RESEARCH HANDBOOK ON Competition and Corporate Law

Edited by
FLORENCE THÉPOT • ANNA TZANAKI



RESEARCH HANDBOOKS IN COMPETITION LAW

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Research Handbook on Competition and Corporate Law

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To Anders and Sofia
To Thibault, Eliott and Noah

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Introduction to the *Research Handbook on Competition and Corporate Law*

Florence Thépot and Anna Tzanaki

Edward Elgar's invitation to take on editing the *Research Handbook on Competition and Corporate Law* came to us as an honour. We received it as a recognition of our research contribution to issues at the edge of both branches of law. But it also came as a challenge to continue questioning their intersections and jointly look at the future. Fascinated by the inner complexities of corporate organisations, we have long been dedicated to advancing the understanding of issues of competition law, through the joint lens of the corporation and of the market.[1] Both competition law specialists in the first place, our research has never been confined to the outer boundaries of firms, where it traditionally operates.[2] We thus took on this task knowing it would be as complex as it is rewarding. Not even terminology is helpful: a business, a firm or a corporation are not entirely overlapping terms, they may not mean the same thing to a competition and a corporate law expert, their boundaries may not be understood or carved out by the same frame of reference. The inherent complexity notwithstanding, competition law can be both theoretically and practically enriched by opening the black box of the firm. The gained insights can in turn inform corporate law and governance research and policy. Markets may start where firms end, but one cannot exist without the other – their interaction is real, contemporaneous and ever-evolving. Modern challenges such as common ownership and interlocking directorates keep on reminding us of the deep links between the two fields. Such challenges set us on our academic path, inquiring the meeting points between competition and corporate law.[3] We now join forces to pursue this important mission.

[1] Professor Rock most eloquently explains the division of labour between the two fields. See Edward B. Rock, 'Corporate Law Through an Antitrust Lens' (1992) 92 Columbia Law Review 497, 498: "Antitrust is about markets; corporate law is about firms. Antitrust is about competition; corporate law is about cooperation. Antitrust regulates relations among firms; corporate law governs relations within firms."

[2] It all goes back to our doctoral projects at University College London, where we also first met. See Anna Tzanaki (2017) *The Regulation of Minority Shareholdings and Other Structural Links Between Competing Undertakings: A Law & Economics Analysis* (PhD, UCL); Florence Thépot (2014) *The Interaction between Competition Law and Corporate Governance: Opening the 'Black Box'* (PhD, UCL).

[3] Anna Tzanaki, 'Varieties and Mechanisms of Common Ownership: A Calibration Exercise for Competition Policy' (2022) 18 Journal of Competition Law & Economics 168; Bénédicte Brullebaut and others, 'Persistence in Corporate Networks through Boards of Directors? A Longitudinal Study of Interlocks in France, Germany, and the United Kingdom' (2022) 16 Review of Managerial Science 1743; Florence Thépot, 'Interlocking Directorates in Europe – An Enforcement Gap?' in Marco Corradi and Julian Nowag (eds), *Intersections between Corporate and Antitrust Law* (Cambridge University Press 2023).

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Competition law, also called antitrust law in some jurisdictions, may refer to substantive rules and enforcement processes aimed at protecting competition in free market economies. Its subject is inter-firm relations. Corporate law, also called company law in some countries, governs how business organisations are formed and managed. In all its national variations, corporate law across jurisdictions commonly provides a set of legal attributes to business enterprises, such as legal personality and limited liability, that facilitate and encourage the conduct and organisation of business.[4] These characteristic legal features single out corporations from other business organisations. At first glance, competition law and corporate law seem to operate within very distinct conceptual arenas. While competition law typically operates outside the boundaries of the firm, corporate law is concerned with the internal organisation of corporations. Competition law treats firms as units and discourages cooperation between them for the benefits that competition in the market brings. Corporate law, on the other hand, is very much about encouraging cooperation among corporate constituents for the organisation to work seamlessly and maximise value. While competition law's core purpose may be consumer welfare or more generally the protection of the competitive process for the benefit of consumers (sometimes along with different goals),[5] corporate law may be regarded as traditionally centred on the protection of shareholders' interests.[6] Competition law may well be considered to have a public interest flavour, whereas corporate law is commonly structured to align and serve private interests. While competition law often has a strong federal or supra-national character, corporate law demonstrates notable national variance in corporate features and rules that rest on institutional particularities and path dependencies. US antitrust law and EU competition law have their own parallel yet unique historical trajectories: the former has been conceived as a force disciplining and liberalising state corporate laws, whereas the latter unifies EU Member States under a supreme mission of integrating the internal market through the protection of competition across the EU.[7]

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[4] John Armour and others, 'What Is Corporate Law?' in Reinier Kraakman and others (eds), *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd edn, Oxford University Press 2017) 1–2.

[5] There is a long and ongoing debate on the goals and purpose of competition or antitrust law, with regional and country variations influencing academic views and policy choices. Contemporary discussions on digital antitrust cases best showcase this range of opinions. See for instance Konstantinos Stylianou and Marios Iacovides, 'The Goals of EU Competition Law: A Comprehensive Empirical Investigation' (2022) 42 Legal Studies 620; Ariel Ezrachi, 'The Goals and Scope of Competition and Antitrust Laws' in Ariel Ezrachi (ed), *Competition and Antitrust Law: A Very Short Introduction* (Oxford University Press 2021); Ioannis Lianos, 'Polycentric Competition Law' (2018) 71 Current Legal Problems 161; A. Douglas Melamed and Nicolas Petit, 'The Misguided Assault on the Consumer Welfare Standard in the Age of Platform Markets' (2019) 54 Review of Industrial Organization 741.

[6] Although the shareholder primacy vision has long been debated, ever since Berle's contribution on the Modern Corporation. See Joseph L. Weiner, 'The Berle-Dodd Dialogue on the Concept of the Corporation' (1964) 64(8) Columbia Law Review 1458. Stakeholderism as the countervision to shareholderism is nowadays on the rise again, with the environmental, social, and governance (ESG) movement taking a strong hold within corporate governance.

[7] Anna Tzanaki, 'Common Ownership and Minority Shareholding at the Intersection of Competition and Corporate Law Looking Through the Past to Return to the Future?' in Marco Corradi and Julian Nowag (eds) (n 3).

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Beyond the surface, however, corporate law and competition law are closely intertwined fields. As special branches of business law, both centre around legal and economic variations of the conception of the 'firm'.[8] They look 'inside' or 'outside' of roughly the same thing: business entities. The understanding of the firm or the corporation and its contours is fundamental to both disciplines. This is where it all begins. But there is more. Historically, the existence of antitrust law in the US has its roots in state corporate law(s), and their inability (or unwillingness) to tame corporate power.[9] In merger control, the competitive impact of acquisitions can only be apprehended through an understanding of how corporate control may be gained and exerted, through legal or economic rights. Transformations in corporate finance and governance also bring numerous challenges to the application of competition policy. The financialisation of the economy, and the growing role of institutional investors, may cause concerns that concentration of common ownership – small, parallel equity holdings by overlapping institutional investors – within sectors may impact competition in product markets. The debate on the theoretical mechanisms and empirical evidence is far from settled. At the centre of this debate, the core question of the channels of influence of common investors on product market competition is one that demands corporate law expertise. Interlocking directorates are yet another example of a business practice that touches on both disciplines. Intriguingly, from the vantage point of each field, having common directors on the boards of multiple companies may lead to very different, largely contradictory implications and policy prescriptions. What may be seen as 'good' in the corporate eye may appear 'suspect' or 'evil' to the antitrust-minded specialist.

If we dig further, the list of issues at the juncture of competition and corporate law continues. The emergence of new business models in digital markets has not only has brought about organisational transformation but has also triggered some revolutions or recalibrations across competition law regimes. Hybrid modes of economic organisation equally challenge formalistic and siloed ways of approaching and regulating firms and markets. The environmental, social, and governance (ESG) movement and sustainability goals affect both corporate entities and their market activities: a 'purpose' reorientation of corporate and competition law beyond pure shareholderism or efficiency considerations may facilitate the attainment of such goals. This further raises the question of how corporate governance and competition can be made more 'green' and whether a coordinated recalibration of the two fields is apposite. The complex realities of corporate groups, and how competition law should apply to legally independent but affiliated entities has also been at the forefront of discussions. Unlike US antitrust law, which heavily borrows from corporate law and builds on notions of legal personhood and control to determine its applicability and questions of intra-group liability, EU competition law is idiosyncratic. Different kinds of corporate and economic links among affiliated

[8] For a discussion of the conception of the firm in competition and corporate law, see Florence Thépot, *The Interaction between Competition Law and Corporate Governance* (Cambridge University Press 2019).

[9] Herbert Hovenkamp, *Enterprise and American Law, 1836–1937* (Harvard University Press, 1991) 249; Naomi Lamoreaux and William Novak, 'Corporations and American Democracy: An Introduction' in Naomi Lamoreaux and William Novak (eds), *Corporations and American Democracy* (Harvard University Press 2017) 1–33; Anna Tzanaki (n 7); Michelle Meagher, 'Corporate Law, Antitrust, and the History of Democratic Control of the Balance of Power' in Marco Corradi and Julian Nowag (eds) (n 3).

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companies may matter differently for different purposes such as attribution of intra-group liability and calculation of antitrust fines. Alas, the boundaries of the firm are not fixed or a 'one-size-fits-all' even within a single discipline. Finally, in the area of antitrust enforcement, to ensure effective corporate compliance and antitrust sanctions, one needs to start taking a firm look inside the corporation. Understanding its internal dynamics and the interplay among corporate actors may be a useful lens for sharpening antitrust's focus.

Thus, competition law and corporate law deserve a joint perspective on numerous issues. It is supply to this demand which the curation of this Research Handbook aims to provide. Our call has found hospitable reception within the academic and professional community. A unique combination of competition and corporate legal scholars as well as economists, from a diversity of backgrounds, countries, and career stages, is gathered in this Handbook. Their contributions have been greatly enriched by discussions at a research event organised in March 2023, in partnership with the Mannheim Centre for Competition and Innovation (MaCCI) under the leadership of Professor Jens-Uwe Franck, with the support of Lund University and the DRES research centre and the ITI MAKErS of the University of Strasbourg. We are grateful to all the authors for illuminating and expanding with us the research frontier at the intersection of competition law and corporate law and for their unique perspectives.

The Research Handbook on Competition and Corporate Law is organised into four parts:

- Purposes and paradigms in competition and corporate law;
- The firm and its boundaries;
- Corporate organisation and effects on competition;
- Corporate governance and antitrust compliance and enforcement.

I. PURPOSES AND PARADIGMS IN COMPETITION AND CORPORATE LAW

Operating in distinct conceptual orders, competition law and corporate law seem to pursue different objectives, respectively the protection of consumer welfare and the competitive process, and the maximisation of shareholders' value.[10] Yet, behind this apparent distinction, contributions in the first part of the Handbook show that competition and corporate law objectives have much in common. In addition, potential shifts in paradigm in competition and corporate law may not only call for revisiting first principles within each field but also put under scrutiny their mutual standing.

Francesco Ducci and *Alvaro Pereira*, in 'Shareholder Primacy and Consumer Welfare' inquire whether, and the extent to which, the debates on the purpose of competition policy and corporate governance coincide. Developing very insightful theoretical, legal and institutional

[10] At the turn of the century, US scholars had persuasively argued that we have reached the 'end of history' in both disciplines in that we have settled on the goals of corporate and competition law being shareholder primacy and the consumer welfare standard, respectively. Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2000) 89 Georgetown Law Journal 439; Herbert Hovenkamp, *The Antitrust Enterprise: Principle and Execution* (Harvard University Press 2005). Recent developments in and outside the US challenge this view and reactivate old debates.

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parallelisms between challenges to the consumer welfare and shareholder primacy standards, they argue that the two can be seen as part of a unified normative phenomenon. They explain that the mainstream goals of competition and corporate law share a microeconomic foundation: both consumer welfare and shareholder primacy reflect a preference for economic, single-purpose objectives. This economic paradigm is subject to criticism in both competition law and corporate law however, with those in favour of pluralistic models advocating the need for embracing broader, non-economic goals such as the protection of small businesses or sustainability. An integrated discussion of calls to reconsider the foundations of each field, they suggest, may better reflect the overall social benefits and risks of expanding the purpose of corporate and competition law and how they tackle issues of market power and corporate governance. Next, in 'Market Power and Shareholder Control', *Saura Masconale* and *Simone M. Sepe* explore the impact of market-power shareholders on corporate governance. Starting from the theoretical thesis that effective shareholder control of public corporations can be achieved through competitive markets, they show that the current reality is somehow different. Shareholder empowerment has been achieved, but the newfound ability of 'empowered shareholders' to discipline management is not due to a robust market for corporate control; rather, it is a by-product of ownership reconcentration, and hence market power, due to the rise of index funds. They further demonstrate that the model of 'competitive shareholders' fails under conditions of market incompleteness, heterogenous shareholder preferences and misaligned incentives. On the other hand, they argue that the prevailing market-power model of shareholder control may address such efficiency concerns but only at the price of creating new economic and political challenges due to shareholders' support for a novel model of stakeholder capitalism. Thus, drawing definitive conclusions about the efficiency of one governance model over another is considered premature.

Picking up on this thread, in 'Varieties of Capitalism, Competition, and Prosocial Corporate Purposes', *Massimiliano Vatiero* reflects on what model of capitalism – 'armed' or 'disarmed' – is more prone to the pursuit of prosocial corporate purposes. Armed capitalism characterises public corporations in countries with high-powered corporate owners and workers, and high barriers to entry, as opposed to disarmed capitalism, which is associated with low power of such actors and low entry barriers. His analysis concludes there is no 'one-size-fits-all' answer. Where large public corporations compete in financial capital, labour and product markets, there is room for prosocial objectives to be pursued provided this is the preference of the different actors (investors, managers, etc.) with influence on outcomes. In turn, in 'Corporate Governance and Antitrust: Lessons from Japanese Occupation Policy', *J. Mark Ramseyer* invites us on a historical journey in the post-Second World War period in Japan, to show that corporate governance and competition objectives may sometimes be wrongly confused. Providing very informative contextual insights into family-owned enterprises, such as Mitsui, or specific corporate forms prevalent in Japan, including zaibatsu and keiretsu, he explains how the dissolution of diversified conglomerates and the banning of holding companies, for fear they exploited consumers, have had detrimental effects on corporate governance, and on the Japanese economy. A forceful illustration that although there are meaningful connections between corporate governance and competitive outcomes, rarely, it is argued, are those connections determinate.

Shifting to discussions on the ends of competition law, in 'Markets, Competition, and Fairness', *Eliana Garcés* and *Giuseppe Colangelo* explain that fairness is increasingly invoked as one of the goals of competition policy and is central in recent EU regulations in

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the digital space. While it has so far been anchored in an economic perspective, fairness now has the potential to drive EU competition policy towards more vigorous protection of equal opportunities in the competitive process, and of fair outcomes, away from well-defined and economic-rooted forms of abuses. It remains to be seen from the future implementation of EU competition rules and digital regulations how far one may be willing to go to replace the market as the proper mechanism to allocate rents, even jointly created ones, or whether the 'fairness impetus' is a temporary and local phenomenon. To round off this part with another hot topic of current debate, in 'ESG: The Corporate and Antitrust Puzzle', *Marco Corradi* and *Julian Nowag* offer us a much-needed joint assessment of the incorporation of non-economic goals, more specifically ESG (environmental, social, and governance) considerations, into the realm of competition law and corporate law. Their chapter analyses how ESG concerns may impact each area of law separately, in particular the economic paradigms they lie on, and how changes in one area may affect the other. To preserve economic liberty and ensure policy effectiveness, they make the case for favouring softer and flexible regulatory approaches, and for the need of a coordinated approach to the integration of ESG policies into competition and corporate law.

II. THE FIRM AND ITS BOUNDARIES

The second part of the Handbook focuses on the entities subject to competition and corporate laws, that is, 'undertakings' under EU competition law and 'corporations' or companies in corporate law. The competition law definition of the firm and its boundaries, not only critically determines the scope of application of competition law rules, but it also has significant implications in terms of liability and fines within groups of economically affiliated but legally independent entities. Several contributors press the point that there is not one definition of the firm for all purposes; rather the boundaries of the firm may vary with the context. Although the single economic entity doctrine suggests that competition law is agnostic to the legal form of entities, it is further demonstrated that competition law is in many ways confronted with the legal formalism carried over by corporate law.

Stephen Daly and *Alison Jones*, in 'The Undertaking and Single Entity Doctrine in EU and UK Competition Law: Proposals for a Refined Approach', expound what an 'undertaking' is, its dissociation from legal personality, and the implications for the application of competition law, particularly to groups of companies. They explain that the 'single economic unit' approach to groups of legal or natural persons may create some difficulties and inconsistencies. The authors propose a refined approach that would entail, on the one hand, treating the economic unit and undertaking concepts as distinct and, on the other hand, embracing principles of UK company law. Although this would require a change of direction from that in recent EU case law, they note that such an approach could be followed more freely in the UK. Throwing further light on these issues, *Thomas K. Cheng* in 'The Single Economic Entity Doctrine' analyses how the single entity doctrine has expanded from being a shield, insulating intra-group activities from competition law scrutiny, to a sword, enabling the attribution of liability to other legal entities within a corporate group. The limitless and unprincipled expansion of the doctrine is said to be illustrated by certain of its applications to establish collective liability for members of a corporate group, including the *de facto* irrebuttable presumption of parental liability for competition law infringements of their wholly-owned subsidiaries and,

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more contentiously, subsidiary liability for breaches of a parent or other sister companies. To counter this trend, it is argued that the application of the doctrine should be pinned to an explicit policy objective, with deterrence being the most fitting candidate. However, given the multiple purposes the doctrine serves, such as in the context of liability attribution and fine calculation, its differential and contextual application would be more appropriate in contrast to the EU Courts' current uniform approach.

Marcos Araujo Boyd, in turn, clarifies in 'Undertakings and Legal Entities as Addressees of Articles 101 and 102 TFEU' how legal formalism permeates the public and private enforcement of EU competition law. Despite the seeming centrality of economic units or 'undertakings' as the only subject of competition rules, the legal structure used by economic entities is legally relevant in several ways. For instance, statements of objections and decisions are addressed to entities with legal personality, not to undertakings. As a result, EU antitrust rules apply both to undertakings and legal entities. The author analyses possible tensions created by such 'dual attribution' model for public and private enforcement, and discusses the relevance of this duality in the field of public procurement. Next, in 'Enforcement of EU Competition Law Against Groups of Companies: The Calculation of Fines', *Carsten Koenig* reviews the role of the single economic unit doctrine in the calculation of antitrust fines, in the light of relevant decisions by the European Court of Justice. Although legal entities are addressees of prohibition decisions, the amount of the fine critically depends on whether the legal entity is part of an economic unit comprising other legal entities. Given the distinct function of the doctrine when calculating fines, as opposed to determining liability, different guiding principles are needed. The author then goes on to formulate such principles. A key takeaway is that to reflect the actual economic strength of the group and encourage specific deterrence, the European Commission should base the calculation of fines on the corporate group as it is at the time of the prohibition decision, whereas any structural changes in the group during or after the infringement should be disregarded.

Beyond structural and economic links between separate entities, competition law may draw the boundaries of the firm by reference to other kinds of ties. In 'Family Ties and the Boundaries of the Firm in Antitrust Law', *Mariana Pargendler*, *Maria Luiza Mesquita e Silva* and *Lucas Víspico* explore the extent to which non-economic ties, such as family links, have been used in antitrust enforcement against anticompetitive agreements and mergers. While such ties are typically used as a sword to expand merger review and facilitate proving collusion, there are also instances where they are used as a shield by invoking the single entity doctrine to exclude liability in bid-rigging offences. The authors point to the greater relevance of family ties in antitrust practice in the Global South, denoting a source of local variation in antitrust law enforcement, and bring to light a novel illustration of 'veil peeking' – or disregard of legal separateness – across natural persons mirroring its use in cases of legal persons linked by equity ties.

III. CORPORATE ORGANISATION AND EFFECTS ON COMPETITION

The third part of the Handbook discusses how recent evolutions in corporate organisation may give rise to new antitrust concerns or, vice versa, may require rethinking of old classifications. The increased role of institutional investors in corporate finance and governance has entered

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the antitrust arena, with concerns that common ownership of competing firms by such investors may cause anticompetitive effects. Similarly, the practice of interlocking directorates, that is, companies sharing members of their board of directors, is now under the spotlight across jurisdictions. Finally, acquisition strategies within the tech and digital sector may have anticompetitive effects that fall short of competition law provisions. At the same time, novel and hybrid modes of economic organisation may deserve greater immunity from competition rules even when they do not fit the 'box' of legally privileged full integration.

In 'Common Ownership in Europe and the US: A Network Analysis Approach', *Nuria Boot*, *Albert Banal-Estañol* and *Jo Seldeslachts* offer useful empirical evidence on common ownership links among the largest firms in the two continents using measures based on individual and joint levels of ownership. Drawing on ownership patterns of the Top 50 firms in Europe's S&P 350 and the US's S&P 500 in 2004 and 2015, they analyse and compare the structure and characteristics of the common ownership networks among European and US firms separately, as well as links between European firms on the one hand and US firms on the other. A key finding is that the Top 50 European firms are generally less connected than the Top 50 US ones, through joint or individual ownership links at the 5% level, although the former have become more connected over time. The identity of common investors in European firms has also dramatically changed when one considers joint ownership links. More broadly, the evolution of the network structure critically depends on the level of ownership stake considered. In turn, this suggests that the effects of common ownership may hinge on the level of ownership and the potential individual or joint influence of common investors, and whether such links exist within or across sectors. Next, in 'Common Ownership: The Paradox in Japan's Corporate Governance', *Steven Van Uytsel* sheds light on the transformation of postwar corporate governance in Japan, and the transition from cross-shareholding between non-competing companies, characteristic of the keiretsu system, to a model based on the presence of institutional investors with common ownership of competing companies. What drove the dissolution of cross-shareholding was the objective of freeing Japanese managers from acting in the interests of cross-shareholders, which could mitigate their competitive orientation. Recent scholarship suggests, however, that the growing role of common ownership by institutional investors may produce an equivalent outcome. Ironically, law reforms that facilitated this change in Japan's shareholding structure could have substituted one problem with another. Verifying the existence of such a paradox demands further empirical study.

Turning to possible antitrust solutions, in 'Addressing Common Ownership Through Abuse of Collective Dominance', *Giorgio Monti* discusses under what circumstances the EU competition law concept of abuse of collective dominance may capture the anticompetitive effects of common ownership. When common shareholding gives rise to sufficient economic links among all firms in a concentrated industry and common shareholders have the ability to influence their decisions, a position of collective dominance may be established, he argues. However, identifying abuse of such a position, as well as an effective remedy, is more challenging. While certain actions by common investors seeking to influence the conduct of directors on the market may constitute abusive conduct, higher prices resulting from common ownership because the mere presence of common investors affects director incentives may not, in themselves, constitute an abuse. In conclusion, although ex ante merger control could be apt to tackle harmful effects resulting from such structural economic incentives, the application of Article 102 TFEU ex post is limited and cannot offer a systematic response to all forms of anticompetitive common shareholding.

