ENHANCEMENT MEASURES

This Subchapter concludes the analysis of the perspective application of "anti-cartel" audits briefly discussing the possible effects in terms of optimal antitrust enforcement,[347] also in comparison with another preemptive tool: the compliance programs.

Pre-acquisition "anti-cartel" audits clearly produce positive enforcement effects since their performance may lead to an on-going cartel infringement being terminated and reported to the competition authorities, thus allowing the authorities to prosecute and punish the infringement and victims to obtain redress, when this would not have happened in the absence of the exercise or would only have happened at a later point in time or at a higher cost to the authorities or the victims.

347 See in this respect, W. Wills, *The Optimal Enforcement of EC Antitrust Law* (Kluwer, 2002).

Such positive effects are analogous to those expected by the performance of antitrust compliance programs with the significant difference that no negative side effects is apparently detectable. According to some authors, compliance programs may in fact also enhance employees inclined to engage in antitrust infringements to learn from compliance training how to engage more effectively in antitrust infringements or how to avoid detection and punishment.[348]

In any event, the implementation of antitrust compliance programs is already incentivized in some European jurisdictions.

For example, among the national competition authorities of the EU Member States the UK Office of Fair Trading regularly grants fine reductions of up to 10

348 See in this respect, See also in this respect, Ghosal, Vivek and Sokol, D. Daniel, *Compliance, Detection, and Mergers and Acquisitions* (May 1, 2013). Managerial and Decision Economics 34(7) 2013; Minnesota Legal Studies Research Paper No. 13-21. Available at SSRN: http://ssrn.com/abstract=2259039 or http://dx.doi.org/10.2139/ssrn.2259039; Geradin, Damien, Antitrust *Compliance Programmes & Optimal Antitrust Enforcement: A Reply to Wouter Wils* (March 29, 2013). Journal of Antitrust Enforcement (2013) (Forthcoming). Available at SSRN: http://ssrn.com/abstract=2241452; Wils, Wouter P. J., *Antitrust Compliance Programmes & Optimal Antitrust Enforcement* (October 31, 2012). Journal of Antitrust Enforcement, Volume 1, Issue 1, April 2013, Forthcoming. Available at SSRN: http://ssrn.com/abstract=2176309; Sokol, D. Daniel, *Policing the Firm* (March 7, 2013). Notre Dame Law Review, 82(2):785-848; Minnesota Legal Studies Research Paper No. 13-13. Available at SSRN: http://ssrn.com/abstract=2230121; Sokol, D. Daniel, Cartels, *Corporate Compliance and What Practitioners Really Think About Enforcement* (June 6, 2012). Antitrust Law Journal, Vol. 78, 2012. Available at SSRN: http://ssrn.com/abstract=2079336; Sokol, D. Daniel, *Detection and Compliance in Cartel Policy* (September 30, 2011). CPI Antitrust Chronicle, Vol. 2, September 2011. Available at SSRN: http://ssrn.com/abstract=1935907; Hofstetter, Karl and Ludescher, Melanie, *Fines Against Parent Companies in EU Antitrust Law - Setting Incentives for 'Best Practice Compliance'* (December 22, 2009). World Competition: Law and Economics Review, Vol. 33, No. 1, March 2010. Available at SSRN: http://ssrn.com/abstract=1502769; J. Murphy and W. Kolawsky, *The Role of Anti-Cartel Compliance Programs In Preventing Cartel Behavior*, Antitrust, Vol. 26, No. 2, Spring 2012.

% on the ground of "*adequate steps having been taken with a view to ensuring compliance*".[349]

In addition, French law provides for a settlement procedure (*"procédure de non-contestion des griefs"*), under which companies that do not contest the statement of objections sent to them by the *Autorité de la concurrence* may obtain a fine reduction.[350] In the context of this specific procedure, the *Autorité de la concurrence* is willing to grant, in addition to a 10 % fine reduction corresponding to the settlement proper, and to a further 5 % reduction that may be awarded in return of other commitments, a fine reduction of up to 10 % to companies that did not have a compliance program in place at the time of the issuing of the statement of objections and that commit to set up a compliance program meeting the best practices set out by the *Autorité de la concurrence*. A similar fine reduction is available if the company already had a compliance program that did not meet these best practices and commits to upgrade it according to these best practices.[351]

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349 This policy was recently reaffirmed by the Office of Fair Trading (OFT) in OFT's Guidance as to the appropriate amount of a penalty (OFT423, September 2012), at 2.15 and footnote 26; see also How your business can achieve compliance with competition law (OFT1341, June 2011), at 7.2. The OFT has indeed granted compliance discounts in many of the cases in which it imposed fines for antitrust infringements in the past decade (Arriva/First Group, Case CA98/9/2002; Hasbro and Distributors, Case CA98/18/2002; Replica Kit, Case CA98/6/2003; Toys, Case CA98/8/2003; West Midlands Roofing, Case CA98/1/2004; Desiccant, Case CA98/8/2004; Scottish Roofing I, Case CA98/1/2005; North East Roofing, Case CA98/2/2005; Scottish Roofing II, Case CA98/4/2005; England and Scotland Roofing, Case CA98/1/2006; Stock Check Pads, Case CA98/3/2006; Spacer Bars, Case CA98/4/2006; Construction Recruitment Forum, Case CA98/01/2009; Construction, Case CE/4327- 04; Tobacco, Case CA98/01/2010; Gaviscon, Case CA98/02/2011; Dairy Retail Price Initiatives, Case CA98/03/2011).

350 Article L.464-2, III of the French Commercial Code.

351 *Framework-Document of 10 February 2012 on Antitrust Compliance Programmes*, paragraphs 29-31, and Communiqué de procedure du 10 février 2012 relatif à la non-contestation

Lastly, the Italian Competition Authority has recently released new guidelines setting forth the criteria it uses to impose fines for violations of Italy's antitrust laws. Notably, the guidelines list the adoption and enforcement of a compliance program as a potential mitigating factor that can reduce the base fine amount. Merely having such a program on the books does not qualify as mitigating; rather, the enterprise must prove its commitment to compliance. The guidelines provide examples of how this commitment might be demonstrated, such as involving management in the creation and implementation of a compliance program, designating specific employees who are responsible for the program, organizing training activities, providing incentives for adherence to the program (as well as disincentives for failure to do so), and implementing a system of monitoring and auditing.[352]

In light of the above, the performance of a pre-acquisition "anti-cartel" audit in the context of M&A transactions reveals to be beneficial not only to the M&A parties but also to the entire system of antitrust enforcement. For this reason, the widespread performance of such exercises shall be incentivized by the legislators at least in the same manner antitrust compliance programs are starting to be rewarded in some jurisdictions.

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des griefs, accessible at http://www.autoritedelaconcurrence.fr/user/standard.php?id_rub=260.

352 The text of the Guidelines are available at http://www.agcm.it/trasp-statistiche/doc_download/4498-lineeguidacriteriquantificazionesanzioni.html .

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