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The focus then shifts to another currently hot topic dividing corporate governance and antitrust experts. In 'Interlocking Directorates in the United States', *Yaron Nili* discusses the prevalence and policy implications of 'horizontal directors' – directors serving on multiple corporate boards within the same industry – in the US context. Long regulated under Section 8 of the Clayton Act, the issue has lately received increased attention from US antitrust authorities. In parallel to recent debates on common ownership, horizontal directors stand uniquely at the intersection of corporate governance and antitrust law: they can improve corporate governance and benefit shareholders but at the same time, they create competition risks and may harm consumers. The grey regulatory environment in which they operate underscores the tension between antitrust laws and corporate governance. This, in turn, calls for re-evaluation of the current regulatory framework governing horizontal directors with a view to maximise their benefits and minimise risks. Further on the same theme, in 'Interlocking Directorships: Evidence from a Natural Experiment by Israeli Competition Law', *Moran Ofir* and *Anat Alon-Beck* empirically examine the effect of law reforms targeting pyramid-structured corporations and specifically provisions regulating the composition of their board of directors on the level and intensity of interlocking directorates in Israel. Using data on large Israeli public corporations before and after the regulatory changes, the authors demonstrate that as a result of the reform, boards generally have fewer directors and each director holds fewer board seats on average. The level of connectivity of board interlocks within such corporations has also decreased. Overall, it is shown that firms in the market reacted in accordance with the legal requirements, reducing board interlock connectivity, although the intensity of the decline was lower than what would be expected under full compliance with the minimal standard set by the reform.

Other situations where competition law may have been under- or over-inclusive by focusing more on form over substance are explored next. In '"Killer Acquisitions" or "Killing Innovation": Antitrust Implications of the New Wave of Tech Acquisitions and the New European and Italian Regimes for Below-Threshold Mergers', *Valeria Falce* and *Nicola M. F. Faraone* discuss the suitability of merger control regimes in the EU and in Italy to tackle potential anticompetitive effects of acquisition strategies in innovative sectors, in particular start-up acquisitions by large incumbent firms that are also called 'killer acquisitions'. Such transactions typically escaped scrutiny under both regimes as they had been limited by turnover thresholds. Recent changes aimed at addressing this 'enforcement gap' empower EU and Italian competition authorities to review or call in below-threshold mergers, even when already completed, under certain circumstances. Contrary to previous policy and practice, these reforms show a reorientation towards flexibility and discretion over certainty and ex-ante review. Caution is advocated, however, in balancing intervention under these expanded merger control powers and protecting legitimate expansion and innovation strategies by digital players. In 'Antitrust in an Age of New Modes of Economic Organization', *Teodora Groza* challenges whether the antitrust conception of the firm, that determines the scope of the antitrust prohibition of coordinated action, is well-suited to innovative modes of organisation. Taking innovation networks and decentralised autonomous organisations ('DAOS') as examples, she argues that hybrid organisational forms can equally produce efficiency gains even if they do not fit antitrust's vision of the large, vertically integrated, managerially-directed firm. The suggestion then is to liberalise antitrust frameworks to accommodate collaboration under such hybrid organisational forms. Two approaches are put forward: either an 'unorthodox'

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expansion of the antitrust concept of the firm, or recognising them as organisational alternatives to firms that could be permitted subject to ex-ante approval akin to merger control.

IV. CORPORATE GOVERNANCE AND ANTITRUST COMPLIANCE AND ENFORCEMENT

Drawing attention within the boundaries of the firm, the fourth part of the Handbook discusses some of the most pressing issues in competition law enforcement, through the lens of businesses and mechanisms internal to the corporation. The analysis delves into the internal drivers of compliance, or non-compliance with competition law, and discuss both challenges and opportunities for compliance induced by recent policy and technological evolutions. Antitrust compliance and sanctions are evaluated in conjunction with governance mechanisms available under corporate law. The interplay of external and internal sanctions may influence their effectiveness and affect the goals of competition law enforcement and corporate governance. Although across jurisdictions antitrust sanctions are typically imposed on business organisations, liability may be extended to or shifted among corporate actors within such organisations. In light of the deterrence objective of antitrust sanctions, it is debated the extent to which there may or should be greater liability of managers, through various mechanisms (derivative actions, individual sanctions, etc.), and more broadly, any liability shifting within corporations and corporate groups.

In 'When Bad Things Happen in Good Business: The Need for Compliance Focused Antitrust Enforcement', *Andreas Stephan* makes the case for competition agencies to take compliance seriously. Although businesses already do so, competition law, especially in the EU, insists on considering compliance an entirely internal matter: all law infringements are the product of failed compliance. As he explains, this view rests on false premises. Although corporate compliance programmes are potent tools to deter or detect competition law violations, and thus reduce antitrust risk, they cannot eliminate it completely. Despite 'good' compliance, businesses may find it difficult to effectively educate, control or discipline all employees. In addition, considerable uncertainty as to how competition rules will apply – especially in novel situations or in the context of effects-based rules – makes it difficult for businesses to distinguish legal from illegal behaviour. Against this backdrop, the author advocates for a more proportionate and 'compliance focused' approach to competition law enforcement that rewards good compliance, takes into account genuine uncertainty and reserves the heaviest fines for the most serious violations where the need for deterrence is strongest. In turn, in 'Antitrust and Regulatory Compliance in the 21st Century: New Challenges, New Opportunities and the Role of AI', *Rosa M. Abrantes-Metz* and *Albert D. Metz* present new opportunities for corporate compliance in light of recent technological advances. Increasing regulation and antitrust enforcement, especially in the tech industry, may create complexity for businesses but also add demand for cutting-edge compliance systems. Moreover, recent changes in US antitrust policy with the issuance of the sentencing guidelines may incentivise the internal adoption of compliance measures. New technologies and tools empowered by the use of artificial intelligence (AI) and based on data and automation may well cater to increasing regulatory demands and offer novel, targeted, more objective and more cost-effective mechanisms to firms both for detecting and deterring breaches of antitrust law. As an early sign of success, competition authorities around the world have started adopting these tools. Yet, for all the promise and

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efficiencies AI-enhanced compliance programmes may bring, human input and expertise are critical to make the best of their use.

Empirical evidence is presented then to throw new light on the potential contribution of corporate governance to antitrust enforcement, and conversely, the impact of antitrust sanctions on corporate governance. In 'The Effect of Corporate Board Gender Diversity on Compliance with EU Competition Law', *Amber Scheepers* explores the relationship between board gender diversity and competition law compliance. Based on a sample composed of DAX30 companies in Germany and a natural experiment design, she finds that greater representation of women on corporate boards decreases the likelihood of being subject to competition law fines. As the first empirical study to provide evidence of such positive relationship, it has important implications. It suggests that greater diversity may improve the quality of corporate decision making and be a driver of compliance. As such, it provides incentives to businesses and a guide to policymakers on diversity targets. Next, in 'CEO Turnover and Shareholder Awareness in Cartel Cases', *Catarina Marvão* and *Giancarlo Spagnolo* examine the relationship between antitrust enforcement and corporate governance, finding corporate governance mechanisms that operate in the shadow of enforcement inadequate to prevent competition law infringements. Based on data on detected EU and US cartels and an analysis of career paths of colluding CEOs, they show that only rarely are CEOs involved in cartels fired (especially in the EU, less so in the US), and quite often they may remain in positions of authority within the organisation. Evidence on shareholders' awareness further suggests that internal mechanisms of detection and control typically fail to prevent managers from colluding. Overall, antitrust enforcement is found to be suboptimal, and expected sanctions, especially in the EU, may be too low to deter cartels by setting in motion changes in corporate governance. Therefore, the need arises for policy reforms to strengthen the deterrent effect of antitrust intervention.

Further on the interplay of corporate governance and antitrust sanctions, in 'Managerial Liability, Managerial Duties, And Liability Within Corporate Groups: Optimal Competition Law Sanctions by Rearranging the Deckchairs Within the Undertaking?', *Florian Wagner-von Papp* analyses the incentive effects of competition law sanctions targeting the infringing 'undertaking' when these may trigger internally (breach of) managerial duties or a shifting of liability within the undertaking, be it to its managers or to other corporate entities within a corporate group. His analysis focuses on managerial liability for antitrust violations of the undertaking, liability for failure of internal compliance schemes, intra-corporate group liability of an affiliated company for violations of another, and their desirability from the perspective of the public interest and optimal antitrust enforcement. Discussing several cases where undertakings seek to recoup corporate fines from managers, the author argues against such indemnification actions that enable the fine to be shifted to directors and officers (D&O) liability insurance, limiting its effectiveness. As the existence and operation of effective compliance schemes are predicated on balancing of the private interests of the company, they do not justify an additional ex post bonus when setting corporate fines. Rather, their benefit consists in endogenously reducing the expected value of the fine, and a strict liability approach to compliance failure is more suitable. In turn, within corporate groups, the extension of antitrust liability to parent companies and occasionally to subsidiaries based on the single economic entity doctrine is justified to restore the principle of responsibility, often constrained by corporate law's limited liability. Coming to a close, in 'Management Liability for Companies' Antitrust Fines', *Jens-Uwe Franck* and *Till Seyer* develop a contrasting view on attempts by undertakings and their shareholders to shift liability to managers for antitrust fines imposed

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on the company. Taking as a starting point court cases from the Netherlands, the UK and Germany that for the most part have denied such recourse claims, taking the view that it would undermine the deterrence objective of antitrust fines, they analyse whether managerial recourse liability under national (company) law should be banned or limited to preserve the effectiveness of EU (antitrust) law. Although it is acknowledged that a shift in liability may reduce the deterrent effect of fines on companies and shareholders, especially given the availability and deficiencies of D&O insurance, it provides shareholders with an indispensable governance tool to effectively address agency problems within the company and ensure managers' antitrust compliance. Besides, recourse claims may add a complementary deterrence mechanism against managers that compensates for potential shareholder under-deterrence. Thus, the overall effect on deterring antitrust violations may be positive. On the other hand, the threat of recourse liability may create risks of over-deterrence of managers, but those too may be mitigated by counterbalancing forces. Taken altogether, it is concluded that antitrust fining policy cannot command a restriction on managerial liability.

A heartfelt thank you to all the amazing contributors and our readers! This mission is now complete, and it is time for sharing the joy together with the results. We hope you enjoy delving into the Handbook and the individual chapters as much as we do.

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PART I

PURPOSES AND PARADIGMS IN COMPETITION AND CORPORATE LAW

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1. Shareholder Primacy and Consumer Welfare

Francesco Ducci and Alvaro Pereira

1. INTRODUCTION[1]

Competition law and corporate law share a microeconomic foundation.[2] In different ways, both areas of law aspire to maximize economic outcomes related to firms' conduct in markets—the first, by focusing on market interactions between firms that distort the competitive process and raise market power concerns; the second, by laying out rules on corporate internal governance to make firms work efficiently. In the competition policy domain, the consumer welfare standard[3] originally advocated by Robert Bork in *The Antitrust Paradox*[4] reflects an economic paradigm that in various jurisdictions tends to take precedence over other possible objectives such as the protection of small businesses, economic inequality, or socio-political concerns about bigness. In corporate law, the economic perspective is reflected in the notion of shareholder primacy, famously defended by Nobel-prize economist Milton Friedman.[5] This doctrine, prevalent in Anglo-American jurisdictions and highly influential elsewhere,[6] sustains that the main purpose of corporations' decision-making should be to maximize

[1] The authors would like to thank Martin Pertin and Andrew Keay for their helpful comments and Andrew Kupfer for his excellent research assistance.

[2] In corporate law, see, generally, Frank Easterbrook and Daniel Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1996). In competition law, see Massimo Motta, *Competition Policy* (Cambridge University Press 2004); Richard Posner, *Antitrust Law* (University of Chicago Press, 2001).

[3] For a discussion, see: Herbert Hovenkamp, 'The Slogans and Goals of Antitrust; Herbert Hovenkamp, On the Meaning of Antitrust' (2010) 22 Loyola Consumer Law Review 336; Douglas Melamed and Nicolas Petit, 'The Misguided Assault on the Consumer Welfare Standard in the Age of Platform Markets' (2019) 54(4) Review of Industrial Organization 741; Lina Khan, 'Amazon Antitrust Paradox'; The Economist, 'In Defense of The Consumer Welfare Standard' (29 January 2022) https://www.economist.com/leaders/2022/01/29/in-defence-of-the-consumer-welfare-standard accessed 15 September 2023; Herbert Hovenkamp, 'Is Antitrust's Consumer Welfare Principle Imperiled?' (2019) 45(1) Journal of Corporation Law 65; Francesco Ducci, 'Consumer Welfare and the Competitive Process' (working paper, 2023).

[4] Robert Bork, *The Antitrust Paradox: A Policy at War with Itself* (Free Press 1993).

[5] Milton Friedman, 'The Social Responsibility of Business Is to Increase Its Profits' *The New York Times* (13 September 1970) 32.

[6] Ibid; see also Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2000) 89 Georgetown Law Journal 439, 449 (arguing that there is a global convergence trend towards this model, which they referred to as 'standard shareholder-oriented' or 'standard model': 'not just because of the failure of the alternatives, but because important economic forces have made the virtues of that model increasingly salient.'). For criticisms, see Section 1(a) below. For recent policy initiatives related to corporate governance and sustainability, see https://commission.europa.eu/business-economy-euro/doing-business-eu/corporate-sustainability-due-diligence_en.

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shareholder value, as opposed to non-economic considerations, which would instead incorporate a broader set of stakeholders' interests and objectives.[7]

While an economic interpretation can still be seen today as the mainstream perspective on the goals of both competition policy and corporate governance,[8] this economic paradigm is subject to growing criticisms and contrasted by alternative normative models.[9] Evidence of increasing levels of market concentration in industrialized countries across sectors[10] is raising doubts about the merits of the consumer welfare objective (and the economic efficiency

[7] Hansmann and Kraakman (n 6) 441–442; cf. Stephen M Bainbridge, 'Director Primacy: The Means and Ends of Corporate Governance' (2002) 97 Northwestern University Law Review 547 (distinguishing "shareholder primacy" from "shareholder wealth maximisation", and arguing that, while shareholders should not have ultimate control, it is their interest which should be prioritized by directors).

[8] In corporate law, see Dorothy S. Lund and Elizabeth Pollman, 'The Corporate Governance Machine' (2021) 121 Columbia Law Review 1 (sustaining that the notion of "corporate governance" and even "good governance" developed alongside "shareholder primacy", which explains why attempts to redesign the model of corporate governance have further strengthened shareholder-value maximization); Andrew Keay, 'Shareholder Primacy in Corporate Law: Can It Survive–? Should It Survive?' (2010) 7 European Company and Financial Law Review 369, 413 (arguing that, at least in Anglo-American jurisdictions, shareholder primacy is unlikely to be replaced, given pervasive factors, such as "the focus on the company as an economic entity; the function of law in enhancing trade freedom; the political policy of promoting competition; the development of the market for corporate control and the significance of the hostile takeover"). In competition law, see Francesco Ducci, 'Consumer Welfare and the Competitive Process' (working paper, 2023); Douglas Melamed and Nicolas Petit, 'The Misguided Assault on the Consumer Welfare Standard in the Age of Platform Markets' (2019) 54(4) Review of Industrial Organization 741; Leah Samuel and Fiona Scott Morton, 'What Economists Mean When They Say "Consumer Welfare Standard"' (*ProMarket* February 16, 2022) https://www.promarket.org/2022/02/16/consumer-welfare-standard-antitrust-economists/ accessed 15 September 2023; Herbert J. Hovenkamp and Fiona Scott Morton, 'The Life of Antitrust's Consumer Welfare Model' (*ProMarket*, April 10, 2023) https://www.promarket.org/2023/04/10/the-life-of-antitrusts-consumer-welfare-model/ accessed 15 September 2023.

[9] In corporate law, see Colin Mayer, *Prosperity: Better Business Makes the Greater Good* (Oxford University Press 2018). In competition law, see Kirk Ott, 'Event Notes: The Consumer Welfare Standard Is Dead, Long Live the Standard' (ProMarket November 1, 2022) https://www.promarket.org/2022/11/01/event-notes-the-consumer-welfare-standard-is-dead-long-live-the-standard/ accessed 15 September 2023; Sandeep Vaheesan 'The Profound Nonsense of Consumer Welfare Antitrust' (2019) 64(4) The Antitrust Bulletin 479; Tim Wu, 'After Consumer Welfare, Now What? The "Protection of Competition" Standard in Practice' (2018) Competition Policy International https://www.pymnts.com/cpi_posts/after-consumer-welfare-now-what-the-protection-of-competition-standard-in-practice-2/ accessed 15 September 2023.

[10] See for instance, Thomas Philippon, 'The Economics and Politics of Market Concentration' (NBER: The Reporter, December 2019) accessed 15 September 2023; Affeldt, Pauline, Tomaso Duso, Klaus Peter Gugler, and Joanna Piechucka, 'Market Concentration in Europe: Evidence from Antitrust Markets' (2021) Center for Economic Studies and Ifo Institute Working Paper No.8866 accessed 15 September 2023; David Autor, David Dorn, Lawrence F. Katz, Christina Patterson, and John Van Reenen, 'The Fall of the Labor Share and the Rise of Superstar Firms' (2020) 135(2) The Quarterly Journal of Economics 645; Gustavo Grullon, Yelena Larkin, and Roni Michaely, 'Are U.S. Industries Becoming More Concentrated?' (2019) 23(4) Review of Finance 697; Jan De

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perspective that it implies), with growing voices advocating in favor of broader non-economic objectives such as inequality, small businesses, and environmental sustainability.[11] In parallel, concerns over corporations' excessive risk-taking and cost externalization have led to uncluttered criticism of shareholder primacy, with increasing support for a corporate governance model that prioritizes environmental sustainability and directly advances the interests of various stakeholders, such as employees, management, customers, suppliers, or creditors.[12]

Is there an overlap between these debates on the purpose of competition policy and corporate governance? This question points to an under-explored normative nexus at the intersection of competition law and corporate law, which is the focus of analysis in this chapter. At a general level, both criticisms of consumer welfare and shareholder primacy reflect a rejection of economic objectives in favor of non-economic goals (a normative perspective). As such, both also imply a rejection of single-purpose law in favor of a multi-purpose, pluralist orientation that departs from the view of strict specialization in the design of legal instruments (an institutional and legal perspective). Hence, at least from these angles, consumer welfare and shareholder primacy, and their respective critiques, represent a microcosm for ongoing tensions between economic, single-purpose models and non-economic, pluralist conceptions of the normative ends of both competition and corporate law.

Several substantive questions of central importance that lie at the interplay between these two areas of law have been recently explored by various scholars. These include, among others, the problem of collusive behavior and corporate structure,[13] and the competitive effects of common ownership and horizontal shareholding and the resulting challenges for competition law enforcement.[14] The scope of this contribution, which has a more general focus on the

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Loecker, Jan Eeckhout and Gabriel Unger, 'The Rise of Market Power and the Macroeconomic Implications' (2020) 135(2) Quarterly Journal of Economics 561.

[11] See for instance CPI Antitrust Chronicle, 'Hipster Antitrust' 2018; Lina M. Khan, 'Amazon's Antitrust Paradox' (2017) 126 Yale Law Journal 710; Carl Shapiro, 'Antitrust: What Went Wrong and How to Fix It' (2021) 35(3) Antitrust 33; Ioannis Lianos, 'Polycentric Competition Law' (2018) 71(1) Current Legal Problems 161; Simon Holmes, 'Climate change, sustainability, and competition law' (2020) 8(2) Journal of Antitrust Enforcement 354; Julian Nowag, 'Competition Law's Sustainability Gap? Tools for an Examination and a Brief Overview' (2022) 1 Nordic Journal of European Law 149; Roman Inderst and Stefan Thomas, 'Reflective Willingness to Pay: Preferences for Sustainable Consumption in a Consumer Welfare Analysis' (2021) 17 Journal of Competition Law & Economics 848.

[12] Christopher M. Bruner, 'Corporate Governance Reform and the Sustainability Imperative' (2022) 131 The Yale Law Journal 1062; Beate Sjåfjell, 'Sustainable Value Creation Within Planetary Boundaries—Reforming Corporate Purpose and Duties of the Corporate Board' (2020) 12 Sustainability 6245.

[13] See for instance, Florence Thépot, *The Interaction Between Competition Law and Corporate Governance: Opening the 'Black Box'* (Cambridge University Press 2019).

[14] Anna Tzanaki, 'Varieties and Mechanisms of Common Ownership: A Calibration Exercise for Competition Policy' (2022) 18(1) Journal of Competition Law & Economics 168. See also José Azar, Martin Schmalz and Isabel Tecu, 'Anticompetitive Effects of Common Ownership' (2018) 72(4) Journal of Finance 1513; see also Einer Elhauge, 'Horizontal Shareholding' (2016) 129 Harvard Law Review 1267; Edward B. Rock and Daniel L. Rubinfeld, 'Antitrust for Institutional Investors' (2018) 82 Antitrust Law Journal 221. See also Mariana Pargendler, 'Controlling Shareholders in the Twenty-First Century: Complicating Corporate Governance Beyond Agency Costs' (2020) 45(4) The Journal of Corporation Law 953.

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nexus between the goals of competition policy and corporate governance, is to analyze three key parallelisms—theoretical, legal, and institutional—between the consumer welfare standard and shareholder primacy and discuss their implications.

The first parallelism is about the theoretical premises of shareholder primacy and consumer welfare. Milton Friedman's well-known defense of shareholder primacy was premised on the assumption of competitive markets.[15] This theoretical starting point raises relevant questions about the interplay between market power and corporate social responsibility, and more generally about the implications that a potential decline in competition may pose for the theoretical basis of the shareholder primacy paradigm.[16] Not only does the competitive landscape impact the theoretical strength of the shareholder primacy model, but the design of competition law doctrines can, at least to a degree, also affect the importance of shareholder (or producer) welfare in competition law cases.[17] These and other theoretical overlaps are discussed in section 2 of the chapter.

The second parallel, briefly discussed in section 3, relates to normative complementarity in legal regimes. Given the existence of a theoretical overlap between consumer welfare and shareholder primacy (i.e., economic versus non-economic objectives, single-purpose versus multi-purpose law), would it be reasonable to expect that an efficiency, economic-oriented antitrust regime based on consumer welfare would go hand-in-hand with an equally efficiency-driven and economic-oriented corporate governance model based on shareholder primacy? Assuming coherence across public policies, a given jurisdiction that adopts a single-purpose efficiency-oriented competition law would in theory be expected to gravitate toward a single-purpose efficiency-oriented corporate law, and vice versa. If that is not the case, possible differences in the normative aims might reveal something specific about each area of law, and the relative influence of ideology, theory, path dependence, and socio-economic factors in each field.[18]

Finally, section 4 of this chapter highlights and analyzes an institutional parallelism underpinning the trade-off between purpose pluralism and policy specialization that characterizes debates and ongoing developments in both competition and corporate law. On the one hand, a single-purpose economic model provides clarity and predictability, but is often criticized for its narrow focus and lack of pluralism, i.e., for discounting a set of values that should potentially be part of the mix of objectives guiding competition and/or corporate law enforcement. On the other hand, pluralist perspectives face the challenge of creating less predictable rules, while delegating discretionary power to decisionmakers (public agencies in the case of competition law, private actors like managers in the case of corporate law) that are not necessarily

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[15] See Section 2 below.

[16] See Mark Roe, 'Corporate Purpose and Corporate Competition' (2021) 99 Washington University Law Review 223.

[17] For example, regimes with strong efficiency defenses in antitrust will place (all else being equal) more weight on producer surplus (and therefore shareholders) than consumer surplus.

[18] On path dependence, see Lucian Bebchuk and Mark Roe, 'A Theory of Path Dependence in Corporate Ownership and Governance' (1999) 52(1) Stanford Law Review 127. See also Mark Roe and Roy Shapira, 'The Power of the Narrative in Corporate Lawmaking' (2021) 11 Harvard Business Law Review (arguing that powerful narratives often work against good policymaking, and using stock market short-termism as an example of a powerful narrative that prevents good policymaking in corporate law).

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well-positioned, either in terms of expertise or accountability, to balance difficult conflicting social and political values. This tension, which arguably is the key challenge characterizing the future direction of both fields, is ultimately about the trade-offs created by the choice of institutional design between policy specialization and a pluralistic mandate. In order to shed more concrete light on this issue and the relevant analogies between competition and corporate law, the chapter provides a brief case study on two important Canadian competition and corporate law decisions – the *Superior Propane* case[19] by the Federal Court of Appeal on the role of efficiency and distributive equity in Canadian merger policy, and the *BCE* decision[20] by the Supreme Court of Canada on the content of corporate directors' fiduciary duty. By focusing on this conflict between pluralism and accountability, this chapter shows that existing normative debates in competition policy and corporate law share similar trade-offs related to the optimal, or most cost-effective, choice among alternative legal and policy instruments, a dimension that goes beyond existing ideological battlefields.

Building on these theoretical, legal and institutional parallelisms, we conclude that questions about the role of consumer welfare and shareholder primacy are intrinsically related and should be seen as part of a broader, unified normative phenomenon that exceeds the domain of each field alone. We suggest that integrating existing academic controversies on the goals of antitrust and corporate governance is a necessary step to properly evaluate the implications of an expansionary trend in the way the legal system regulates market power and firms' governance in particular contexts.

2. SHAREHOLDER PRIMACY AND CONSUMER WELFARE: NORMATIVE BASES AND CRITIQUES

This section provides a discussion of shareholder primacy in corporate law and the consumer welfare standard in competition law, their respective normative bases, and critiques. It is useful to lay out general commonalities at the outset. First, shareholder primacy takes economic efficiency as its lodestar; similarly, consumer welfare endorses an economic interpretation of competition policy.[21] Second, both shareholder primacy and consumer welfare assume that a clear, single objective may better serve the management of enforcement than the pursuit of multiple, often conflicting goals. Third, insofar as critiques of these predominant economic paradigms share some grounds of discontent with economic liberalism and globalization more generally, corporate and competition law debates can also be seen as closely related to longstanding concerns about the economic and non-economic effects of international trade—for example, on domestic employment and job displacements, environmental harms, and fair trade between developed and developing economies.[22] Hence, from this perspective, the clashes between the consumer welfare-Neobrandeis antitrust paradigm and shareholder

[19] *Canada (Comm'r of Competition) v. Superior Propane, Inc.*, [2003] 3 F.C. 529 (Can. Fed. Ct. App.).

[20] *BCE Inc v. 1976 Debenture Holders* [2008] 3 SCR 560.

[21] The original meaning of the term 'consumer welfare', as will be explained, is in fact closer to efficiency, or total welfare, than consumer surplus. See Section 1.b below.

[22] See Francesco Ducci and Michael Trebilcock, 'The Revival of Fairness Discourse in Competition Policy' (2019) 64(1) The Antitrust Bulletin 79.

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primacy-stakeholder governance find an additional counterpart in the free trade-fair trade debates in international markets.[23]

2.1 Shareholder Primacy in Corporate Governance

The theoretical economic account of the large corporation's mission is shareholder-centered.[24] It conceives shareholders as 'residual claimants', meaning that they can only receive gains once the corporation has paid all costs and expenses, including taxes, suppliers, and workers—i.e., their risk exposure is higher than any other constituency.[25] In this perspective, shareholders are also regarded as more vulnerable: unlike other stakeholders, whose interests are protected by specialized regulation or contracts, shareholders can only protect themselves by participating in the governance of the corporation and making sure it is run efficiently. Thus, shareholders have a higher interest in maximizing its value.[26] Hence, despite historical and contextual differences across legal systems, these two fundamental aspects tend to justify the prioritization of shareholders' interests.

A straightforward way of prioritizing shareholders' interests is by making it the 'purpose' of the corporation. Prevailing accounts sustain that orienting corporate decision-making towards shareholders' value maximization ensures higher clarity and efficiency than pursuing multiple goals with complex trade-offs.[27] From this perspective, promoting shareholders' interests is also an efficient way of advancing the interests of all stakeholders and increasing social wealth because the corporation must comply with its legal and contractual obligations before generating profits. While almost no corporate statute explicitly mandates corporations to exclusively pursue that specific purpose, in practice, advancing shareholders' interests has a preeminent role in corporate decision-making due to a combination of forces, including markets (e.g., financial), institutions (e.g., investor associations, proxy advisors, and stock exchanges and indexes), and culture (e.g., professional education).[28]

Another expression of shareholder primacy is in shareholders having greater and more direct influence in firms' governance compared to other stakeholders—what we may call shareholder empowerment. Shareholders generally have powers to nominate, appoint and remove directors, approve fundamental transactions, and sue directors for breach of obligations to the

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[23] Ibid.

[24] A distinction has been made between "shareholder purpose" (i.e., that corporate decision-making should prioritize or advance the interests of shareholders) and "shareholder control" (i.e., that shareholders should have ultimate control over the corporation). While our analysis mainly focuses on the former, we use "shareholder primacy" to include both. On this distinction, see Bainbridge (n 7).

[25] Frank H. Easterbrook and Fischel (n 2) 36–39.

[26] Ibid; Hansmann and Kraakman (n 6) 449.

[27] This holds true, even for those who reject shareholders' ultimate control. See, e.g., Bainbridge (n 7).

[28] See Lund and Pollman (n 8) (arguing that the pervasiveness of this approach in the United States is reinforced by law, institutions, and culture); Hansmann and Kraakman (n 6) (arguing that the global convergence towards this model is explained inter alia by the failure of alternative models, competitive pressures, and the emergence of a public shareholder class across developed economies).

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company or to some of them.[29] Accordingly, even where the primacy of shareholders' interest is not explicitly conceived as the purpose of the corporation (in the law or in its guiding principles), these legal powers reveal a deference to a shareholder-oriented corporate governance model. The strength of shareholders' powers is thus indicative of how much legal systems rely on—or defer to—shareholders' interest as the normative foundation of corporations.

Shareholder empowerment has pervasively guided the global development of corporate governance at least since the 1990s. The disintegration of the Soviet Union and technological improvements facilitating cross-border equity investments unleashed a widespread competition to reduce the cost of equity capital and, in this context, strengthening shareholder protection emerged as a common regulatory strategy to attract foreign investors.[30] Key international organizations, such as the OECD and the World Bank, also fostered the empowerment of shareholders through widely adopted codes of corporate governance and annual indexes comparing the legal instruments that shareholders have in various countries to protect their interests.[31] Even after the global financial crisis exposed pervasive problems in corporate governance (and, perhaps, even problems with shareholder primacy), the response has been to further strengthen shareholders' powers, as evidenced by the adoption of the Stewardship Code in the United Kingdom, and the Dodd-Frank Act in the United States, each of which fostered shareholder participation in corporate governance, e.g., on executive compensation.[32]

Still, the influence of shareholder primacy has not been exempted from criticism. Whether shareholders are, in fact, residual claimants and more vulnerable has been questioned on the grounds that employees, suppliers, and other stakeholders also make firm-specific investments that tie their financial stability and economic prosperity to the company's success, bearing at least the same risk as shareholders.[33] Further, even if shareholders are indeed the more vulnerable residual claimants, as economic theory posits, critics note that shareholders are not a homogeneous group, but one with divergent approaches to risk and opposing interests.[34] Hence, prioritizing shareholders' interests would not necessarily enhance efficiency in decision-making but rather require balancing the interests of various shareholders, including

[29] Reinier Kraakman and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd Edition, Oxford University Press 2017) 51–61.

[30] Hansmann and Kraakman (n 6).

[31] OECD, *OECD Principles of Corporate Governance*, OECD Publishing (1999); OECD, OECD White Paper on Corporate Governance in Latin America, OECD Publishing (2002); OECD, OECD White Paper on Corporate Governance in Asia, OECD Publishing (2003); Doing Business 2020: Comparing Business Regulation in 190 Economies, Washington, DC: World Bank (2020).

[32] On post-financial crisis developments in corporate law and governance, see David Kershaw and Niamh Moloney, 'The Global Financial Crisis and Corporate Governance Reform: A Comparative Analysis of the United States and the United Kingdom' (2010) 64(4) Journal of Business Law 286; Mark Roe, 'Corporate Governance and the Financial Crisis: A Review' (2011) 3(1) Annual Review of Financial Economics 371.

[33] Margaret M Blair and Lynn A Stout, 'Specific Investment: Explaining Anomalies in Corporate Law Symposium: Robert Clark's Corporate Law: Twenty Years of Change' (2005) 31 Journal of Corporation Law 719, 738–739.

[34] Andrew Keay, 'Shareholder Primacy in Corporate Law: Can It Survive? Should It Survive?' (2010) 7 ECFR 369, 406–408.

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future shareholders. In practice, critics note, shareholder primacy has led to the prioritization of short-term returns and the disregard for corporate negative externalities.[35]

These and other critiques of shareholder primacy have gathered unprecedented public support in recent years, given the growing concern about how corporate externalities may be contributing to the deterioration of the environment and the exacerbation of social issues, such as racial and economic inequalities.[36] An influential alternative to shareholder primacy, frequently referred to as 'stakeholderism', proposes to redefine the corporate purpose, requiring corporations to be managed in the interest of all stakeholders.[37] In line with this view, the 2019 US Business Roundtable's Statement on the Purpose of a Corporation expresses a shared "fundamental commitment to all…stakeholders…" and a commitment to "deliver value to all of them, for the future success of our companies, our communities and our country."[38] Similarly, the World Economic Forum's Davos Manifesto declared: "The purpose of a company is to engage all its stakeholders in shared and sustained value creation. In creating such value, a company serves not only its shareholders, but all its stakeholders."[39]

Neither of these statements on stakeholderism has led to concrete legal reform or meaningful changes in corporate decision-making,[40] but they evidence growing support for requiring corporations to consider and advance the interests of non-shareholder constituents, a perspective that has influenced legal reform. The United Kingdom's 2006 Companies Act, for example, adopted the so-called 'enlightened shareholder value', which does not reject the prioritization of shareholders' interests, but explicitly requires corporate directors to consider the interests of multiple stakeholders when making decisions.[41] The 2013 Companies Act in India adopted an equivalent approach, which was strengthened shortly after with specific corporate social responsibility obligations.[42] In 2022, the European Commission presented a proposal for a Corporate Sustainability Due Diligence Directive.[43] This proposed Directive, currently under institutional negotiation within the European Union and expected to be adopted in

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[35] Lisa Fairfax, 'The Rhetoric of Corporate Law: The Impact of Stakeholder Rhetoric on Corporate Norms' (2005) 31 Journal of Corporation Law 675, 679–680.

[36] See Lund and Pollman (n 8).

[37] See generally, Andrew Keay, 'Ascertaining the Corporate Objective: An Entity Maximisation and Sustainability Model' (2008) 71 Modern Law Review 663.

[38] Business Roundtable, Statement on the Purpose of Corporation (August 19, 2019), https://perma.cc/CMR8-WMXE accessed 15 September 2023.

[39] Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution, World Econonic Forum (December 2, 2019) https://perma.cc/3NAK-SCDQ accessed on 15 September 2023 (hereinafter Davos Manifesto 2020).

[40] See Lucian A. Bebchuk and Roberto Tallarita, 'The Illusory Promise of Stakeholder Governance' (2020) 106 Cornell Law Review 91 (showing that the Business Roundtable Statement on the Purpose of the Corporation was signed by CEOs without board approval, and that boards did not implement any significant change after the Statement was published).

[41] United Kingdom, Companies Act 2006, s. 172.

[42] See Afra Afsharipour, 'Lessons from India's Struggles with Corporate Purpose' in Elizabeth Pollman and Robert Thompson (eds), *Research Handbook on Corporate Purpose and Personhood* (Edward Elgar Publishing 2021), 363–386.

[43] European Commission, Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937.

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2024, would create new duties for companies and directors to ensure that the interests of relevant stakeholders are thoroughly considered in every corporate decision.[44]

While the complete rejection and replacement of shareholder primacy has yet to materialize, calls for expanding the corporate purpose and empowering non-shareholder corporate constituents have significantly influenced policy and academic debate. This trend towards an expanded corporate purpose has parallels with ongoing normative debates on the scope of competition policy, which are discussed in turn.

2.2 The Consumer Welfare Standard in Competition Law

A competition law regime focused on the so-called consumer welfare standard can be seen as the normative twin of a shareholder-oriented corporate governance paradigm. In broad terms, such a standard reflects an emphasis on economic theory as the central paradigm for analysis, and emphasizes the importance of promoting efficient markets for the benefit of consumers while minimizing the role of non-economic objectives in competition policy.[45]

Obviously, economic goals are not the only possible 'purpose' model for a competition law regime. In fact, the legislative history (and often the wording) of many competition law regimes reflects a variety of public concerns, including a mix of fairness toward consumers, small producers, and attempts to enhance economic efficiency by exploiting scale economies.[46] For example, South Africa's competition laws aim at promoting full citizen participation in the economy, a fair distribution of market ownership and control among different racial groups, and a balance of the interests of workers, owners, and consumers alike. The objectives of China's relatively recent anti-monopoly law include promoting efficiency, while safeguarding the healthy development of a socialist market economy and the public interest, protecting the state-owned economy and small businesses, encouraging the expansion of domestic enterprises, and scrutinizing foreign takeovers. Japan's competition law regime espouses consumer welfare as an objective, but also seeks to protect small and medium-sized businesses while devoting significant resources to policing low prices in the Japanese economy. The European Union historically placed particular emphasis on distortions within the EU single market and has devoted attention to the protection of small competitors and market structure.[47]

Yet the dialectic between economic and non-economic goals in mature antitrust regimes, even when competition legislation on paper acknowledges a broad set of worthy goals, has

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[44] For a critical account of the proposal, see Alessio Maria Pacces, 'Civil Liability in the EU Corporate Sustainability Due Diligence Directive Proposal: A Law & Economics Analysis' (ECGI, March 16, 2023) European Corporate Governance Institute - Law Working Paper No. 691/2023, Amsterdam Law School Research Paper No. 2023-14, Amsterdam Center for Law & Economics Working Paper No. 2023-02, https://ssrn.com/abstract=4391121 accessed 15 September 2023.

[45] Ducci and Trebilcock (n 22).

[46] See Eleanor Fox and Michael Trebilcock (eds) *The Design of Competition Law Institutions*: *Global Norms, Local Choices* (Oxford University Press 2013).

[47] Edward Iacobucci and Michael Trebilcock, 'Fairness as a Counterpoint to Efficiency in Competition Policy?' in Liber Amicorum for Professor Eleanor Fox (Concurrences 2020); Assimakis Komninos, 'Consumer Welfare and the EU Courts: An Unexpected Refuge for a Persecuted Concept?' in Oles Andriychuk (ed), *Antitrust and the Bounds of Power – 25 Years On* (Hart 2023); Konstantinos Stylianou and Marios Iacovides, 'The goals of EU competition law: a comprehensive empirical investigation' 42(4) Legal Studies 620.

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for decades been characterized by a growing trend toward economic analysis. In this regard, Chicago School thinkers have been particularly influential, both within and beyond US antitrust law, in promoting a theoretical and doctrinal shift toward economic theory. Such a change of paradigm has been synthesized in the endorsement of a welfare standard—consumer welfare—as the normative lodestar of antitrust enforcement.[48] This choice of terminology requires some clarification, as it is in many ways problematic from a definitional standpoint.[49] On the one hand, as said, consumer welfare encapsulates an economic perspective that promotes efficient markets and leaves broader policy concerns such as protecting small businesses or inequality outside the domain of competition law. On the other hand, the term refers explicitly to consumers and thus represents a modified version of economic efficiency. In general terms, efficiency refers to the efficient allocation of resources (total surplus or social welfare) and ignores how resources are distributed, including wealth transfers among different groups (for example, between producers and consumers). Conversely, consumer welfare appears to be concerned not simply with total welfare but rather with the effects of anticompetitive conduct on consumers (for example, higher prices due to monopoly power). Curiously, Robert Bork's definition of 'consumer welfare' was in fact closer to economic efficiency than a standard displaying distributional concerns for final consumers, and the reasons for the adoption of such a label are not fully clear.[50] Nonetheless, it is indisputable today that the references to consumer welfare can be best approximated with a model of competition policy that focuses on an economic objective (efficiency and low prices for consumers) as opposed to multiple goals, including non-economic ones.

Like in corporate governance, however, the economic model of antitrust enforcement has been under attack in recent years. Among other criticisms, Neo-Brandeisian perspectives on antitrust policy criticize the consumer welfare standard for contributing to increasing levels of market concentration and for failing to capture novel forms of competitive harm emerging in digital platforms and zero-price markets.[51] Such perspectives would favor the incorporation of a broader public interest mandate for competition policy in order to constrain the political power of large corporations, reduce market concentration, address issues of inequality, sustainability, and so on.[52]

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[48] Producer welfare may be even closer to shareholder primacy than consumer welfare. Nonetheless, the consumer welfare standard remains a suitable normative parallel in its focus on a single economic objective as opposed to broader non-economic goals.

[49] See, for instance, Herbert Hovenkamp, 'The Corruption of Consumer Welfare' (*ProMarket*, August 22, 2022), https://www.promarket.org/2022/08/22/the-corruption-of-consumer-welfare/ accessed 15 September 2023; Herbert Hovenkamp, 'Is Antitrust's Consumer Welfare Principle Imperiled?' (2019) 45(1) Journal of Corporation Law 65.

[50] One potential explanation may be that the former label appears more politically palatable: by referring explicitly to consumers, the normative shift toward an economic framework may potentially be seen as more acceptable or attractive to various political constituencies, as it appears to endorse economic analysis while including an element of distributive justice toward consumers. See Ducci and Trebilcock (n 22).

[51] See generally Khan (n 11).

[52] See, for example Lina Khan, 'The New Brandeis Movement: America's Antimonopoly Debate' (2018) 9 Journal of European Competition Law and Practice 131. For a larger discussion on monocentric and polycentric visions of competition law, see Lianos (n 11); Frank Easterbrook, 'The Limits of Antitrust' (1984) 63 Texas Law Review 1.

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The potential legal implications of these ongoing normative turbulences can be illustrated and summarized by reference to the purpose clause in the Canadian Competition Act, an example that will also be useful for the discussion of two short case studies in Section 4 of this chapter. Section 1 of the Act sets out a list of goals pursued through the enforcement of competition law:

> **1.1** The purpose of this Act is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and in order to provide consumers with competitive prices and product choices.

While Section 1 provides a list of different goals that are in theory pursued simultaneously by the Competition Act, historically the economic goals of the Act have tended in practice to take priority in the enforcement of competition law. Recent calls for a broadening of the competition policy mandate would support renewed emphasis on existing non-economic objectives, such as the protection of small businesses, or even the potential expansion of listed goals to include sustainability, fairness to workers, privacy, etc. In many ways, such a shift toward normative pluralism presents several analogies with the pursuit of stakeholderism in the corporate governance context.

3. THEORETICAL PARALLELISM

This brief introduction on shareholder primacy and consumer welfare provides a background to explore the first normative parallelism discussed in this chapter, namely, the theoretical relation between shareholder primacy and competition. In *Capitalism and Freedom*, Friedman boldly stated the argument for shareholder primacy as follows: "[F]ew trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible."[53] At the same time, Friedman also stressed the necessity of the following important preconditions: "[T]here is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition, without deception or fraud."[54]

One relevant implication can be derived from this qualification: a shareholder-centric paradigm can be seen as creating the strongest incentives for managers to run the firm effectively, provided that monopoly profit is eroded by competitive forces. In such a paradigm, a competitive economy ensures that firms and markets operate efficiently while social responsibility and negative externalities are addressed through regulation following a principle of social and policy specialization.[55]

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[53] Milton Friedman, *Capitalism and Freedom* (Chicago University Press 1962) 133.
[54] Friedman (n 5).
[55] See Roe (n 16).

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While Friedman possibly did not perceive monopoly power to be widespread or durable, it is worth noting that a violation of such a premise raises questions about the theoretical appeal of shareholder primacy in the presence of market power.[56] As highlighted by Roe, for instance, theory suggests that a firm in a perfectly competitive industry would have no ability to incorporate social corporate purpose.[57] Even if it desired to do so, social goals under perfect competition could not be pursued by a given firm without incurring a profit loss, which would be unsustainable *unless* social responsibility is transformed into a relevant and profitable dimension of competition and product differentiation. In contrast, a firm that can price at the monopoly level and cut production obtains extra surplus that can theoretically be directed toward corporate social purpose independently of competitors. From this perspective, then, a competitive economy should paradoxically lead to lower levels of corporate social spending than one with widespread market power. In the latter scenario, the supra-competitive monopoly surplus becomes a "distributional battlefield"[58] as it can be retained for shareholders or alternatively consumed by other stakeholders and spent on corporate social purpose activities. The implication stemming from this interpretation is that social corporate purpose may play a role in curbing or redistributing monopoly profits in an economy with widespread market power.[59]

The antitrust literature proposes even more radical perspectives of the normative nexus between consumer welfare and shareholder primacy. For example, one recent interpretation proposed in the legal commentary would favor a consumer orientation for corporate governance.[60] Woodcock, in particular, identifies a contradiction between the profit minimization mission of antitrust law and the profit maximization goal of corporate law and supports a solution that instead imposes a duty on management to *minimize* profit.[61] This argument is grounded in the idea that a consumer welfare-driven corporate law would solve the distributive puzzle between shareholders and corporate social responsibility in favor of consumers, using corporate law as a substitute for antitrust policy. While this alleged contradiction between a profit-maximization objective and competitive forces driving prices down to marginal cost is debatable, this and other emerging proposals nonetheless reflect a growing interest in revisiting the shared theoretical premises underpinning these two areas of law and their implications for the future determination of their respective normative paradigms.

On its part, the design of competition law doctrines can indeed play some role in determining the scope of such a distributional battlefield. For one thing, a competition law regime may endorse non-economic goals, thereby affecting the analysis of competitive effects and the implications of anticompetitive conduct for various constituencies beyond shareholders and consumers. For another, the role that efficiency plays in a given regime has an impact on the

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[56] Ibid.

[57] Unless there is demand for such corporate social goals.

[58] Ibid.

[59] Ibid.

[60] Ramsi Woodcock, 'Antitrust as Corporate Governance: Why a Firm's Mission Is to Earn No Profit' (*CLS Blue Sky Blog*, March 28, 2018) clsbluesky.law.columbia.edu/2018/03/28/antitrust-as-corporate-governance-why-a-firms-mission-is-to-earn-no-profit accessed 15 September 2023; Ramsi Woodcock, 'The Antitrust Case for Consumer Primacy in Corporate Governance' (2020) 10 UC Irvine Law Review 1395.

[61] This argument is based on an economic rather than accounting definition of cost.

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size of shareholder (producer) surplus. For example, a hypothetical competition law regime pursuing total welfare as an objective would generally be more favorable to shareholders than other benchmarks, in that producer surplus and consumer surplus would have equal weight. Moreover, even under the consumer welfare standard, the presence of efficiency defenses can save conduct that harms competition but at the same time increases producer welfare, and as a result, the share of producer surplus that could hypothetically be allocated for corporate social purposes.

4. LEGAL PARALLELISM

Theories of antitrust and corporate governance are reflected in concrete legal rules and doctrines. Hence, the discussed theoretical nexus between shareholder primacy and consumer welfare raises a related legal question of normative coherence between corporate and competition law. Suppose, for instance, that jurisdiction A opts for a consumer welfare or efficiency-oriented competition policy. Would it be reasonable to expect that jurisdiction A's choice of corporate law regime would also favor a shareholder-centric paradigm? Or is it plausible that a jurisdiction endorsing a multi-purpose competition policy will also likely endorse, or at least be attracted toward, normative pluralism in corporate governance? More broadly, is the influence of a given normative model symmetric between competition and corporate law, both within and across jurisdictions? In this regard, possible forms of normative 'incoherence' across the two fields could reveal something relevant about the presence of specific factors at play in each field, whether related to historical developments, idiosyncratic legal principles, or the weight and influence of specific ideologies in different fields of law.

Measuring the relative importance of different normative goals in either area is notoriously difficult. For example, goals may not be explicit in legislation, or general-purpose statements in statutes may not reflect the precise normative orientation of the law as developed and defined through case law. Nonetheless, the influence of normative or ideological paradigms at a country-specific level would point to potential parallelisms between rules that govern market power and firms' governance. A similar question can be raised at the international level. According to Bradford et al,[62] for example, among the countries that stipulated goals in their antitrust statutes, only 22 percent focused exclusively on efficiency, and 50 percent of countries had explicitly codified non-efficiency-related goals by 2010.[63] The authors also show that 42 percent of countries with antitrust regimes had, by 2010, adopted merger defenses unrelated to efficiency reasons.[64] These trends seem to defeat conventional wisdom on the assumed influence and role of the Chicago School on antitrust regimes globally.[65] In parallel, there is evidence of a shift away from a single purpose in corporate law. In a recent study of corporate

[62] Anu Bradford, Adam Chilton and Filippo Maria Lancieri, 'The Chicago School's Limited Influence on International Antitrust' (2020) 87(2) University of Chicago Law Review 297.

[63] Ibid.

[64] Ibid.

[65] Ibid.

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purpose, Amir Licht[66] found that approximately one-third of the surveyed jurisdictions were stakeholder-oriented, evidencing support for a pluralistic purpose of the corporation.[67]

An assessment of normative trends, both in specific jurisdictions and from a comparative perspective, not only reveals something specific about identified historical international developments at play in each field, but also raises questions about the role and influence of shared ideological frameworks and paradigms and their respective impact in the contemporary domain of competition policy and corporate law, both domestically and internationally.

5 INSTITUTIONAL PARALLELISM

Debates on both corporate and competition law's objectives are often interpreted as reflecting longstanding battles between irreconcilable theoretical paradigms. In this section, however, we focus on a distinct but equally important institutional factor at play underneath these normative debates: namely, a trade-off between normative pluralism and policy specialization intrinsic in the design of legal instruments, an aspect that goes beyond well-established substantive divergences on the intrinsic importance of different goals.[68] Beyond their theoretical bases and critiques, consumer welfare and shareholder primacy share a preference for a single, clear, and administrable objective, which allows decision-makers to reach outcomes in predictable ways. Critiques, on their part, share the desire for normative pluralism, and see problems of uncertainty, unpredictability, and lower accountability that can stem from a multi-purpose orientation of the law as overstated.[69] This tension relates to the merits and downsides of institutional and policy specialization, and is arguably a central legal dimension in the existing debates in competition policy and corporate governance.

Given its importance, this section provides a brief case study on two important competition and corporate law decisions in Canada to show how this tension between accountability and pluralism is at play in discrete specific cases in both areas of law. Canada is an interesting case study because its competition law was, at least until very recently, the most efficiency-oriented among modern antitrust regimes, and its case law has dealt directly and explicitly with relevant questions on the balance between economic welfare and the distributional or equity consequences of market power. In particular, the section analyzes the *Superior Propane* merger

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[66] Amir N. Licht, 'Varieties of Shareholderism: Three Views of the Corporate Purpose Cathedral' in Elizabeth Pollman and Robert Thompson (eds), *Research Handbook on Corporate Purpose and Personhood* (Edward Elgar Publishing 2022), 387–408. For a discussion of international corporate law, see also Mariana Pargendler, 'The Rise of International Corporate Law' (2021) 98(6) Washington University Law Review 1765.

[67] Still, the normative goals in corporate law are not only those explicitly expressed when defining the purpose of the corporation, but can also be inferred by the powers afforded to shareholders. See Section 1.a above. Studies measuring shareholders' powers have identified meaningful convergence towards stronger shareholder power. See Mathias Siems, *Convergence in Shareholder Law* (Cambridge University Press 2008).

[68] For an excellent discussion on the choice and design of alternative regulatory instruments in various contexts, see Michael J. Trebilcock, Douglas G. Hartle, J. Robert S. Prichard, and Donald N. Dewees, *The Choice of Governing Instrument* (Economic Council of Canada's Regulatory Reference, 1982).

[69] See for instance, Lianos (n 11).

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decision by the Federal Court of Appeal, which involved the application of different welfare standards in merger cases under the controversial "efficiency defence" in section 96 of the Competition Act. In parallel, Canadian corporate law jurisprudence has settled the scope of the fiduciary duty by dismissing shareholder primacy while at the same time not explicitly embracing stakeholderism. As will be discussed, the *BCE* decision by the Supreme Court of Canada has crystallized the principle that the fiduciary duty is owed to the *corporation* itself, not shareholders or other groups, leaving the content of the fiduciary duty within unclear boundaries. These cases are discussed in turn.

5.1 The Efficiency Defence in *Superior Propane*

For a long time, Canada's competition law regime stood out in the international antitrust arena for its *standalone* efficiency defence for mergers.[70] The efficiency exception under section 96, recently repealed in December 2023, stated that the Competition Tribunal could not block a merger if the efficiency gains would be greater than and offset the effects of any substantial prevention or lessening of competition under section 92 of the Act.[71] The section was created following the recommendation of the 1969 Economic Council Report, which suggested that a merger policy for a small market economy with a large geographic scope like Canada should include an efficiency defense to achieve domestic scale economies and to encourage participation in global markets. In practical terms, the efficiency defense could save an anticompetitive merger when the transaction enabled the fruition of synergies and efficiency gains through consolidation. As explained below, over time the efficiency exception under section 96 became controversial as it raised an explicit and difficult trade-off between efficiency and equity in merger cases.

Until the *Superior Propane* saga discussed here took place, starting with the first decision of the Competition Tribunal in 2000, the balancing exercise between anticompetitive effects and efficiencies was based on a total surplus standard.[72] Following the classic Williamsons'

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[70] See generally Trebilcock and others, *The Law and Economics of Canadian Competition Policy* (University of Toronto Press 2003). At the time of writing, Bill C-56 introduced a significant competition law reform package, which includes the repeal of the efficiency defense under section 96. The defense will remain applicable to transactions notified before December 15, 2023. See Competition Bureau, Guide to the December 2023 Amendments to the Competition Act (December 18, 2023): https://ised-isde.canada.ca/site/competition-bureau-canada/en/how-we-foster-competition/education-and-outreach/guide-december-2023-amendments-competition-act#sec02 accessed 15 September 2023.

[71] Section 96. (1) The Tribunal shall not make an order under section 92 if it finds that the merger or proposed merger in respect of which the application is made has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger and that the gains in efficiency would not likely be attained if the order were made.

[72] *Canada (Comm'r of Competition) v. Superior Propane Inc*., [2000] C.C.T.D. No. 15 (Can. Competition Tribunal); *Canada (Comm'r of Competition) v. Superior Propane Inc*., [2001] F.C.J. No. 455 (Can. Fed. Ct. App.); *Canada (Comm'r of Competition) v. Superior Propane Inc*., [2002] C.C.T.C. No. 10 (Can. Competition Tribunal); *Canada (Comm'r of Competition) v. Superior Propane, Inc*., [2003] 3 F.C. 529 (Can. Fed. Ct. App.).

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trade-offs paradigm,[73] a merger may create efficiency gains by lowering production costs, while also leading to market power (and thus the ability to charge higher prices). The latter results in a transfer of surplus from consumers who continue to buy at the higher price to producers, and a deadweight loss (inefficiency) stemming from consumers that are priced out of the market altogether. Under a total surplus standard, the Competition Tribunal would compare the deadweight loss with the efficiency gains created by the merger and approve the merger if the efficiency gain was larger than the deadweight loss. The transfer of surplus from consumers to producers (representing a distributional effect for those consumers that remain in the market but pay a higher price post-merger) would be treated as neutral and therefore excluded from the analysis.

In *Superior Propane*, the application of the total surplus standard became the subject of a lengthy controversy related to the appropriate role of efficiency and distributional considerations in merger analysis. The case involved a merger between two propane suppliers, which was found to create significant market power in several retail propane markets and across multiple geographic markets in Canada, with market shares above 90 percent in various local markets. While the Tribunal[74] found that the merger would lead to anticompetitive effects under section 92 of the Competition Act,[75] the merger was approved on the basis of section 96's efficiency defense. In the case, the efficiency gains of $29.2 million were found to outweigh the estimated deadweight loss of $3 million.[76]

The Competition Tribunal found it unnecessary to evaluate the distributive effects of the wealth transfer on various grounds. First, the Tribunal characterized the assessment of the distributive effects as a political task best performed by elected politicians, not by members of the Tribunal with specialized expertise in economics.[77] Second, the Tribunal interpreted Parliament's objective in introducing section 96 as requiring efficiency gains to be balanced exclusively against the efficiency (deadweight) loss, leaving aside distributive effects. Third, the Tribunal stressed that a total surplus standard would lead to higher predictability in merger analysis.

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[73] Oliver Williamson, 'Economies as an Antitrust Defense: The Welfare Tradeoffs' (1968) 58 American Economic Review 18.

[74] *Canada (Commissioner of Competition) v. Superior Propane Inc*., [2000] C.C.T.D. No. 15.

[75] Section 92(1) states that: "Where, on application by the Commissioner, the Tribunal finds that a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially… the Tribunal may, subject to sections 94 to 96, (*f*) in the case of a proposed merger, make an order directed against any party to the proposed merger or any other person...(i) ordering the person against whom the order is directed not to proceed with the merger."

[76] *Canada (Commissioner of Competition) v. Superior Propane Inc* (n 74), at 458.

[77] Under the total surplus standard, "the wealth likely to be transferred from consumers to producers as a result of the merger is not considered to be an anti-competitive effect, because such a transfer is neutral: that is, it neither increases, nor decreases total societal wealth. Proponents of the total surplus standard argue that there is no economic reason for favouring a dollar in the hands of consumers of the products of the merged entity over a dollar in the hands of the producers or its shareholders, who are, after all, also consumers. Moreover, in the absence of complete data on the socio-economic profiles of the consumers and of the shareholders of the producers, it would be impossible to assess whether the redistributive effects of the wealth transferred as a result of the higher prices charged by the merged entity would be fair and equitable". *See Canada (Comm'r of Competition) v. Superior Propane Inc*., [2001] F.C.J. No. 455 (Can. Fed. Ct. App.), at 27.

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The Federal Court of Appeal, however, rejected the Tribunal's analysis of section 96 and endorsed a more pluralistic interpretation of the objectives of the Competition Act. As stated by Judge J.A. Evans:

> In my view, section 1.1 suggests that an interpretation of "effect" should not focus exclusively on one of the objectives of promoting competition, namely, promoting the efficiency and adaptability of the economy. Rather, the "effects" to be considered under section 96 should also include the other statutory objectives to be served by the encouragement of competition that an anti-competitive merger may frustrate, such as the ability of medium and small businesses to participate in the economy, and the availability to consumers of a choice of goods at competitive prices.[78]

While the Federal Court of Appeal did not prescribe a particular methodology to be followed under section 96, it saw the total surplus standard as problematic in its sole focus on the net effect of a merger on the economy's allocation of resources (treating consumers and producers alike and disregarding distributional effects when producers are wealthier than consumers).[79] It concluded that any selected standard would instead need to reflect the different objectives of the *Competition Act* beyond economic efficiency, including the distributional effects of the merger on consumers. [80]

As discussed in the decision itself, alternative approaches to achieve these desiderata could include consumer surplus-oriented standards, according to which mergers would be approved only when efficiency gains are greater than the sum of the deadweight loss plus the wealth transfer, or when efficiency gains are so large that the post-merger price either decreases or remains the same (meaning that at least some of the cost savings must be passed on to consumers through lower prices).[81] However, given the existence of a standalone efficiency defence for mergers, alternatives accounting for the wealth transfer would be problematic on their own in this particular legal framework, as they would have significantly restrained the application of section 96 and its relevance and raison d'être in practice.

Partially due to these concerns, the Federal Court of Appeal provided qualified support for a further alternative—a 'balancing weight' standard—advanced by the Commissioner's expert witness, which opted for a compromise that is neither efficiency nor consumer surplus.[82] Specifically, such a standard would allow the Tribunal to attach a different weight (as opposed to a fixed weight) to the wealth transfer depending on the aggregate characteristics of consumers in each case: the Tribunal would first identify a weight that balances consumer loss and producer gains, and on that basis, it would then decide whether such a balancing weight is reasonable based on available quantitative and qualitative information regarding the distributional impacts of a merger. Interestingly, after the Federal Court of Appeal set aside the decision and remitted the matter back to the Tribunal, the latter still approved the merger

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[78] *Canada (Comm'r of Competition) v. Superior Propane Inc*., [2001] F.C.J. No. 455 (Can. Fed. Ct. App.), at 88.

[79] Ibid, at 140.

[80] Ibid, at 92.

[81] An explicit example of such standard is provided by Article 101 of the Treaty on the Functioning of the European Union, which requires a fair share of benefits arising from an agreement to be passed on to consumers.

[82] *Canada (Comm'r of Competition) v. Superior Propane Inc.,* [2001] F.C.J. No. 455 (Can. Fed. Ct. App.), at 141.

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even under this new proposed approach, finding distributional effects minimal in comparison to the efficiency gain.

In many ways, the balancing weight standard could be seen as an elegant compromise balancing pure efficiency and the distributional effects of mergers. Given the statutory existence of a standalone efficiency defense under section 96 at the time of the decision, consumer surplus-oriented standards would have contradicted the very purpose and application of the efficiency defense and its relevance in practice. At the same time, total surplus could nonetheless be interpreted as disregarding a plurality of worthy competition policy objectives other than efficiency, including low prices and distributional concerns in favor of consumers. The solution provided by the balancing weight standard was a compromise: it reflected the centrality of efficiency in Canadian merger policy better than pure consumer surplus, while delegating to the Tribunal the task of weighting the wealth transfer on a case-by-case basis, and as such better accounting for both efficiency and distributional effects of a given merger than pure total surplus.

Such a pluralist compromise poses a challenge; however, one that does not speak directly to the worth of different goals but is about the implications of enforcing multi-purpose versus single-purpose legal provisions in the competition policy domain. In particular, the balancing weight test would ask a specialized tribunal to engage in the assessment of wealth redistribution on a case-by-case basis, and in so doing it would negatively affect the predictability of merger review more than *either* consumer surplus or total surplus.[83] While the Federal Court of Appeal found the Tribunal's concerns about expertise and predictability unpersuasive,[84] several commentators later interpreted this approach as subordinating predictability for the sake of an uncertain compromise between efficiency and equity concerns.[85]

From this perspective, the controversy in *Superior Propane* provided an insight into a larger issue at play in the broader antitrust normative puzzle. On the one hand, the case reflected a clash between fundamentally divergent views on what competition policy should do normatively—in particular, on the respective role of efficiency and redistribution, or vertical fairness between consumers and producers.[86] On the other hand, alternative views on the appropriate standard also reflected largely conflicting perspectives on an underlying tension and trade-off between policy specialization and pluralism in the design of legal instruments and related institutions tasked with a given policy mandate. A single-purpose orientation for competition policy offers specialization, accountability, and the pursuit of a clear, predictable goal, which by implication would delegate other objectives to alternative policies and legal tools (for example, sustainability to environmental regulation, wealth distribution to tax law, etc.).

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[83] For a discussion, see Edward Iacobucci, 'The Superior Propane Saga: The Efficiencies Defence in Canada' in Barry Rodger (ed.), *Landmark Cases in Competition Law: Around the World in Fourteen Stories* (Kluwer International 2013).

[84] *Canada (Comm'r of Competition) v. Superior Propane Inc*., [2001] F.C.J. No. 455 (Can. Fed. Ct. App.), at 116.

[85] Iacobucci and Trebilcock, for example, suggest that the balancing weight standard cannot be defined as a standard. Unlike the uncertainty at play in the quantification of specific merger effects, they suggest that the balancing weight approach inevitably leads to methodological indeterminacy as merging parties have no way of knowing what weight will be used to assess their merger. See Iacobucci and Trebilcock (n 47).

[86] For a taxonomy of fairness in competition policy, see Ducci and Trebilcock (n 22).

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Pluralist interpretations, in contrast, see merit in a multi-purpose mandate, even if it comes at the cost of reduced predictability and accountability.

Without discounting the importance of broader normative views on the merit of different goals, underplaying the role of these legal and institutional trade-offs risks painting only a partial perspective on what is at stake in the search for desirable antitrust goals. And if it is true that such trade-offs are relevant, then the key question becomes *how* relevant they are in a specific institutional context. For instance, despite the just-mentioned virtues of single-purpose competition law regimes, such a choice implies the existence and workability of other, specialized legal tools to which different goals will be delegated. When the latter are not available, however, such virtue may be put into question. For example, in relation to the efficiency-equity debate at play in *Superior Propane*, while redistributive instruments such as the tax and transfer system may usually be seen as better suited than competition policy to redress issues of inequality—in this way, justifying a specialization of objectives between competition (efficiency) and tax law (redistribution)—it is equally important to recognize that redistributive policies may also be imperfect, limited, or unavailable in particular contexts, entailing efficiency-equity trade-offs of their own.[87] When these limitations are significant, smaller, multiple distortions stemming from the use of multiple second-best legal tools, including competition law, to achieve a given goal (in this example, redistribution) may potentially be better than delegating most of the burden to a single instrument.[88]

Nonetheless, such a pluralist approach must inevitably wrestle with the expected negative effects on predictability and accountability, especially because these trade-offs stemming from normative pluralism will be exacerbated when the number of objectives is further expanded toward more polycentric paradigms of competition policy. The *Superior Propane* example discussed in this chapter involved a very circumscribed, narrow question on the scope of merger policy that was tightly linked to the different effects of market power post-merger. The conflict between different objectives is likely to be more pronounced once one moves beyond the narrow confines of an efficiency-redistribution trade-off at play in the merger context and potentially adds to the mix broader considerations such as sustainability, labor, fairness, and other non-economic factors, which at some point may render any balancing exercise even less tractable. In such cases, the price of normative pluralism on the application of legal principles such as certainty and accountability is likely to be larger.

As a result, the relevant question appears to be about the concrete role and impact that competition law is expected to have on a desired non-economic objective, on the one hand, and how that compares to the resulting cost of a multi-purpose paradigm, on the other. For reasons discussed in this section, questions related to the scope of such trade-offs arguably have central importance on their own and relate to the institutional dimension of policy specialization beyond the standalone merit of different normative objectives.

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[87] See discussion in Ducci and Trebilcock (n 22).

[88] This is, for example, the argument advanced by the economist Anthony Atkinson in favor of distributive goals in competition policy. See Anthony Atkinson, *Inequality: What Can Be Done?* (Harvard University Press 2015).

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5.2 The Fiduciary Duty in *BCE v. 1976 Debentureholders*

With due caveats and distinctions, analogies can be drawn in the context of corporate governance's purpose. Formally, Canadian corporate law is not explicitly representative of shareholder primacy. The Canadian Business Corporations Act (CBCA) does not specifically provide that corporations exist or should be managed to promote the interests of shareholders. Still, in practice, directors generally regard shareholder-value maximization as a duty,[89] and courts seldom agree to scrutinize directors' decisions, as those fall within the business judgment rule.

Questions about the goals of corporate governance and the scope of the fiduciary duty in Canadian corporate law were at center stage of the *BCE v. 1976 Debentureholders*[90] decision, which involved a large leveraged buyout under the CBCA.[91] The controversy resulted from the acquisition of BCE Inc by a consortium led by the Ontario Teachers' Pension Plan. The transaction represented a 40 percent premium to the closing price of BCE shares. However, a subsequent 20 percent drop in the market value of debentures led to a challenge by debentureholders, which claimed that the transaction was oppressive and not fair and reasonable under the CBCA. The case eventually reached the Supreme Court of Canada (SCC), which rejected the debentureholders' challenge and addressed the issue of whether or not the interest of the corporation was to be interpreted as being aligned with that of shareholders.[92]

At the time, the relevant provision provided that "every director and officer of a corporation in exercising their powers and discharging their duties shall act honestly and in good faith with a view to the best interests of the corporation; and exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances."[93] The broad scope of this provision left unspecified whether the interests of the corporation were to be interpreted as being aligned with those of shareholders, as usually perceived by directors, or otherwise. Citing its earlier decision in *People Department Stores*,[94] the SCC rejected a pure shareholder primacy paradigm and stated that the fiduciary duty is owed to the *corporation,* and not shareholders or other stakeholders:

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[89] See Carol Liao, 'A Canadian Model of Corporate Governance' (2014) 37 Dalhousie LJ 559 (quoting a senior legal practitioner: "Shareholders do not have primacy in the corporate context in Canada, although directors generally think that they do.").

[90] [2008] 3 SCR 560.

[91] For a discussion, see Edward Iacobucci, 'Indeterminacy and the Canadian Court's Approach to Corporate Fiduciary Duty' (2009) 48 Canadian Business Law Journal 232.

[92] See also Ed Waitzer and Johnny Jaswal, 'Peoples, BCE, and the Good Corporate Citizen' (2009) 47 Osgoode Hall LJ 439; Michael Marin, 'Disembedding Corporate Governance: The Crisis of Shareholder Primary in the UK and Canada' (2013) 39 Queen's LJ 223; Liao (no 89); Barnali Choudhury and Martin Petrin, 'Stuck in Neutral? Reforming Corporate Purpose and Fiduciary Duties' (2023) 67 Canadian Business Law Journal 291; Poonam Puri, 'The Future of Stakeholder Interests in Corporate Governance' (2009) 48 Canadian Business Law Journal 427; Li Lin, 'The 'Good Corporate Citizen' Beyond BCE' (2021) 58 Alberta Law Review 551, 566.

[93] Section 122, Canada Business Corporations Act, 1985.

[94] *In People Department Stores Inc (Trustee of) v. Wise* [2004] 3 SCR 461. See also Mohamed F. Khimji, 'Peoples v. Wise - Conflating Directors' Duties, Oppression, and Stakeholder Protection' (2006) 39 University of British Columbia Law Review 209; Ian B. Lee, 'Peoples Department Stores v. Wise and the Best Interests of the Corporation' (2004) 41 Canadian Business Law Journal 212.

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> It may be legitimate, given all the circumstances of a given case, for the board of directors to consider, inter alia, the interest of shareholders, employees, suppliers, creditors, consumers, governments and the environment.[95]

This interpretation of fiduciary duties, which was later explicitly codified in the law,[96] does *not* require that directors account for the effects of decisions on all stakeholders. However, it creates an obligation to resolve conflicts based on the best interest of the corporation viewed as a "good corporate citizen"[97]—indicating that the specific content of the duty will have to be assessed on the basis of each particular situation.

Such an emphasis on the best interest of the *corporation* leads in many ways, albeit in a different context, to a similar tension between specialization and pluralism as previously discussed in the competition policy domain. Such a standard allows directors to "look to the interests of, inter alia, shareholders, employees, creditors, consumers, governments and the environment to inform their decisions."[98] As such, the focus on the corporation itself can be seen as an attempt to resolve the conflict between multiple paradigms by not giving priority to any stakeholder and by deferring to the business judgement rule the specific weight to be given to different interests, including those of shareholders, in specific cases. In so doing, it attempts to settle the dispute between shareholderism and stakeholderism through a pluralist compromise that allows, but does not mandate, consideration of stakeholder interests beyond shareholders.[99]

Such a pluralist conception has faced several criticisms, among other reasons for endorsing a model that potentially undermines legal certainty, accountability of directors' and officers' decisions, and economic performance.[100] At the core, such criticisms may reflect fundamentally different normative views of what the objectives of corporate law and governance should be. But as argued in the competition policy domain, questions about the purpose of corporate law cannot be reduced simply to a clash between different philosophical paradigms and the intrinsic merit of shareholder-centric versus stakeholder governance. A parallel conundrum

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[95] [2008] 3 SCR 560, at 39.

[96] C-97, 141 Section 122 of the Canada Business Corporations Act is amended by adding the following after subsection (1): "Best interests of the corporation (1.1) When acting with a view to the best interests of the corporation under paragraph (1)(a), the directors and officers of the corporation may consider, but are not limited to, the following factors: (a) the interests of (i) shareholders, (ii) employees, (iii) retirees and pensioners, (iv) creditors, (v) consumers, and (vi) governments; (b) the environment; and (c) the long-term interests of the corporation."

[97] [2008] 3 SCR 560, at 66, 81.

[98] [2008] 3 SCR 560, at 40.

[99] BCE, at 36.

[100] See general discussion in Anthony VanDuzer, *The Law of Partnerships & Corporations* (Irwin Law 2018); Bebchuk and Tallarita (n 40) 93 (arguing that "acceptance of stakeholderism could well impose major costs. By making corporate leaders less accountable and more insulated from shareholder oversight, acceptance of stakeholderism would increase slack and hurt performance, reducing the economic pie available to shareholders and stakeholders."). Problematic examples include, for instance, situations where a shareholder may wish to challenge a decision made by directors based on the protection of other stakeholders, in the context of a change of control where the interests of corporate constituents are likely to conflict, and more broadly, in the pursuit of corporate social responsibility or environmental and social goals.

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is at play in this controversy, one that is animated by difficult and inevitable trade-offs raised by the pursuit of purpose pluralism. This traces back to an institutional dilemma: in what way is corporate stakeholderism better equipped to achieve a given goal than other more direct and tailored policy instruments and institutions? In other words, what is at stake is not only the appropriate hierarchy of economic and non-economic objectives in corporate law, but also the balance between the concrete effectiveness of stakeholderism, compared to other policy instruments, in achieving socially worthy goals, and its offsetting negative impact on reduced accountability of firms' governance in practice. A proper assessment of the legal and institutional trade-offs resulting from the choice of different corporate governance models is a necessary and central dimension in existing debates, and one that extends beyond substantive and normative divergences.

6. CORPORATE GOVERNANCE AND COMPETITION POLICY AT THE CROSSROAD

In many ways, pluralistic models of corporate and competition law represent calls for action in response to the failure of politics to effectively address pressing social issues with direct and more targeted policies, and therefore they can be seen as a way to bypass the stall of the political process.[101] But the analysis of what a normative expansion in these legal domains would entail remains unnecessarily siloed in separate academic discussions on the limits of the consumer welfare standard, on the one hand, or shareholder maximization, on the other, without a joint assessment of their commonalities and intersections. We suggest that integrating these debates on the purpose of corporate and competition law, and seeing them as two faces of the same coin, would better direct the future direction of these areas of law and their joint role in addressing socially relevant goals.

For one thing, seeing these expansionary trends as part of a unitary, larger phenomenon of pluralism or 'stakeholderism'[102] can help us identify more clearly the overall magnitude of change implied by the calls to expand the purposes of both fields. Competition and corporate law pluralism working in tandem may be a positive development if the goal is to effectively compensate for the perceived failure of the political process to tackle social issues, but it may also result in over-expansion. The joint effect on the legal system in terms of predictability and coherence may also be magnified when both fields depart from a clear, single objective. It is difficult to conceptualize the scope of change potentially resulting from stakeholderism without looking at corporate and competition law together. For another, a joint assessment forces us to think about the implications that expanding one domain may have on the other. As was discussed in the chapter, market power and competition intersect in several ways with

[101] See for instance Oliver Hart and Luigi Zingales, 'Companies Should Maximize Shareholder Welfare Not Market Value' (2017) 2 Journal of Law, Finance, and Accounting 247, 249; Aneil Kovvali, 'Stakeholderism Silos Busting' (2022) 90(1) University of Chicago Law Review 203; Marcel Kahan and Edward Rock, 'Corporate Governance Welfarism' (2023) 15 Journal of Legal Analysis 108 https://www.ecgi.global/sites/default/files/working_papers/documents/emergenceecgi.pdf accessed 15 September 2023.

[102] See Kovvali (n 101).

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the scope of corporate governance, and changing the way we deal with one is likely to have at least some relevance for the other.

Moreover, merging the normative debates can allow us to better compare and contrast the nature and specific trade-offs at play in each field. In the competition policy domain, for example, the key institutional question is usually about the virtues and limits of policy specialization and expertise across different *public agencies.* For example, is a competition authority, which builds expertise on economic and legal questions related to market power, well-equipped to deal with non-economic matters? How effective can it be in the pursuit of a multi-purpose mandate? And what are the risks associated with multiple objectives in terms of institutional accountability?[103] In the corporate law context, in contrast, the main issue is related to the scope of decision-making authority allocated to *managers* of a business corporation as a result of the content of their fiduciary duty. How socially effective is stakeholderism and what are the offsetting accountability concerns stemming from a stakeholder-based mandate for officers and directors? And is the discretion in the hands of private actors more or less problematic than in the case of a public agency in charge of antitrust policy with the power to decide on non-competition issues? In both cases, the institutional context prevailing in a specific jurisdiction arguably matters in determining the merit of different antitrust and corporate governance models and their complementary interaction.[104]

As seen throughout this chapter, parallelisms between the goals of competition and corporate law have many facets and dimensions. Here, we highlighted a shared and, in our view, central tension that stems from the search for normative pluralism, often justified in both areas by the pursuit of social goals not sufficiently addressed by more direct regulations and more tailored policy instruments. From this angle, debates about the normative ends of corporate and competition law converge on a similar conundrum—one that is not reducible to the respective merit of alternative goals but that instead also includes questions about the expected effectiveness of second-best legal solutions and the resulting costs of pluralism on accountability and predictability. However, the lack of an integrated discussion of stakeholderism in both fields contributes to the forestalling of novel academic debates on these issues. Indeed, commentators in corporate and competition law seldom think about how legal pluralism or stakeholderism in one area expresses in the other. As a result of this narrow and siloed perspective, the increasing pressure to reconsider the foundations of these areas of law has permeated both fields individually and uncoordinatedly. This may be a further reason why, in addition to the overlaps highlighted earlier in the chapter, these two normative debates should be analyzed together and not separately.[105] A shared assessment will better reflect the overall social benefits and risks of expanding the purpose of both corporate and competition law.

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[103] Jean Tirole, 'Socially Responsible Agencies' (*Toulouse School of Economics*, December 7, 2022) https://www.tse-fr.eu/sites/default/files/TSE/documents/doc/by/tirole/socially_responsible_agencies_071222.pdf accessed 15 September 2023.

[104] This institutional dimension is also related to the question of capture. See ibid.

[105] For emerging literature on this interface, see Kovvali (n 101).

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7. CONCLUSION

Do consumer welfare and shareholder primacy have anything in common? The goal of this chapter has been to identify and discuss, at a general level, three key parallelisms between the shareholder-stakeholder governance debates in corporate law and the consumer welfare-Neobrandeis antitrust controversy in competition policy: (i) a theoretical overlap and interplay across these two fields; (ii) legal complementarities between existing antitrust and corporate law models in specific legal regimes; and (iii) the trade-off between legal pluralism and policy specialization, which stems from an institutional dimension at the heart of the existing normative questions on the future goals of corporate law and competition policy. When taken together, these theoretical, legal, and institutional parallelisms uncover the need to move beyond a siloed assessment of the consumer welfare standard and the shareholder primacy paradigm and toward a joint assessment of the desirable objectives of antitrust and corporate governance. A unified analysis will provide a better interpretation of the normative questions at stake in these debates and the potential policy implications in different institutional contexts.

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2. Market Power and Shareholder Control

Saura Masconale and Simone M. Sepe

1. INTRODUCTION

In 2001, Henry Hansmann and Reinier Kraakman, in *The End of History for Corporate Law*, proclaimed that "[t]here is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value."[1] In actual corporate practices, however, the risk of managers opportunistically deviating from shareholder value maximization for their own benefit remained a central issue.[2] In response, a case for "shareholder empowerment" quickly gained traction. As put by one of us elsewhere, this case rests on two key assumptions: "first, shareholders [as residual claimants] have the right incentives to mitigate the managerial agency problem, and, second, competitive markets are intrinsically superior to institutions as coordinators of production."[3] Under these assumptions, efficient corporate governance calls for a model where managers are held accountable through shareholder control, the constant discipline of competitive markets and the stock price's performance metric.[4]

Now, fast forward to 2023. Shareholder empowerment has turned from a normative aspiration into a positive reality, with management willingly yielding to shareholder inputs on governance and business planning on a going concern basis.[5] But today's version of shareholder empowerment differs significantly from the model theorized by its proponents.

[1] Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2001) 89 GeoLJ 439, 439.

[2] This model of corporate governance applies mostly to the Anglo-American business world and large public corporations. In other parts of the world, the main agency problem may be horizontal (i.e., controlling vs. minority shareholders) rather than vertical (i.e., managers vs. shareholders). Also, in these other contexts market forces and the market for corporate control may not have the same strength or traction as we portray here. See generally Kraakman R. et al., *The Anatomy of Corporate Law* (3rd edn) (Oxford University Press 2017).

[3] William W. Bratton and Simone M. Sepe, 'Corporate Law and the Myth of Efficient Market Control' (2020) 105 CornellLRev 675, 676–77.

[4] An immediate corollary of the model is that anti-takeover barriers and other entrenchment mechanisms insulating managers from market discipline are the main obstacle to efficient shareholder governance of the corporation. See, e.g., Martijn K.J. Cremers, Saura Masconale and Simone M. Sepe, 'Commitment and Entrenchment in Corporate Governance' (2016) 110 Northwest ULRev 727, 744–47 (surveying studies defending the idea that "good corporate governance is equivalent to stronger shareholder rights").

[5] See, e.g., Jill E. Fisch and Simone M. Sepe, 'Shareholder Collaboration' (2019) 98 TexLRev 863, 883–92.

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First, shareholder control of the public corporation has not been achieved through competitive markets (or corporate law reform),[6] but rather through a change in ownership structures. Over the past few decades, the distribution of shareholdings in the U.S. capital markets has increasingly moved away from households toward financial institutions[7] such as mutual and exchange traded funds.[8] The recent rise of indexation has accelerated this trend, leading to an unprecedented concentration of equity ownership.[9] Through the funds they oversee, the three largest asset managers—BlackRock, State Street and Vanguard—now collectively own the largest stake in 40 percent of all US-listed companies[10] and vote on approximately 25 percent of the shares in all S&P 500 companies.[11] These numbers give the "Big Three" significant influence over many of the world's largest companies, particularly when considering that these asset managers tend to share common "policies" regarding various kinds of decisions that the companies in their portfolios must make.[12] Moreover, the anticipation of the Big Three's pivotality and coordinated influence provides strong incentives for managers to consider their inputs, even before matters come to a vote.[13] Thus, shareholders are more empowered than ever, but their newfound ability to discipline management is a by-product of ownership concentration and hence market power, rather than competitive dynamics.

Second, today's empowered shareholders are among the most vocal and active advocates for a new governance model that rejects the exclusive focus on maximizing shareholder value. This model, which Professors Marcel Kahan and Edward Rock have dubbed "corporate governance welfarism,"[14] embraces a broader notion of welfare that encompasses the interests of all corporate stakeholders. Larry Fink, the CEO of BlackRock, is perhaps the most outspoken

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[6] For defenders of shareholder empowerment, corporate law reform is an essential tool to adjust the process framework so that market control of management conduct can work in fact. See n 50 and accompanying text.

[7] See Ronald J. Gilson and Jeffrey N. Gordon, 'The Agency Cost of Agency Capitalism: Activist Investors and the Reevaluation of Governance Rights' (2013) 113 ColumLRev 863, 874–88 (explaining this transformation as the combined result of "(i) political decisions to privatize the provision of retirement savings and to require funding of such provision and (ii) capital market developments that favor investment intermediaries offering low-cost diversified investment vehicles.")

[8] See Jeff Schwartz, 'Stewardship Theater' (2022) 100 WashULRev 395, 403 ("The asset-management industry is enormous. At the end of 2020, there were over 9,000 mutual funds and 2,000 exchange traded funds, with total assets of $29.3 trillion.").

[9] See John C. Coates, 'The Future of Corporate Governance Part I: The Problem of Twelve' (2019) Harvard Public Law Working Paper No. 19-07, 2 n 4, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3247337 (accessed 1 February 2023).

[10] See Jan Fichtner, Eelke M. Heemskerk and Javier Garcia-Bernardo, 'Hidden Power of the Big Three? Passive Index Funds, Reconcentration of Corporate Ownership, and New Financial Risk' (2017) 19 BusPolit 298, 313.

[11] See Lucian Bebchuk and Scott Hirst, 'The Specter of the Giant Three' (2019) 99 BULRev 721, 724.

[12] See Coates (n 9) 13–15.

[13] See Saura Masconale and Simone M. Sepe, 'Citizen Corp. – Corporate Activism and Democracy' (2022) 100 WashULRev 257, 304; see also Lucian Bebchuk and Scott Hirst, 'Index Funds and the Future of Corporate Governance' (2019) 119 ColumLRev 2029, 2047.

[14] Marcel Kahan and Edward Rock, 'Corporate Governance Welfarism' (2023) 15(1) J Legal Analysis 108.

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supporter of what he calls "stakeholder capitalism":[15] capitalism driven by mutually beneficial relationships between companies and employees, customers, suppliers, and local communities.[16] And each of the Big Three asset managers has endorsed the increasing emphasis on ESG (environmental, social and governance) investments and defended the merits of corporations' new social engagement.[17]

This misalignment between the theory and practice of shareholder empowerment provides the motivation for this chapter's investigation of the relationship between shareholders, competition, and corporate governance in the context of U.S. public corporations. While several studies have examined the impact of newly empowered shareholders on product competition between firms,[18] corporate scholars have paid only scant attention to the effect of competition between shareholders, or lack thereof, on shareholder power.[19] This chapter seeks to fill this gap in the literature.

We begin by revisiting the economic theory supporting the claim in favor of shareholder empowerment through competitive markets, drawing on the prior work of one of us.[20] This claim critically relies on the assumption that competitive markets efficiently coordinate the economy, where the link between shareholder value and the maximization of aggregate welfare is provided by Adam Smith's invisible hand.[21] This is the idea that self-motivated individuals, coordinated only by the price system, can act in mutual compatibility. As applied to corporate governance, this idea implies that a strong market for corporate control boosts productivity because the directives are market-driven and coordinated by agents with the proper incentives, namely the shareholders.

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[15] Larry Fink, 'Larry Fink's 2022 Letter To CEOs: The Power of Capitalism' (BlackRock, 2022) https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter

[16] *ibid*.

[17] See, e.g., Stavros Gadinis and Amelia Miazad, 'Corporate Law and Social Risk' (2020) 73 VandLRev 1401, 1405–06.

[18] These studies highlight that institutional investors' common ownership of competitor firms might hurt firms' incentives to compete with each other, lead to higher prices and slow economic growth. See e.g., José Azar and others, 'Anticompetitive Effects of Common Ownership' (2018) 73 JFin 1513; Einer Elhauge, 'Horizontal Shareholding' (2016) 129 HarvLRev 1267; Eric A. Posner and others, 'A Proposal to Limit the Anticompetitive Power of Institutional Investors' (2017) 81 AntitrustLJ 669. For a more recent study, see Anna Tzanaki, 'Varieties and Mechanisms of Common Ownership: A Calibration Exercise for Competition Policy' (2022) 18 JCLE 168 (introducing a distinction between concentrated and diffuse common ownership).

[19] For an exception, see Mark Roe, 'Corporate Purpose and Corporate Competition' (2021) 99 WashULRev 223, 223–24 (discussing the relationship between corporate purpose and competition and arguing that "the profit-oriented but purpose-pressured firm" is only sustainable in monopolistically organized industries). Although Roe does not directly examine the relationship between shareholder power, corporate governance, and competition, and our economic analysis of the purpose-pressured firm suggests competition among firms may promote stakeholder capitalism, we share Roe's conclusion that purpose-pressure "can infuse basic corporate governance with social conflict, contributing to or exacerbating our rising political and social instability."

[20] See Bratton and Sepe (n 3) 694–722 (providing an in-depth analysis of the economic case for shareholder empowerment).

[21] See Kahan and Rock (n 14) 4.

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However, the link between shareholder empowerment, competition and aggregate welfare maximization weakens when we move from Adam Smith's "magic of the marketplace" to its formalization through the general equilibrium theory (GET) of markets.[22] GET shows that the prediction of reliable coordination of the economy by competitive markets holds only under the assumption of complete markets, where everything can be traded and parties can deal with uncertainty by insuring their preferences in advance.[23] In real-world incomplete markets, there is no invisible hand that transmits value to help coordinate production and maximize consumer surplus. As a result, the efficiency argument for shareholder governance falls apart due to insufficient insurance against uncertain future states of the world and production decisions based on shareholders' heterogeneous consumption preferences rather than fundamental value.[24]

GET studies have proposed ways to address the issue of shareholders' project selection problem. However, what has gone so far unnoticed is that these solutions closely resemble the model of market-power shareholder control that currently dominates the corporate landscape in the United States. This leads us to the second part of our analysis, which investigates the impact of concentrated market power on the normative desirability of a "shareholder economy."

Twenty years ago, economist Peter DeMarzo theorized that a dominant blockholder with a financial incentive to implement a production plan that maximizes value and the ability to build a majority coalition could solve the shareholders' project selection problem.[25] This outcome assumes face-to-face boardroom bargaining, where the board controls the agenda, directors are shareholders themselves or act on behalf of certain shareholders, have veto power, and can negotiate with each other over various proposals.[26] The scenario theorized by DeMarzo resembles the mechanisms of the Big Three's corporate influence. Economically, market-power shareholders can be seen as bringing in blockholders who own a sufficient number of shares to align their interests with the optimal outcome and avoid the incentive misalignment of shareholders with small stakes. DeMarzo's model also interpolates a venue for face-to-face contracting among shareholders, which accurately captures the dynamics of asset managers' coordinated decision-making.

If market-power shareholders can address the efficiency concerns of a shareholder economy, could this be the actual "end of history for corporate law"? According to DeMarzo's model, one should conclude that asset managers' support for a broader social purpose is a plan that maximizes value. But, as recently noted by several scholars, in the ESG era, it is unclear what pursuing a broader social purpose entails.[27] Traditional stakeholderist claims called for

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[22] General equilibrium studies the microeconomics of all markets simultaneously and incorporates their interactions. See pt I 7; Alfred Marshall, *Principles of Economics* (Macmillan & Co., London 8th edn 2013) 269–75; Ross M. Starr, *General Equilibrium Theory: An Introduction* (Cambridge University Press 2nd edn 2011) 3.

[23] See pt 1.2.

[24] See pt 1.2.

[25] Peter M. DeMarzo, 'Majority Voting and Corporate Control: The Rule of the Dominant Shareholder' (1993) 60 RevEconStud 713, 719.

[26] ibid 728.

[27] See, e.g., Elizabeth Pollman, 'The Making and Meaning of ESG' (2024) 14 Harvard Business Law Review 403.

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pursuing the economic interest of stakeholders in addition to shareholders,[28] but welfarism goes beyond both shareholder and stakeholder value and focuses on social welfare directly. As we discussed in prior joint work, this focus increasingly encompasses divisive social issues such as gender and racial equity, climate change, immigration, abortion, gun control, and so on.[29] However, the demand for taking a stance on these issues is not "like anything else individuals desire." Markets cannot internalize heterogenous social preferences as they do with other preferences.[30] Consequently, DeMarzo's model loses its predictive power, and the normative implications of market-power shareholders become uncertain.

Economically, there might not be an efficiency concern in the short-term, at least under the asset price effects triggered by investors' demand for corporations' social initiatives. As long as engaging in socially focused corporate projects is appealing to the largest investors, companies engaged in such projects will attract more capital and be competitive.[31] However, it is uncertain whether this equilibrium is sustainable in the long term. Because the asset price effects of corporations' social engagement depend on investors' sustained demand, there is a risk of an asset bubble bursting if this demand drops. This could occur due to classic bubble-bursting reasons, such as an exogenous shock (e.g., geopolitical crises) or unforeseen changes in fundamentals, including a shift in investors' social preferences.[32]

Furthermore, the rise of market-power shareholders with divisive social preferences presents political challenges, for both corporate and electoral governance. On the one hand, the nature of divisive corporate social initiatives is "exclusionary," as one cannot stand on both sides of a highly charged social issue.[33] On the other, the concentration of both economic and voting power in the hands of a few large shareholders incentivizes corporations to adopt socially focused initiatives that cater exclusively to the demand of these shareholders while excluding any "contrarian" preferences.[34] This new trend toward "corporate conformity" raises concerns for both stakeholders and citizens at large.[35] Within corporations, the risk is that corporate conformity might threaten the political freedom of contrarian stakeholders, especially those who are economically dependent on the corporation, such as employees. In society at large, there is a concern that corporate conformity may interfere with the democratic adjudication of divisive outcomes to the extent that it leads to actions against non-conformist

[28] See, e.g., Margaret Blair and Lynn Stout, 'A Team Production Theory of Corporate Law' (1999) 85 VaLRev 248 (arguing that the law of public corporations serves to allocate the economic surplus generated by the corporation among the various "team-members-stakeholders"); Thomas A. Smith, 'The Efficient Norm for Corporate Law: A Neotraditional Interpretation of Fiduciary Duty' (1999) 98 MichLRev 214 (defending an interpretation of fiduciary duty as a duty to maximize the sum of all financial claims against the corporation).

[29] See Masconale and Sepe (n 13) 270–73 (providing anecdotal evidence on corporations' engagement in divisive social issues).

[30] See pt 2.2.1.

[31] See pt 2.2.2.

[32] See pt 3.1.

[33] See pt 3.2.1.

[34] By the term "contrarian," we mean that the engagement in the same socially focused initiative by corporations might create good for some individuals and bad for individuals holding a divergent view on that divisive initiative. See pt 3.1.

[35] See pt 3.2.

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state laws, as has already happened in several states.[36] Meanwhile, many U.S. states have now joined the ESG battlefield, introducing partisan regulations that either promote or restrict ESG investing, which is likely to trigger additional conflicts.[37]

The complexity of the interplay between shareholder power, competition and corporate governance indicates that any conclusions drawn about the status of corporate law and the prevalence of one normative model over another should be approached with caution. Further research is needed to examine the tradeoffs associated with each model, not only from an economic standpoint but also through the lens of democratic theory. In the meantime, the only dependable conclusion is that we are far from the end of history for corporate law.

2. COMPETITIVE SHAREHOLDERS

This part revisits the economic theory supporting the claim in favor of shareholder empowerment through competitive markets,[38] which we refer to as the case for "shareholder capitalism." We first illustrate the various versions this argument has taken over time, along with their shared foundations in the principal-agent model of corporate governance put forth by Jensen and Meckling (J-M).[39] Next, we show how the argument falls apart when we move from J-M's partial equilibrium model—where the equilibrium condition is determined by considering only one market at a time, while keeping "all other things equal"—to an analytical approach grounded in general equilibrium theory (GET).[40] Methodologically, GET looks at the economy as a closed and interrelated system, simultaneously determining the equilibrium values of *all* variables of interest in all markets.[41] Therefore, unlike results produced in partial equilibrium analysis, results yielded under GET are not conditional on the specific details of the model, and thus have normative implications rather than just local ones.[42] Reference to GET shows that the prediction of reliable coordination of the economy by competitive markets breaks down due to market incompleteness and distorted incentives, with shareholders making production decisions based on idiosyncratic consumption preferences rather than fundamental value.[43]

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[36] See n 111.

[37] See Saura Masconale, "ESG and Boundary Risks: A Social Welfare Approach," (2024) 35 EurBusLR 551, 570–71.

[38] In elaborating on this part, we draw on the prior work of one of us. See Bratton and Sepe (n 3).

[39] Michael C. Jensen and William H. Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 JFinancEcon 305.

[40] See Marshall (n 22) 269–75 (pioneering the study of partial equilibrium).

[41] See Starr (n 22) 3.

[42] See pt 1.2. 9; Starr (n 22) 3; Marshall (n 22) 269–75.

[43] GET models also show uncertainty undermining market pricing accuracy, which undermines the efficient capital market hypothesis that is similarly central to the efficient case for shareholder capitalism. See Bratton and Sepe (n 3) 714–19.

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2.1 The Promise of Shareholder Capitalism

Shareholder capitalism defends the efficiency of a governance model where shareholders operating in competitive markets are empowered to determine business decisions at publicly traded companies. Economically, this model is rooted in Jensen and Meckling's principal-agent framework,[44] combined with classic, Smithian assumptions about market coordination of the economy.[45] "Competitive shareholders" serve as the bridge between these two economic apparatuses.

In J-M's representation of the corporate context, the only problem facing the firm is the conflict of interest arising out of the delegation of authority from the shareholders as principals to the managers as agents. Under this assumption, reducing agency costs is always value maximizing, making robust competition among shareholders essential to corporate efficiency. This is because in competitive equity markets, market trading prices management moral hazard and allocates its cost, giving managers and shareholders incentives to contract with respect thereto. Restated, an efficient governance model requires competitive shareholders as the means to import into the corporate economy the welfare maximizing result of Smith's invisible hand.

Notwithstanding its simplified account of real-world corporate governance,[46] the J-M model has exerted enduring influence on the modern corporate governance discourse.[47] The rise of the hostile takeover in the 1980s was the crucial turning point lending credibility to the model. This development provided tangible evidence that moral hazard had caused agency costs to run to excess, with the market-based control transfer performing a critical agency cost-reductive role and enabling efficient decentralized decision making.[48] This period, however, was relatively short-lived. Hostile takeovers virtually disappeared in the wake of the 1989 economic collapse. A crony capitalism story circulated to explain their disappearance: managers seeking renewed insulation from the markets had gone to state legislatures and appealed to state judiciaries to promote antitakeover statutes and validate antitakeover measures that had come to impair the effectiveness of market discipline.[49] Shareholder capitalism

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[44] Jensen and Meckling (n 39).

[45] See Intro (n 20) 4; Bratton and Sepe (n 3) 694–722.

[46] See Bratton and Sepe (n 3) 686–7 (noting that the J-M model leaves out the separation of ownership and control, shareholder voting, hostile takeovers, any corporate governance issues other than managerial moral hazard, and any corporate interaction with exterior actors and product markets).

[47] Frank Easterbrook and Daniel Fischel are credited with having reinstated Jensen and Meckling for corporate legal theory and adapted the J-M model so that it could fully accommodate real-world corporate governance. In Easterbrook and Fischel's adaptation of the model, the corporate "contract" was expanded to include corporate law itself and internal corporate legislations enacted over time, rather just being the result of face-to-face bargaining between managers and shareholders at the moment of the IPO. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *The Economic Structure of Corporate Law* (HUP 1991).

[48] Reliance on the market for corporate control to discipline management does antedate Jensen and Meckling's principal-agent model of the firm and originates in the work of Henry Manne. See Henry G. Manne, 'Mergers and the Market for Corporate Control' (1965) 73 JPolEcon 110.

[49] See, e.g., Roberta Romano, 'The Future of Hostile Takeovers: Legislation and Public Opinion' (1988) 57 UCinLRev 457, 458–65.

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was then redirected into a regulatory program to reinstate competition in the equity market and facilitate decentralized decision-making—a program that encompassed the removal of antitakeover barriers and the adoption of measures designed to shift control of business policy to shareholders.[50]

Shareholder capitalism in the form of shareholder empowerment has now come about, although through changes in shareholding patterns and the growth of indexation, rather than regulatory intervention.[51] However, before analyzing whether this revised version of shareholder capitalism has fulfilled the model's efficiency promise, we must first examine whether that promise ever had a firm economic justification.

2.2 The Perils

The argument at the core of shareholder capitalism is that a strong market for corporate control boosts productivity because the directives are coordinated by agents—the shareholders—having the right incentives to rein in agency costs. Conceptually, this argument deploys the J-M model as a normative theory of corporate law. This exercise, however, proceeds on a narrow partial equilibrium framework, where management moral hazard is the only incentive problem and "all other things" are not just equal but efficient.[52] This means that but for management moral hazard, the assumption is that corporate production and investments would realize a Pareto optimal competitive equilibrium.

By its very nature, however, partial equilibrium analysis is not robust to counterexamples that expand the range of variables of interest and/or the mode of exploring the variables' behavior.[53] This is the problem with a normative account that draws on partial-equilibrium analysis for inspiration. GET is the remedy to this problem, offering a general microeconomic theory construed from primitive concepts and minimal assumptions. Because the equilibrium concept of GET sweeps in all markets simultaneously and incorporates their interactions, GET enables reliable normative considerations.

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[50] See Cremers, Masconale and Sepe (n 4) 740.

[51] See Intro (nn 5–12).

[52] See Starr (n 22) 3.

[53] It bears emphasis that other partial equilibrium models problematize shareholder influence, suggesting that it might involve negative tradeoffs. These tradeoffs were first introduced in the late 1980s when rational-myopia models posited that myopic management responses to shareholder-driven stock market pressures could sacrifice value. (See, e.g., Jean-Jacques Laffont and Jean Tirole, 'Repeated Auctions of Incentive Contracts, Investment, and Bidding Parity with an Application to Takeovers' (1988) 19 RandJEcon 516, 529–31 (showing formally that if investments are "invisible," high investments might be mistaken for low effort); Jeremy C. Stein, 'Efficient Capital Markets, Inefficient Firms: A Model of Myopic Corporate Behavior' (1989) 104 QJEcon 655, 656–61 (modeling suboptimal investment where managers maximize a weighted average of near-term stock prices and long-run value)). Rational-myopia models shift the locus of imperfection from management moral hazard to another set of asymmetric information—that shareholders know less than managers when it comes to corporate affairs—and then endogenize management investment decisions in anticipation of future hostile shareholder action. See K.J. Martijn Cremers and Simone M. Sepe, 'The Shareholder Value of Empowered Boards' (2016) 68 StanLRev 67, 114–15 (applying a rational-myopia model to the discussion on the normative desirability of staggered boards).

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Importing GET in corporate law undercuts the case for shareholder capitalism. First, GET shows that the link between competition and aggregate welfare maximization can only be relied upon if one assumes complete markets. In the classic representation by Kenneth Arrow and Gerard Debreu,[54] complete markets imply a world where, among other conditions, there is a market for each good in the economy, information is symmetric, all externalities are taken into account and priced, and all producers and consumers are price takers.[55] Under these conditions, everything can be traded and parties can deal with uncertainty by insuring their preferences in advance, almost as if uncertainty did not exist. But when the heroic assumptions of the Arrow-Debreu model are relaxed and market failures are considered, competitive markets may no longer reliably coordinate the economy.[56] And when this lesson from GET is applied to the shareholder control model of the corporation, that model yields a picture of heterogeneous shareholder preferences and distorted shareholder incentives.

2.2.1 Heterogenous shareholder preferences

When markets are complete except for managerial moral hazard, as posited by J-M, shareholders can be safely assumed to have homogeneous preferences. In such an environment, all shareholders place the same value on the firm's future returns: they all agree on a single plan of production and investment that pursues the objective of maximizing the present value of the firm's returns. This value will equal fundamental value and be manifested in the market price of the firm's securities.[57]

With market incompleteness, however, the number of financial securities available to market actors to insure against uncertain future states of the world is less than the number of future states. This means that market actors can only insure their position by using currently available assets. As a result, they may only be able to consider their actions' direct effect on their own wealth, but not the general equilibrium effect produced by such actions on prices, behaving as if the value of their assets would not change.[58] Consequently, inefficient allocations of resources may result. Further, under these circumstances, market actors might have limited ability to transfer wealth across states (i.e., for future consumption). Because in incomplete markets individuals are not optimally coordinated by the price system, they may direct excessive resources toward their state of relative deprivation, without considering the effect

[54] See Kenneth J. Arrow and Gerard Debreu, 'Existence of an Equilibrium for a Competitive Economy' (1954) 22 Econometrica 265.

[55] For a discussion of these conditions tailored for a legal audience, see Bratton and Sepe (n 3) 699–701.

[56] See John Geanakoplos, 'An Introduction to General Equilibrium with Incomplete Asset Markets (1990) 19 JMathEcon 1, 26; See e.g. Bratton and Sepe (n 3) 701–05 (tailoring the discussion to a legal audience).

[57] John Geanakoplos, Michael Magill, Martine Quinzii and Jean Dreze, 'Generic Inefficiency of Stock Market Equilibrium When Markets are Incomplete' (1990) 19 JMathEcon 113, 121. Market completeness thus fulfills a necessary condition for the operation of the Fisher separation theorem, under which a firm should increase its value to the fullest extent regardless of the preferences of its owners. See Irving Fisher, *The Theory Of Interest* 141 (The Macmillan Company 1930).

[58] See Joseph E. Stiglitz, 'The Inefficiency of the Stock Market Equilibrium' (1982) 49 RevEconStud 241, 242.

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(that is, the pecuniary externality) they impose on others when they trade (such as a higher security price).[59]

Under the combination of insufficient insurance against uncertain states of the world and the shareholders' different marginal propensity to consume (some want more now while others are more patient), shareholders will tend to no longer agree on the same, value-maximizing production plan.[60] Instead, their heterogeneous consumption preferences are going to affect a project's evaluation, and shareholder disagreement ensues regarding project selection. The goal of profit maximization becomes a matter of subjective decision-making, varying with the shareholders' own visions of the economy and idiosyncratic preferences regarding future consumption. As a result, governance by competitive shareholders may produce suboptimal results in incomplete markets.

2.2.2 A two-sided incentive problem

GET with incomplete markets teaches that it is not safe to assume that agency cost reduction stemming from decentralized shareholder decision-making maximizes value. Instead, it situates us in a world with a two-sided incentive problem: one, well-known, concerning managers and the other, long understudied in corporate law, concerning shareholders themselves. In the meantime, the modern corporation with enhanced shareholder power has transformed into a "hybrid form that straddles the firm and the market."[61] In a prior study, one of us has argued that the best we can do in the face of this transformation is to rely on "good incentives prodded by good contracts."[62] Indeed, "given incomplete markets, economic theory counsels that contracting that directs incentives in the proper direction is a more promising route to productive efficiency than is market control."[63] This conclusion, however, could not account for yet another practical shock that was to occur in the corporate world: the rise of market-power shareholders.

Shareholder control of the public corporation has been achieved through a change in ownership structures, under which the largest asset managers, through the funds they oversee, now hold enormous economic and voting power in U.S. corporations.[64] That is, actual shareholder governance has come about not through competitive markets but through "market-power shareholders." Strikingly, this new version of a shareholder economy closely resembles one of

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[59] See, e.g., Guido Lorenzoni, 'Inefficient Credit Booms' (2008) 75 RevEconStud 809 (showing how the conjunction of limited commitment in financial contracts and the fact that asset prices are determined in a spot market generates a pecuniary externality that is not internalized in private contracts).

[60] Only under the "spanning condition," which is satisfied if investors can ascertain the project's value by reference to currently traded securities, which are assumed to reflect the value of other firms' projects of other firms in the economy, and the firm's project is small relative to the economy as a whole, can shareholders can be expected to make an undistorted choice in such circumstances. See Andreu Mas-Colell, Michael D. Whinston and Jerry R. Green, *Microeconomic Theory* 714–15 (OUP 1995). Most projects, however, do not satisfy the spanning condition. See Bratton and Sepe (n 3) 709–10.

[61] Bratton and Sepe (n 3) 681.

[62] ibid 725.

[63] ibid.

[64] See Intro; Gilson and Gordon (n 7) 874–88; Schwartz (n 8) 403; Coates (n 9) 2 n 4; Fichtner, Eelke and Garcia-Bernardo (n 10) 313.

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the theoretical solutions proposed by GET scholars to address the two-sided incentive problem of managerial moral hazard and heterogeneous shareholder preferences: dominant blockholding. This leads us to the second part of our analysis, which begins with introducing the basic tenets of the dominant blockholding model and a discussion of how it fits today's paradigm of shareholder power. We then move to examine the additional problems that arise under this novel shareholder paradigm, not just from an economic viewpoint, but also from the perspective of democratic theory.

3. MARKET-POWER SHAREHOLDERS

3.1 The Promise of (Shareholder-Driven) Stakeholder Capitalism

This part analyzes the relationship between the emergence of market-power shareholders and GET's dominant blockholding model. It also explores the reasons why it is challenging to derive any conclusive normative implications from this alignment. The model's fundamental premise is that dominant blockholders who own a significant number of shares can ensure that their interests are aligned with the optimal firm outcome, thereby avoiding the incentive misalignment that affects shareholders with smaller stakes. Therefore, market-power shareholders could potentially improve the normative desirability of shareholder control, raising the question of whether current shareholder support for a new model of "stakeholder capitalism" might be the actual "end of history for corporate law."

We are skeptical that this is the case. In the current ESG era, pursuing a broader social purpose involves not only considering the economic interests of various stakeholders but also taking a stance on society's focal points of moral and political disagreement. This goes beyond the scope of the dominant blockholding model, resulting in the normative implications of market-power shareholders becoming uncertain both economically and in terms of their impact on democracy.

3.1.1 Project selection and dominant blockholders

The dominant blockholding model, articulated in the 1990s by economist Peter DeMarzo, formally shows that a dominant blockholder who has a financial incentive to implement a production plan that maximizes value could potentially build a majority coalition under specific conditions, thereby addressing the issue of shareholders' disagreement on the optimal production plan.[65] DeMarzo's conditions for success include a board with agenda control, where board members are either shareholders or act on behalf of certain shareholders.[66] The board must also deliberate with unanimity, and each member must have veto power. [67] Finally, the board members may negotiate transfers between themselves to gain acceptance of a proposal, and they may bargain with each other over various proposals.[68]

For a long time, DeMarzo's assumption of "face-to-face bargaining in a highly stylized boardroom" appeared to significantly constrain the applicability of the dominant blockholders'

[65] See DeMarzo (n 25) 719.
[66] ibid 728.
[67] ibid.
[68] ibid.

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model to real-world public companies characterized by dispersed shareholders.[69] And even after the emergence of empowered shareholders, there remained doubts regarding the model's applicability in real-world settings, since the initial drivers of shareholder power were shareholders who held relatively small blocks of stock, such as hedge funds.[70] With the emergence of market-power shareholders, however, many of the limitations that once seemed to restrict the practicality of DeMarzo's model have disappeared.

In line with the bargaining process and the unanimity rule assumed by DeMarzo, large asset managers can informally coordinate over various corporate issues, with their actual votes serving to reinforce this coordination process.[71] And because these votes are public, each asset manager can obtain strong signals about the views of other funds.[72] Additionally, public companies' management are likely to anticipate that non-compliance with the asset managers' demands could lead to corporations being excluded from fund portfolios, as asset managers can create portfolios that meet certain criteria, even within the context of index investing.[73] This gives asset managers a lever they routinely use to exercise a form of agenda control.[74] In fact, corporate law scholars are now predicting that voting in most public companies will soon be dominated by the Big Three.[75]

These corporate governance changes then beg the question of whether the real corporate world has finally caught up with the two-sided incentive problem of a shareholder economy. Do market-power shareholders preserve the effectiveness of a shareholder economy in addressing managerial moral hazard while simultaneously avoiding the shareholders' selection problem? In order to answer this question, we must first examine the other practice shock that has recently emerged in corporate America: the shift towards a shareholder-driven model of "stakeholder capitalism."

3.1.2 The end of history?

In a turn of events, the rise of market-power shareholders has coincided with a rejection of the traditional shareholder wealth-maximization model. For years, the notion that corporations should operate with broader social goals in mind, rather than solely to maximize profits for shareholders, was on the fringes of the corporate governance discussion.[76] However, this perspective has now entered the mainstream, so much so that, reversing its longstanding stance in favor of shareholder primacy, the Business Roundtable pledged in the summer of 2019 to adopt a "modern standard for corporate responsibility" and to manage corporations "for the

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[69] See Bratton and Sepe (n 3) 711.

[70] ibid.

[71] See Coates (n 9) 13–15.

[72] ibid.

[73] See Masconale and Sepe (n 13) 304 (citing last year's exclusion of Tesla from the S&P 500 ESG Index as a paradigmatic example).

[74] See, e.g., Dorothy S. Lund, 'Asset Managers as Regulators' (2023) 171 UPaLRev. 77, 105–26 (providing anecdotal evidence that asset managers increasingly exercise this kind of lever in inducing corporations to choose a certain kind of socially focused initiatives).

[75] See Bebchuk and Hirst (n 11) 721.

[76] The idea that corporations should pursue a broader social purpose has loomed in the background of the corporate governance discourse since the Berle-Dodd debate on the purpose of the corporation in the 1930s. See William W. Bratton and Michael L. Wachter, 'Shareholder Primacy's Corporatist Origins: Adolf Berle and The Modern Corporation' (2008) 34 JCorpL 99, 122–35.

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benefit of all stakeholders."[77] More generally, the incorporation of ESG criteria into business conduct has become the new corporate standard.

What makes the transition to stakeholder capitalism so significant is that it is now supported by shareholders themselves. Leading asset managers such as BlackRock, State Street and Vanguard are among the champions of the ESG movement.[78] Indeed, Larry Fink, CEO of BlackRock, coined the term stakeholder capitalism, which he defines as a form of capitalism built on mutually beneficial relationships between companies and employees, customers, suppliers and local communities.[79] Market-power shareholders are shifting corporate governance towards a model of shareholder-driven stakeholder capitalism.

Examining this new conception of corporate governance through the lens of DeMarzo's model raises the question of whether this development signifies the actual "end of history for corporate governance." Under the dominant blockholding model, shareholders' incentives are aligned toward choosing the optimal production plan. But then, if market-power shareholders fit within the descriptive account of DeMarzo's model, shouldn't we conclude that the current trend of shareholder activism in favor of stakeholder capitalism solves the two-sided incentive problems and marks the point of arrival for modern corporate governance?

While this is a tempting conclusion, it overlooks the difficulties introduced by the expanded understanding of a corporation's social purpose under the current stakeholder capitalism model. Traditional stakeholderist claims called for pursuing the economic interest of stakeholders in addition to shareholders, but current claims go beyond stakeholder "value" and focus instead on stakeholder "welfare."[80] And pursuing stakeholder welfare increasingly encompasses taking a stance on divisive social issues such as gender and racial equity, climate change, immigration, abortion, gun control, and so on.[81] As we will discuss below, this complicates the analysis because the demand for taking a stance on these issues is not "like anything else individuals desire." Markets cannot internalize our heterogeneous social preferences as they do with other preferences. Consequently, DeMarzo's model loses its predictive power, and the normative implications of market-power shareholders become uncertain.

3.2 The Perils

In the ESG era, it is unclear what pursuing a broader social purpose entails. As observed by one commentator, "a variety of usage of the term [ESG] have developed that range from seemingly neutral concepts of integrating "'environmental, social and governance' issues into investment analysis to value-laden notions of corporate social responsibility or preferences for what some have characterized as 'conscious' or 'woke' capitalism."[82] Yet, in spite of disagreement on

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[77] See Business Roundtable. 'Business Roundtable Redefines the Purpose of a Corporation to Promote "An Economy that Serves All Americans"' (19 August 2019) https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans The Business Roundtable is a non-profit association bringing together the CEOs of major U.S. companies.

[78] See n 16.

[79] See n 15.

[80] See n 14.

[81] See n 29.

[82] See Pollman (n 27) 403.

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the scope of ESG initiatives or stakeholder capitalism more broadly, recent studies share the view that this new governance model responds to a demand of stakeholders.[83] Economically, these studies also share the assumption that corporations meet this new stakeholder demand in the same way as they do with anything else individuals desire: by internalizing individuals' heterogeneous preferences. This assumption is grounded on the foundational neoclassical idea that competitive markets allow for the greatest diversity in goals and resources.[84] Therefore, these studies conclude, "different corporations can offer different types of altruism [i.e., social initiatives] to different people." [85]

But as we showed elsewhere,[86] the "production calculus" of corporate social initiatives is not the same as that of other production plans corporations undertake. Many of these initiatives focus on divisive social issues—on which reasonable people may be expected to legitimately disagree—and hence tend to be "exclusionary." As we shall discuss below, this is likely to lead to an equilibrium of "corporate conformity:" Because one cannot stand on both sides of divisive social issues, and given current equity reconcentration patterns, corporations have incentives to choose social initiatives that only cater to the preferences of a few large investors while excluding any "contrarian" preference.

3.2.1 Heterogenous stakeholder preferences

In general, the defining virtue of competitive markets is that they allow for the greatest diversity in goals and resources. If you like red shoes and I like blue shoes, corporations will produce both. (In fact, the same corporation will likely produce both kinds of shoes.) But engagement in divisive social issues is necessarily exclusionary, meaning that taking a stance in favor of a controversial issue involves a contextual inability to take a stance on the opposite side. For example, if a corporation takes a position that reflects a more progressive stance on an issue such as gun control (e.g., supporting a gun-restrictive policy), it will be unable to support the "contrarian" conservative position on that same issue (e.g., supporting no gun restrictions). This is because engaging in both initiatives would destroy the corporation's ability to satisfy the demand of either individuals with progressive or conservative preferences and hence destroy the value the corporation derives from engaging in these initiatives.[87]

What we call "moral tradeoffs" add another complication. Under the reasonable assumption that individuals' utility function is constrained by their budget, one can posit that a substitution effect exists between the demand for a corporation's social initiatives and other commodities. This means that the new stakeholder demand for social initiatives is affected by changes

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[83] See Masconale and Sepe (n 13) 273–75.

[84] John Geanakoplos, 'Arrow-Debreu Model of General Equilibrium' in John Eatwell and others (eds), *The New Palgrave Dictionary Of Economics* (Palgrave Macmillan 1987) 119 (In a general competitive equilibrium, "[e]very desire of each consumer, no matter how whimsical, is met by the voluntary supply of some producer. And this is true for all markets and consumers simultaneously.")

[85] See M. Todd Henderson and Anup Malani, 'Corporate Philanthropy and the Market for Altruism' (2009) 571 ColumLRev 571, 575. For example, "those who like the environment can deal with Patagonia, which has pledged about one percent of profits to environmental causes, while those who are concerned about poverty in developing countries can engage with Google, which has made a similar pledge for this cause." ibid.

[86] See Masconale and Sepe (n 13) 290–305.

[87] See ibid 294–96.

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in relevant prices and hence admits tradeoffs. But then this implies that even the satisfaction of the demand for theoretically less divisive social initiatives might end up creating negative externalities for some individuals. For example, one's propensity to care for the environment might well change if caring entails closing down the factory where an individual works. Viewed through this lens, all corporate social initiatives can potentially become divisive and exclusionary and hence be subject to the above production constraints.

Under this recharacterization of corporate social initiatives,[88] the question is how corporations choose *which* social initiatives to engage in at the expense of others. Corporations cannot capture the universal economic demand for divisive social initiatives as they do with other goods or services they produce. Capturing the universal economic demand means that corporations can typically cater to both the majoritarian demand, representing the largest economic interest for goods and services, and minority demands, for which there are niches of interest. But with divisive social initiatives, minority demands are likely to focus on contrarian initiatives and hence cannot be pursued by the new "ESG corporation" for the reasons discussed above. In response, striving to remain competitive, corporations will have incentives to cater only to the majoritarian economic demand for corporate social initiatives. The ultimate question then is where this demand comes from.

3.2.2 Corporate conformity

To some extent, all stakeholders now share a moral/social demand. On this much, scholars seem to agree. However, what is largely overlooked in the literature is that the demand coming from the various stakeholders does not carry equal weight. The number of ESG investments suggests that today's investors are increasingly choosing to hold "moral portfolios."[89] The starting point to understand moral portfolios is portfolio theory, under which all investors can be expected to include some ESG shares in their diversified holdings.[90] However, "sympathetic investors" with a taste for social initiatives will include more ESG shares than other diversified investors (i.e., investors that look only at a firm's fundamentals and are not sympathetic to corporate social initiatives). These distorted portfolio choices are what we call moral portfolios.

Importantly, moral portfolios trigger asset price effects: similar to a financial bubble, the increased demand for ESG assets results in an increase in the share price of ESG corporations.[91] When one considers the magnitude of these asset price effects, the moral preferences

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[88] It is worth emphasizing that divisive corporate social projects are more similar to private than public goods. But see Roland Bénabou and Jean Tirole, 'Individual and Corporate Social Responsibility' (2010) 77 Economica 1, 2–3 (expounding the classic view of corporate social responsibility as a response to "government failures" in the production of public goods). This is because only by being willing to pay for engagement in a given socially focused project can individuals prevent corporations from "producing" projects that are contrarian to their moral identity. To this extent, divisive social projects are excludable, unlike public goods.

[89] In 2020, socially responsible investing reached a staggering $40 trillion worldwide. Anne-Laure Foubert, 'ESG Data Integration by Asset Managers: Targeting Alpha, Fiduciary Duty & Portfolio Risk Analysis' Opimas (17 June 2020), http://www.opimas.com/research/570/detail/.

[90] On portfolio diversification and factor pricing, see Stephen A. Ross, 'The Arbitrage Theory of Capital Asset Pricing (1976) 13 JEconTheory 341.

[91] Compare Christian Gollier and Sébastien Pouget, 'Investment Strategies and Corporate Behaviour with Socially Responsible Investors: A Theory of Active Ownership' (October 2022)

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of sympathetic investors are thus likely to weigh more economically and hence have a disproportionate impact in determining corporations' social choices. Only by conforming to those preferences will corporations be able to capture the positive asset price effects that are triggered by moral portfolios. Hence, one can expect an equilibrium of "corporate conformity," under which corporations have incentives to exclusively cater to the social preferences of their largest investors.

But there is more: under current rules of corporate voting[92] and the reconcentration of equity ownership due to indexation, corporations' social choices are likely to exclusively reflect the preferences of the handful of top agents who run the largest fund families. There are two reasons for this. First, the substantial economic power of the Big Three makes their economic interest likely pivotal in determining the asset price effects of moral portfolios. Second, their voting power is similarly pivotal in most corporate decisions that are subject to a shareholder vote, while the anticipation of this pivotality provides strong incentives to managers to respond to the desires of the Big Three. Under this concentration of power and coordinated influence, it is difficult to imagine that corporations might take a stance on a divisive matter that does not conform to the preferences of their largest investors.

4. NEW CHALLENGES

As mentioned above, in assessing the implications of the advent of shareholder power, one of us argued a few years ago that the modern corporation with enhanced shareholder power had evolved into a "hybrid form that straddles the firm and the market."[93] With the emergence of shareholder-driven stakeholder capitalism and corporate conformity, that hybridization process has taken a step further. Today's corporations straddle not just firms and markets but also the political arena. In the last part of this chapter, we examine the tradeoffs that affect this new iteration of the hybrid corporation, which have an impact on both economic and political outcomes.

4.1 Economic Outcomes

The classic economic argument against a stakeholder, social-oriented model of the corporation posits that it detracts from corporations' ability to fulfill their primary purpose, which is

89(356) Economica 997–1023 (developing a model showing that investors can decrease the equilibrium cost of capital of responsible firms by altering their portfolio allocation towards the assets of these firms).

[92] Although activist decisions are largely driven by asset price effects, these effects are not independent from corporate voting rules. The one-share, one-vote rule that distinguishes corporate governance from electoral governance enters into a corporation's activist decisions through two channels. First, managers anticipate that the failure to satisfy investors' moral demands would mean suffering negative asset price effects, as sympathetic investors would readjust their portfolios accordingly (while the economic magnitude of this loss is proportional to the investors' equity participation). Second, managers also anticipate that the failure to satisfy investors' moral demands increases the likelihood of retaliatory actions that shareholders can exercise through their voting powers, including removing managers.

[93] See pt 1.2.1 (n 60).

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to increase overall wealth by effectively providing goods and services.[94] This argument has been restated against the contemporary shareholder-driven model of stakeholder capitalism, especially by popular press sources that are concerned about the emergence of the "woke corporation."[95] These sources suggest that stakeholder capitalism represents a "scam"—a novel form of private benefits extraction by ultra-liberal CEOs.[96]

We rebut this argument for two reasons. Firstly, it is outdated in that it neglects to recognize the changes that have taken place in the marketplace: the new demand for corporate social initiatives originating from all corporate stakeholders, including shareholders. Secondly, this argument fails to consider the connection between stakeholder capitalism and capital markets. As discussed above, investors' social preferences and moral portfolios influence the price mechanism that informs corporations' decisions in competitive markets. Due to the persistent demand for socially oriented initiatives coming from the largest investors and the positive asset price effects that result from this demand, socially oriented corporations can be expected to attract more capital in the short term and, therefore, be more competitive rather than less.

However, it is uncertain whether the current corporate conformity equilibrium is sustainable in the longer term. This is because the current influx of capital into ESG assets presents features of a bubble or, in economic terms, "overinvestment." Overinvestment occurs when certain conditions cause demand to temporarily exceed its normal level, resulting in the creation of increasing productive capacity that, once demand returns to its usual level, turns out to be excessive productive capacity.[97] A common source of overinvestment is a significant asset bubble where prices surpass fundamental values. A large asset bubble typically encourages companies to increase investment spending by creating a sense of euphoria and optimism about future profits and demand. The remarkable levels achieved by sustainable investments in recent years, combined with the asset price effects caused by investors' persistent demand for these investments, fit within the overinvestment paradigm.

In light of this, the key economic issue is whether the current state of overinvestment in socially focused investments can be sustained in the long term. The literature on overinvestment indicates that all asset bubbles will eventually deflate due to unavoidable structural changes that impact excessively optimistic expectations about future profits and demand. Once this occurs and investment expectations are reversed, consumption declines, a significant amount of excess capacity is suddenly exposed, and the profit rate rapidly decreases. As a result, investment incentives might be suppressed for a considerable period of time.[98]

When considering investments with a social focus, we argue that three main sources of structural changes may trigger a reversal of profit and demand expectations in the medium- to long-term. First, exogenous shocks are a typical structural change that may lead to bubble

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[94] See Milton Friedman, 'The Social Responsibility of Business Is to Increase Its Profits' *New York Times Magazine* (13 September 1970) (pioneering this argument).

[95] See Masconale and Sepe (n 13) 278–81 (providing an overview and critical assessment of these accounts).

[96] See Vivek Ramaswamy, *Woke Inc.: Inside Corporate America's Social Justice Scam* (Center Street 2021) 3.

[97] See, e.g., Robert E. Hall, 'The Over-Investment Hypothesis and the U.S. Economy' (1988) 96 JPolitEcon 1.

[98] ibid.

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bursting,[99] with the current geopolitical crisis arising from Russia's ongoing war in Ukraine potentially being a paradigmatic case in point. Data suggests that the crisis has already compelled traders to reassess their investments in energy (which was the only positive sector in 2022) as well as in weapon stocks.[100] The introduction of anti-ESG regulations in several red states, coupled with increased state-level political scrutiny, has also played a significant role in prompting investors to reconsider their investment criteria in recent times.[101] Overall, these factors might explain why after years of steadily increasing sustainable investments, the total assets under management of ESG funds fell by approximately 163 billion globally during the first quarter of 2023, compared to the previous year.[102]

Second, structural changes might come from changes in "primitives," including intergenerational changes in investors' social preferences. According to some scholars, the Big Three's focus on sustainability is an attempt to attract the soon-to-accumulate assets of the millennial generation, who place a premium on social issues in their economic lives.[103] Under this explanation for the emergence of shareholder-driven stakeholder capitalism, there is a risk that millennials' preferences might change over time, which may lead to a decline in the demand for socially-oriented initiatives and hence the exposure of overinvestment. Indeed, individuals' preferences might change over the course of one's life for various reasons, ranging from external influence (e.g., coming from social imitation or habit formation) to evolving patterns of internal coherence (e.g., religious convictions), correlations between physiological changes and changes in behavior (e.g., changes with increasing age), taste refinement and self-restraint (e.g., maturation or social influence), and doxastic preference changes (i.e., changes in belief that lead to preference changes).[104] Thus, the sustainability of the current trend towards socially focused investments may depend on the long-term stability of investors' social preferences.

Third, changes in the distribution of investors may also affect the current corporate conformity equilibrium and lead to the exposure of overinvestment. In recent times, concerns with the accumulation of economic and voting power in the hands of a few fund families have prompted several commentators to advance proposals for new forms of asset managers regulation.[105] These proposals have ranged from the introduction of voting restrictions[106] to

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[99] See, e.g., James A. Kahn, 'Excess Capacity and Business Fixed Investment in the United States' (1987) 77 AmEconRev 72 (discussing the relationship between overinvestment and exogenous shocks in business cycles).

[100] See, e.g., Nicole Goodkind, 'ESG investing is dying. That's not a bad thing.' *CNN Business* (28 April 2023) https://www.cnn.com/2023/04/28/investing/premarket-stocks-trading/index.html.

[101] See Masconale (n 37).

[102] See Goodkind (n 100).

[103] See Michal Barzuza, Quinn Curtis and David H. Webber, 'Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance' (2020) 93 SCalLRev 1243, 1244.

[104] See Sven Ove Hansson and Grüne-Yanoff Till, 'Preferences' in Edward N. Zalta (ed) *Stanford Encyclopedia of Philosophy (*Spring 2021 ed) https://plato.stanford.edu/cgi-bin/encyclopedia/archinfo.cgi?entry=preferences&archive=win2021.

[105] See, e.g., Jeff Sommer, 'Shareholder Democracy is Getting Bigger Trial Runs' *New York Times* (15 October 2021) https://www.nytimes.com/2021/10/15/business/shareholder-democracy-stocks.html (surveying both private initiatives and regulatory proposals to constrain index fund economic and voting power).

[106] See, e.g., Sean J. Griffith, 'Opt-in Stewardship: Toward an Optimal Delegation of Mutual Fund Voting Authority' (2020) 98 TexLRev 983, 983; Dorothy S. Lund, 'The Case Against Passive

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caps on holdings.[107] If implemented, this and similar new regulations could have an impact on current equity reconcentration patterns and hence on the asset pricing effects arising from moral portfolios. Potentially, this could lead to changes in the majoritarian economic demand for sustainable investments, whose effects are difficult to predict but could well result in a reversal of investment expectations.

4.2 Political Outcomes

Under the current corporate conformity equilibrium, the emergence of market-power shareholders with divisive social preferences also presents political challenges, for both corporate and electoral governance.

Within corporations, the risk is that corporate conformity might threaten the political freedom of contrarian stakeholders, especially those who are economically dependent on the corporation, such as employees.[108] Assuming otherwise would mean positing that the millions of individuals who interact with corporations on a daily basis share the same moral preferences as the restricted group of agents which direct that conformity. This does not exclude the possibility that many individuals may partake in those preferences. But corporate conformity simultaneously, proactively, excludes all those who do not agree with the side chosen by a small group of investors. "Dissenters" are left with no exit options, due to the lack of alternatives in corporations' social engagement under the current corporate conformity equilibrium. Of course, minority stakeholders always have the "option" to abandon the corporate world, but in the case of employees or other stakeholders who are economically dependent on the corporation (e.g., small suppliers), that might very well be an unaffordable option.[109] And anyway, the fact of being forced to choose this option already qualifies as an obstacle to individual freedom.[110]

In society at large, there is a concern that corporate activism may interfere with the democratic adjudication of divisive outcomes, both directly and indirectly.[111] The direct risk is that conformist corporations may attempt to interfere with the outcomes of electoral governance, for example, trying to halt the implementation of contrarian outcomes or otherwise alter them. Recent corporate threats of economic retaliation and actual economic retaliation against the adoption or implementation of "non-conformist" state laws suggest this is now a tangible

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Shareholder Voting' (2018) 43 JCorpL 493, 528–30.

[107] See Coates (n 9) 21–22.

[108] See Masconale and Sepe (n 13) 305–07 (providing a throughout discussion of why corporations engaged in socially divisive policies might violate the "freedom test").

[109] See ibid 261–62 (explaining why privately held corporations might fail in practice to represent a viable exit option for contrarian employees).

[110] This is political philosopher Philip Pettit's 'eyeball test,' under which citizens are free when, by local social and cultural standards, and having only ordinary courage, they "can look others in the eye without reason for the fear or deference that a power of interference might inspire; they can walk tall and assume the public status … of being equal in this regard with the best." Philip Pettit, *On The People's Terms: A Republican Theory and Model of Democracy* (CUP 2012) 84.

[111] See Masconale and Sepe (n 13) 307–11 (providing a throughout discussion of why corporations engaged in socially divisive policies might violate the "equality test").

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risk.[112] Meanwhile, as we saw, many US states have now joined the ESG battlefield, introducing partisan regulations that either promote or restrict ESG investing, which is likely to trigger additional conflicts.[113]

The indirect risk is more subtle. This is the risk that corporate activism may give the wealthiest few exclusive access to the corporate megaphone to influence the public discourse around divisive social issues, thus undermining equal political activity. This concern closely echoes the warning of Justice Stevens in *Citizens United* that corporations' disproportionate means and resources may lead to the marginalization of the voices of ordinary citizens.[114] We note, however, that the problem is not corporate intervention in political activity per se, as Stevens' argument seems to suggest. Instead, it is the exclusive "appropriation" of that intervention by a board-sized group of individuals. If different corporations engaged in different socially focused initiatives—that is, if the new shareholder-driven stakeholder capitalism offered some level of pluralism—that some corporations might serve as a megaphone for some individuals would only have limited impact on political equality. For other corporations would offer a counterweight, by serving as a megaphone for individuals holding different views. But when there is no pluralism in the marketplace for social initiatives but rather corporate conformity, citizens are likely to "lose faith in their capacity, as citizens to influence public policy."[115]

5. CONCLUSION

This chapter has explored the interplay between shareholders, competition, and corporate governance in the public corporation context. Several studies have examined the impact of newly empowered shareholders on competition between firms,[116] but the literature has not yet explored the impact of market-power shareholders on corporate governance. This chapter fills this gap and makes two key contributions to the corporate governance literature.

First, as a positive matter, we show that a market-power model of shareholder control fits general equilibrium theory's (GET) solutions to the efficiency concerns that affect shareholder control of the corporation when confronted with issues of market incompleteness, heterogenous shareholder preferences and misaligned incentives. Second, as a normative matter, we show that the emergence of market-power shareholders presents both novel economic and political challenges. Under market-power shareholders' support for a novel model of stakeholder capitalism, today's corporations increasingly focus on the pursuit of socially focused initiatives that are highly divisive. The demand for these initiatives, however, is not "like anything else individuals desire," because markets cannot internalize heterogenous social preferences as they do with other preferences. Consequently, GET's normative predictions are lost, and the implications of market-power shareholders become uncertain.

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[112] See ibid 270–71 (providing anecdotal evidence on corporations' retribution against nonconformist law).

[113] Masconale and Sepe (n 37).

[114] *Citizens United v. FEC* 558 U.S. 310, 470 (2010) (Stevens, J., concurring in part and dissenting in part).

[115] See ibid.

[116] See n 18.

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Economically, there might not be an efficiency concern in the short-term, at least under the asset price effects triggered by investors' sustained demand for corporations' social initiatives. However, in the longer term this equilibrium is likely unsustainable because of the risk of an ESG bubble bursting (or deflating) due to either exogenous shocks (e.g., geopolitical crises) or unforeseen changes in fundamentals, including a shift in investors' social preferences or ownership patterns. Furthermore, market-power shareholders with divisive social preferences raise concerns for both stakeholders and citizens at large. Within corporations, the risk is that the corporate conformity that characterizes corporations' supply of socially focused initiatives might threaten the political freedom of contrarian stakeholders, especially those who are economically dependent on the corporation, such as employees. In society at large, there is a concern that socially focused corporations may interfere with the democratic adjudication of divisive outcomes to the extent that they undertake both direct and indirect actions against non-conformist electoral outcomes and state laws.

Finally, the discussion in this chapter sheds light on the intricate relationship between shareholder power, competition, and corporate governance, and calls for a cautious approach in drawing definitive conclusions about the status of corporate law and the efficiency of one governance model over another. The evolution of corporate law remains an ongoing process, calling for further research into the tradeoffs associated with each model, not just from an economic standpoint but also from the perspective of democratic theory.

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3. Varieties of Capitalism, Competition, and Prosocial Corporate Purposes

Massimiliano Vatiero

1. INTRODUCTION[1]

Nearly one-third of the top 100 carbon dioxide (CO2) emitters are represented by large public corporations.[2] This and other types of externalities may call for state regulation, such as the EU securities regulation, which has established a taxonomy of environmentally sustainable activities.[3] However, since Ronald Coase's original contributions, economists have acknowledged that state intervention is neither always necessary nor always desirable.[4] In this chapter, we show that a combination of the *invisible hand*, i.e., competition in markets of capital, labour and products, and the *visible hand*, i.e., the hierarchy in each corporate governance regime, may realign the private objectives of the firm with the objectives of a society.[5]

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[2] CDP, 'New report shows just 100 companies are source of over 70% of emissions' (2017), available at: https://www.cdp.net/en/press-releases/new-report-shows-just-100-companies-are-source-of-over-70-of-emissions (last access: April 12, 2025).

[3] Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment [2020] OJ L198/13.

[4] Ronald H. Coase, 'The problem of social cost' (1960) 3 Journal of Law and Economics 1 (showing that public intervention is not necessary because the problem of externality can, under certain conditions, be solved by exploiting the market; furthermore, public intervention is not even desirable, because state failures may occur).

[5] Let me specify several preliminary concepts. First, I refer to the invisible and visible hand to underline that in market transactions, "price movements direct production, which is coordinated through a series of exchange transactions on the market", namely market transactions are driven by an invisible hand; instead, "[w]ithin a firm these market transactions are eliminated, and in place of the complicated market structure with exchange transactions is substituted the entrepreneur-coordinator, who directs production", namely those transactions within a firm are driven by a visible hand characterized by hierarchy. Ronald H. Coase, 'The nature of the firm' (1937) 4 Economica 386, 388. For a more in-depth discussion of the meaning of transaction in transaction cost theory, see: Massimiliano Vatiero, *The Theory of Transaction in Institutional Economics* (Routledge, 2022).

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This chapter starts from the two main *species*[6] of capitalism that the literature identifies:[7]

1. The "disarmed" capitalism of Anglo-Saxon countries is characterized by a disarmed governance in large, public corporations (i.e., *low* power of corporate owners and *low* power of workers) and *low* barriers to entry in the product market.
2. The "armed" capitalism of European continental countries is instead arranged by an armed governance in large, public corporations (i.e., *high* power of corporate owners and *high* power of workers) and *high* barriers to entry in the product market.[8]

In this chapter, we reappraise the literature on varieties of capitalism, to ask the following research question: Which species (if any) among those described in this literature is expected to be the most likely to support prosocial corporate objectives?

This chapter aims to investigate whether and how the corporate governance structure and competitive forces can address and support prosocial objectives, and therefore, correct externalities (more efficiently than the abovementioned state intervention, in some cases). More explicitly, this chapter, exploring the interplay of agents' (e.g., shareholders', investors', workers', consumers', managers') prosocial preferences,[9] corporate governance structures and

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Second, the concept of prosocial corporate purposes in this paper stands for an alignment between private and social objectives, or between private and social costs, in the terminology of Ronald Coase (n 4), namely that the corporation will pursue social objectives even when it is following private, corporate purposes.

[6] In this chapter, we follow a body of literature (originated by contributions of Old-Institutionalists Thorstein Veblen and John Commons) which shows that the evolution of economic institutions, e.g., the market and firm, may share some of the complicated intellectual challenges that characterize the Darwinian evolution of natural species in biology. In particular, this literature argues that any evolutionary process is consistent with a few general principles common to both social and organic evolution: variation, inheritance, and selection. See, *inter alia*, Geoffrey M. Hodgson, *Economics and Evolution* (Blackwell Publishers 1993); and Massimiliano Vatiero, 'On the (political) origin of "corporate governance" species' (2017) 31(2) Journal of Economic Surveys 393.

[7] See, among others: Peter A. Hall & David Soskice, 'An introduction to varieties of capitalism' in Peter A. Hall & David Soskice (eds), *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford University Press 2001) 1; Mark J. Roe, *Political Determinants of Corporate Governance. Political Context, Corporate Impact* (Oxford University Press 2003); Peter A. Gourevitch & James Shinn, *Political Power and Corporate Control: The New Global Politics of Corporate Governance* (Princeton University Press 2005); Kathleen Thelen, 'Varieties of capitalism: Trajectories of liberalization and the new politics of social solidarity,' (2012) 15(1) Annual Review of Political Science, 137; Mark J. Roe & Massimiliano Vatiero, 'Corporate governance and its political economy' in Jeffrey Gordon & Wolf-Georg Ringe (eds), *Oxford Handbook of Corporate Law and Governance* (Oxford University Press 2018) 56; and, Gur Aminadav & Elias Papaioannou, 'Corporate control around the world' (2020) 74(3) Journal of Finance 1191.

[8] In Vatiero (n 6), I coined the terms "armed" vs. "disarmed" capitalism.

[9] Some studies have shown that economic agents, like investors, workers, and consumers, are willing to sacrifice money to promote the prosocial objectives of firms. See, e.g., Einer Elhauge, 'Sacrificing corporate profits in the public interest' (2005) 80(3) New York University Law Review 733; Michal Barzuza, Quinn Curtis & David H. Webber, 'The millennial corporation: strong stakeholders, weak managers' (2023) 28 Stanford Journal of Law, Business, and Finance 255

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competitive forces, provides arguments for both the *pros* and *cons* of how different types of capitalism support (or do not support) prosocial corporate purposes.

On the one hand, large public corporations in disarmed capitalism may pursue prosocial objectives because:

- minority shareholders may be concerned about ethical, social, and environmental issues and therefore want to maximize shareholder *welfare* (instead of market or shareholder value);[10]
- moreover, these corporations are (more) exposed to the force of competition, including pressures from ethical, social, and environmental investors and consumers (but also workers[11]) that push them to follow prosocial objectives.

However, arguments against can also be advanced. Large public corporations in disarmed capitalism may *not* pursue prosocial objectives because:

- minority shareholders may only be concerned about profits (Friedman's doctrine[12]); and
- the high level of competition in the product market, which characterizes disarmed capitalism, does not leave room to abandon market value maximization.[13]

On the other hand, large public corporations in armed capitalism may pursue prosocial objectives because

- the controlling shareholder (a shareholder that has substantial ownership stakes, such as 10% or 20%) that characterizes the corporate governance of that species of capitalism may be concerned about ethical, social and environmental issues, pushing managers to follow prosocial objectives;
- moreover, the workers' voice and power, which are relatively strong in this species of capitalism, may support prosocial objectives;[14]

(formulating an idea of a social demand, namely the demand from investors, employees and consumers, for prosocial conduct by firms and suggesting a recent rise of this social demand).

[10] Cf Oliver Hart & Luigi Zingales, 'Companies Should Maximise Shareholder Welfare Not Market Value' (2017) 2(2) Journal of Law, Finance, and Accounting 247.

[11] Workers place a high value on social responsibility, and they are increasingly seeking employment opportunities at companies that demonstrate a commitment to making a positive impact. According to a 2022 survey by Deloitte, 37% of Gen Zs and 36% of Millennials have rejected a job based on their personal ethics (including issues related to societal and environmental impact). This is particularly true among Gen Zs and Millennials in leadership positions (46%). Deloitte (2022), Striving for balance, advocating for change. See The Deloitte Global 2022 Gen Z & Millennial Survey, available at: https://www2.deloitte.com/content/dam/Deloitte/at/Documents/human-capital/at-gen-z-millennial-survey-2022.pdf.

[12] Milton Friedman, 'The social responsibility of business is to increase its profits' *New York Times* (1970).

[13] Mark J. Roe, 'Corporate purpose and corporate competition' (2021) 99(1) Washington University Law Review 223.

[14] Cf Thelen (n 7).

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- finally, barriers to entry and oligopolistic rents in this species of capitalism may leave room to abandon market value maximization in favour of prosocial objectives.[15]

Arguments against armed capitalism pursuing such objectives are the following. Large public corporations in an armed capitalism may *not* pursue prosocial objectives because:

- controlling shareholders may only be concerned about profits;
- in addition, workers may prefer Mancur Olson's private groups' objectives,[16] e.g., job stability or higher wage rates, instead of reducing social costs, e.g., limiting pollution;
- finally, while the discretion of managers could support the interests of all stakeholders, including the local community, workers, etc.,[17] the presence of controlling shareholders, which reduces agency costs, limits such discretion of managers and, therefore, discourages prosocial corporate objectives.

The chapter is structured as follows. Section 2 describes the emergence and evolution of varieties of capitalism as the consequence of (institutional) complementarities among the domains of corporate ownership, labour protection and competition in product markets. In Section 3, we provide some considerations on how forces of competition in capital, labour and product markets for each species of capitalism may support prosocial corporate objectives.[18] Section 4 offers a theoretical framework on the virtues and vices of each species of capitalism in pursuing prosocial objectives. Section 5 concludes with our remarks.

2. VARIETIES OF CAPITALISM

Given global competition, some commentators predicted that only the US species of corporate governance would have survived,[19] others in the same years, have instead advocated for the virtues of the German species.[20] More recently, some scholars have shown that the COVID-19 pandemic has had the effect of maintaining the differences between species of capitalism.[21]

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[15] Cf Roe (n 13).

[16] Mancur Olson, *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities* (Yale University Press 1984).

[17] In accordance with Margaret Blair and Lynn Stout, the discretion of a manager supports the objectives and investments of all stakeholders. See Margaret M. Blair & Lynn A. Stout, 'A team production theory of corporate law' (1999) 85(2) Virginia Law Review 247.

[18] Readers who are familiar with works on the political economy of corporate governance and on varieties of capitalism may skip Sections 2 and 3.

[19] According to Hansmann and Kraakman, globalization would have led to the "end of history" for corporate governance (CG) analysis: the CGs of all large corporations would have converged towards the US species. See Henry Hansmann & Reiner Kraakman, 'The end of history for corporate law' (2001) 89 Georgetown Law Journal 439.

[20] For instance, Jean Tirole, 'Corporate governance' (2001) 69(1) Econometrica 1.

[21] Martin Gelter & Julia M. Puaschunder, 'COVID-19 and comparative corporate governance' (2022) 46(3) Journal of Corporation Law 557.

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We consider that, in accordance with a great number of works,[22] there are/were two species of capitalism: disarmed capitalism, which is characterized by disarmed corporate governance (i.e., *low* concentration of corporate ownership, *low* workers' voice and/or *low* firing costs) and *low* barriers to entry in the product market; and armed capitalism, which is instead characterized by armed corporate governance (i.e., *high* concentration of corporate ownership, *high* workers' voice and/or *high* firing costs) and *high* barriers to entry in the product market. This diversity depends on differences in various domains (corporate ownership, labour protection and market regulation) and their complementarities, as we show in Sections 2.1 and 2.2.

2.1 The Concentration of Corporate Ownership

The concentration of corporate ownership represents the prime indicator of corporate governance.[23] In a series of articles, Shleifer and his co-authors found that the level of concentration of corporate ownership varies significantly across countries and negatively depends on the quality of legal protections for minority shareholders.[24] Countries with strong legal protections for minority shareholders tend to have more dispersed corporate ownership structures, while countries with relatively weak legal protections are more likely to have corporations with a controlling shareholder. In common-law countries (e.g., the US and UK), controlling shareholders are relatively uncommon, while in civil-law countries, controlling shareholders are the norm. Hence, the legal system (common vs. civil-law system) plays a crucial role in determining the current ownership structure of large corporations. Because the diffused or concentrated corporate shareholding originates from the medieval distinction between common and civil-law systems, this is called *legal origin* theory. According to the legal origin theory, the *quality* of legal obligations that managers have to investors, as well as how courts interpret and enforce these obligations, varies enormously around the world and brings about a variety in levels of corporate ownership concentration in large corporations.

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[22] In particular: Hall & Soskice (n 7); Roe (n 7); Roe & Vatiero (n 7); Vatiero (n 6); and Aminadav & Papaioannou (n 7). More recently, see the updated chapter of Roe and Vatiero (n 7), which addresses the theme of prosocial corporate purposes from a political economy perspective: Mark J. Roe & Massimiliano Vatiero, 'Corporate governance and its political economy, updated' forthcoming in Jeffrey Gordon & Wolf-Georg Ringe (eds), *Oxford Handbook of Corporate Law and Governance* (Oxford University Press, 2nd ed.). A pre-print version is available on SSRN: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4892213.

[23] See Luigi Zingales, 'Corporate governance' in Peter Newman (ed) *The New Palgrave Dictionary of Economics and the Law* (Stockton Press 1998); and Luigi Zingales, 'In search of new foundations' (2000) 55(4) Journal of Finance 1623.

[24] Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, 'Legal determinants of external finance' (1997) 52(3) Journal of Finance 1131; Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, 'Law and Finance' (1998) 106(6) Journal of Political Economy 1113; Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, 'Corporate ownership around the world' (1999) 54(2) Journal of Finance 471; Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, 'Investor protection and corporate governance' (2000) 57 Journal of Financial Economics 1147; and Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, 'The economic consequences of legal origins' (2008) 46(2) Journal of Economic Literature 285.

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Based on the so-called Grossman–Hart–Moore model[25] – according to which, ownership is the first tool to control (=residual control rights) a transaction and protect investments[26] – the legal origin theory maintains that controlling shareholders may reduce agency costs between managers and shareholders in a context where the legal protection is not enough to reduce them. Indeed, if legal protection does not give enough protection to small investors to induce them to part with their money, investors can get more effective protection by being large. Concentration of ownership leverages up legal protection. Indeed, the most direct way to align cash flow and protect investors is to concentrate shareholdings. Then, investors in the capital markets cope with poor minority shareholders' protections by concentrating corporate ownership. This argument is based on agency costs[27] between managers and shareholders that may be reduced by the monitoring and pressures exercised by the controlling shareholders, which may also benefit minority shareholders.[28] The simple idea is that a controlling shareholder has the incentive to collect information and monitor the management, and a controlling shareholder also has enough voting control to put pressure on the management. Controlling shareholders thus address the agency problem in that they have both a general interest and enough control over the assets of the firm to have their interests respected. With poor minority shareholders' protection, ownership concentration becomes a substitute for legal protection, because only controlling shareholders can hope to receive a return on their investment.[29]

This quality-of-law argument (poor minority shareholders' protection causes the controlling shareholder phenomenon) has been objected to[30] or posed as a secondary or tertiary

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[25] See, in particular, Oliver Hart, *Firms, Contracts, and Financial Structure* (Oxford University Press 1995).

[26] This theory suggests that, since firms carry out innovative investments in a context of hold-up risk, corporate ownership structure is a powerful channel to protect and stimulate these investments. The main aspects of this theory can be synthesized by a passage from an interview with Elon Musk. When teased about his reckless, highly innovative and risky investments, Elon Musk replied, "It's OK to have your eggs in one basket as long as you control what happens to that basket. […] The problem with the Silicon Valley financing model is that you lose control after the first investment round." In other words, to stimulate investments (eggs), the investor needs to *own* the basket holding the eggs. Interview available at https://www.inc.com/magazine/20071201/entrepreneur-of-the-year-elon-musk.html?cid=sf01001. See also Marcello Puca & Massimiliano Vatiero, 'Ownership and Innovation: Evidence from Switzerland' (2020), available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2739880.

[27] The essence of the agency problem is the separation of finance and management, or – in more standard terminology – of ownership and control. The financiers need the manager's specialized human capital to generate returns on their funds. The agency problem in this context refers to the difficulties financiers have in ensuring that their funds are not wasted on unattractive projects by managers. See Andrei Shleifer & Robert W. Vishny, 'A survey of corporate governance' (1997) 52 Journal of Finance 737.

[28] However, agency costs between the controlling shareholders and minority shareholders may emerge if the controlling shareholders pursue (only) private benefits of control, instead of general (e.g., minority shareholders') interests. The literature has long discussed potential conflicts between controlling and minority shareholders. For instance, Fabrizio Barca & Marco Becht, *The Control of Corporate Europe* (Oxford University Press 2001).

[29] See Shleifer and Vishny (n 27).

[30] See Priya Lele & Mathias Siems, 'Shareholder protection: A leximetric approach' (2007) 7 Journal of Corporate Law Studies 17; and Holger Spamann, 'The "Antidirector rights index"

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position.[31] However, one of the main merits of the legal origin theory is to stress that a political variation (common vs. civil law) has affected current corporate governance regimes. Nonetheless, as noted by Mark Roe, the politics in this argument exists only in the initial choice of the legal system in a given jurisdiction (common vs. civil law) and no longer plays a role in shaping the actual content or use of law after the initial choice of systems.[32] In this respect, the historic distinction between the common-law and civil-law systems considered by the legal origin theory is only a part of the evolution of corporate governance regimes, but it is not the whole story.[33] Other factors can explain the differences among species of corporate governance and capitalism.

2.2 The Complementarities of Corporate Ownership with Other Domains

The diversity of species of corporate governance and capitalism depends on the complementarities among different institutional domains, i.e., corporate ownership, labour protection and product market regulation. Because agents operate in different institutional domains, choices in one domain act as exogenous parameters in other domains and constitute the institutional environment in which choices are made.[34] In this setting, "one type of institution rather than another becomes viable in one domain, when a fitting institution is present in another domain and vice versa".[35] As long as complementarities are deep and strong, they can affect, or conceivably determine, the best-fitting institutional arrangements, and that institutional arrangement will differ depending on which local complement dominates. In other words, multiple equilibria[36] emerge as Figure 3.1 shows. It is important to underline that the data in Figure 3.1 refer to the end of 1995. This chapter does not aim to categorize each country into armed or disarmed capitalism *today* but rather to highlight that there has been, at least historically, a variety of capitalisms. According to Franks and Mayer,[37] capitalism in individual states or specific regions (such as continental Europe) changed, i.e., evolved. However, what matters for this chapter is that capitalism did and does evolve between two extremes: armed and disarmed capitalism.

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revisited' (2010) 23(2) Review of Financial Studies 467.

[31] Mark J. Roe, 'Corporate law's limits' (2002) 31(2) Journal of Legal Studies 233.

[32] See Roe and Vatiero (n 7).

[33] Vatiero (n 6).

[34] Masahiko Aoki, *Toward a Comparative Institutional Analysis* (MIT Press 2001). See also Ugo Pagano & Massimiliano Vatiero, 'Costly Institutions as Substitutes: Novelty and Limits of the Coasian Approach' (2015) 11(2) Journal of Institutional Economics 265.

[35] Aoki (n 34) 225.

[36] Multiple equilibria can offer explanations for understanding of why some markets work differently from others, why some communities are structured differently from others, why some firms are structured differently from others, and why there are different forms of capitalism. Cf Pagano & Vatiero (n 34). However, the analysis of multiple equilibria does not represent a topical theme *only* for economists; for example, the title of the Nobel lecture in physics of 2023 given by Giorgio Parisi was "multiple equilibria". Giorgio Parisi, 'Nobel lecture: Multiple equilibria' (2023), available at: https://arxiv.org/pdf/2304.00580.pdf.

[37] Julian Franks & Colin Mayer, 'Evolution of ownership and control around the world: The changing face of capitalism' (2017) ECGI Finance Working Paper No. 503.

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	Concentration of corporate ownership (A)	Workers' voice (B)	Firing costs (C)	Product market regulation (D)	Species
Australia	0.45	0.48	0.50	0.15	Disarmed
Austria	0.95	0.64	0.40	0.19	Armed
Canada	0.50	0.38	0.31	0.25	Disarmed
Finland	0.85	0.60	0.37	0.23	Armed
France	0.70	0.60	0.75	0.28	Armed
Germany	0.65	0.70	0.45	0.35	Armed
Ireland	0.55	0.29	0.29	0.13	Disarmed
Italy	0.85	0.43	0.80	0.38	Armed
Norway	0.95	0.69	0.69	0.37	Armed
Sweden	1.00	0.59	0.68	0.23	Armed
Switzerland	0.50	0.43	0.32	0.30	Disarmed
UK	0.10	0.14	0.44	0.08	Disarmed
USA	0.20	0.04	0.15	0.17	Disarmed

Note: The value 0 is the lowest value and 1 is the highest value.
Sources: (A) Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, 'Corporate ownership around the world' (1999) 54(2) Journal of Finance 471, 494 tbl. 3 (which tabulates the portion of the 20 largest firms by stock market capitalization of equity at the end of 1995 that has a 10% controlling shareholder); (B) John Armour, Simon Deakin & Mathias Siems, 'CBR Leximetric dataset' (2016) Apollo – University of Cambridge Repository, https://doi.org/10.17863/CAM.506; Labour Regulation index, year: 1995, variable: Employee representation, https://api.repository.cam.ac.uk/server/api/core/bitstreams/4c1aca65–856d-4c36-bd93–9e05cad77608/content; (C) John Armour, Simon Deakin & Mathias Siems, 'CBR Leximetric dataset' (2016) Apollo - University of Cambridge Repository, https://doi.org/10.17863/CAM.506; Labour Regulation index, year: 1995, variable: Regulation of dismissal, https://api.repository.cam.ac.uk/server/api/core/bitstreams/4c1aca65–856d-4c36-bd93–9e05cad77608/content; and (D) Giuseppe Nicoletti, Stefano Scarpetta & Oliver Boylaud, 'Summary Indicators of Product Market Regulation with an Extension to Employment Protection Legislation' (2000) OECD ECO Working Paper no. 226 79, tbl. A3.6, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=201668.

Figure 3.1 The species of capitalism

Let us start from the institutional domain of labour protection that (has) acted as an exogenous parameter for the domain of corporate ownership in two cases. First, there is evidence that in the first half of the 20th century, due to hyperinflation in several financially developed countries (such as Germany), salaried people became concerned about the labour–income risk associated with free markets.[38] Due to pressures in the political arena, those countries with an impoverished middle class turned to a more pro-labour system and anti-market policies, whereas other countries (e.g., the US) escaped high inflation and hence maintained more market-friendly institutions. Second, as argued by Mark Roe,[39] due to the 20th-century

[38] Enrico C. Perotti & Ernst-Ludwig von Thadden, 'The political economy of corporate control and labor rents' (2006) 114(1) Journal of Political Economy 145.

[39] Roe (n 7).

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destruction of physical capital in the Second World War and the communist influence, there was in several European continental countries increasing pressure from the working class, which called for workers' representation, job security, income distribution, social welfare, and social stability, to name a few of their demands. In particular, 'social democracies,'[40] such as those in Continental Europe, gave voice and protection to the claims of workers. As argued by some commentators, stronger employee legal protections had the consequence of stimulating more concentrated corporate ownership arrangements. That is, owners of capital responded by concentrating ownership to ensure that managers acted in the interests of the firm's owners rather than giving away the store to the workers.[41]

Both examples suggest a causal relationship running from the domain of labour to the domain of corporate ownership arrangements. However, causation may run in the reverse direction as well: a certain degree of concentration of corporate ownership may easily urge employees to call for protection via politics. Therefore, a circular causation emerges: an increase in the protection of labour implies a concentration of corporate ownership, while an increase in the concentration of corporate ownership causes a request by employees for more protection and voice in the corporation. This complementarity between labour and corporate ownership (mediated by politics) is at the base of the emergence of the European corporate governance species characterized by a structure with a higher level of capital concentration and workers' voice and protection.[42]

Figure 3.1 shows that countries with corporations characterized by deconcentrated corporate ownership (column A), such as the UK and the US, and other common-law countries, such as Australia, Canada and Ireland (and also Switzerland[43]), have relatively low values in *both* workers' voice (column B) *and* workers' protections in terms of firing costs (column C), describing a disarmed corporate governance structure. Instead, countries with corporations characterized by concentrated corporate ownership (column A), such as Austria, France, Germany and Italy, and other civil law Scandinavian countries, such as Finland, Norway and Sweden, have relatively high values *either* in workers' voice (column B) *or* workers' protections in terms of firing costs (column C), or *both*, describing an armed corporate governance structure.

So far, we have considered the complementarity between labour and the corporate ownership domain. Let us now consider the domain of competition in the product market, where we look at another complementarity concerning the coalition between owners of capital and owners of human capital (employees), and how it has impacted the product market. As originally

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[40] By social democracy, Mark Roe means a nation committed to private property, but where distributional considerations are vital, where labour is typically powerful and where government action to foster economic equality is central on the political agenda. See Roe (n 7).

[41] Aoki (n 34); Roe (n 7); Martin Gelter, 'The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance' (2009) 50 Harvard International Law Journal 129; Ugo Pagano, 'The evolution of the American corporation and global organizational biodiversity' (2012) 35(4) Seattle University Law Review 1271; and Roe & Vatiero (n 7).

[42] Cf Aoki (n 34); Roe (n 7); and Roe & Vatiero (n 7).

[43] Other political and institutional factors can explain the Swiss exception: Switzerland is a civil-law country but has a corporate governance regime more similar to common-law than civil-law countries, contradicting legal origin theory. See Massimiliano Vatiero, 'Learning from the Swiss corporate governance exception' (2017) 70(2) Kyklos 330.

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argued by Mancur Olson, institutional change is often the outcome of strategies aimed at improving the situation of some or all components of the dominant elite.[44] Groups that interact in the economy contend in the political arena. Their objective is to obtain via politics those institutional settings which are aligned to their own interests and preferences or, alternatively, contrary to those of rival groups in the economy. By this token, as labour unions are rent-seeking organizations, controlling shareholders and insider workers can ally to create a transversal group – in Olson's words, "distributional coalitions" – to limit market forces and preserve their rents from outsiders.[45] The general idea is that controlling shareholders and incumbent workers largely align against outsiders, creating or maintaining monopoly or oligopoly rents in financial, labour and product markets, which can be split between them. Since regulatory protectionism can create rents, controlling shareholders and insider workers will ally in calling (in the political arena) for a strict regulation of the product market, i.e., legal barriers to entry.[46] Then, we can identify a causation from insiders (controlling shareholders and insider workers) and their alliance to a high level of barriers to entry. However, there is also a reverse causation: Market rents strengthen the power of each insider and of their alliance against outsiders, increasing the benefits for the concentration of corporate ownership and the voice and protections of workers.

For measuring these market rents, we use data on product market regulation which are based on two main sources: (1) the responses of Member countries to an ad hoc questionnaire; and (2) data on economy-wide and industry-specific regulations drawn from publications of the OECD or other institutions.[47] Figure 3.1 shows complementarity between corporate governance (power of insiders) and market rents, even if the results are little bit more mixed: countries with a disarmed corporate governance regime have relatively lower values in terms of product market regulation (column D); on the other hand, countries with an armed corporate governance regime have relatively higher values in terms of product market regulation (column D).

As a result, from complementarities among domains of corporate ownership, labour protection and product market regulation, two species of capitalism derive: disarmed capitalism (disarmed corporate governance and *low* barriers to entry in the product market) and armed capitalism (armed corporate governance and *high* barriers to entry in the product market).

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[44] Olson (n 16).

[45] For instance, Nancy Rose provided evidence that union workers in the trucking industry obtained part of the monopoly rents accruing to the trucking firms' owners from the industry's weak competition. Nancy L. Rose, 'Labor rent sharing and regulation: Evidence from the trucking industry' (1987) 95(6) Journal of Political Economy 1146.

[46] Of course, regulation could lower barriers to entry of markets if they are dominated by 'outsiders.' For example, European regulations such as the Digital Market Act and Digital Services Act, which restrict dominant companies (typically non-European) and pave the way for European digital operators to access these markets, could be seen as a political demand from European players.

[47] Giuseppe Nicoletti, Stefano Scarpetta & Oliver Boylaud, 'Summary Indicators of Product Market Regulation with an Extension to Employment Protection Legislation' (2000), OECD ECO Working Paper no. 226.

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3. THE CONSEQUENCES FOR COMPETITION

Firms compete in financial capital, human capital, and product markets, and exploit their corporate governance structure to attract investors, talents, and consumers, including those with attention to prosocial corporate purposes. This section analyzes competitive forces in the capital, labour, and product markets of the two species of capitalism. We find mixed results. On the one hand, the concentration of corporate ownership can create or increase transaction costs in capital markets and reduce competitive forces. On the other hand, the presence of a controlling shareholder, because it may reduce agency costs, may work to the advantage of investors,[48] attracting new investors and strengthening competition in the capital market. Similarly, as we argue in Section 3.2, the regulation of labour and product markets may generate transaction costs and friction to competition but also incentives to make specific investments in human capital and innovation, thus increasing (and not reducing) competition in labour and product markets.

3.1 Competition in Capital Markets

According to the legal origin theory, the concentration of shares in a large public company reflects a poor quality of corporate law, particularly legislation in defence of minority shareholders from managerial discretion. Consequently, investors in capital markets cope with poor minority shareholders' protections by concentrating corporate ownership. In a context with controlling shareholders, competition in the capital market is weakened for at least two reasons. First, relatively low protection of minority shareholders (on which the concentration of corporate ownership depends) may discourage new investors and investments. Second, the presence of a controlling shareholder may make it more difficult to contend for corporate control and its benefits – there is a block of shares and voting rights that can limit hostile takeovers. Both conditions may create and increase transaction costs in the capital market. An investor cannot invest or reduce their investments in the capital market because legal protections are weak (e.g., minority shareholders' protections) and the benefits of corporate control are poorly contestable.

Nonetheless, controlling shareholders may and do monitor managers and, therefore, reduce agency costs, potentially increasing the firm's value,[49] *under certain conditions*.[50] For this reason, investors can be encouraged to invest by the presence of a controlling shareholder who monitors managers and limits their discretion. As long as the interests of controlling shareholders are aligned with those of potential and actual minority shareholders,[51] the presence of a controlling shareholder may protect their own investments as well as the investments

[48] However, a misalignment between the controlling shareholders and minority shareholders may arise, and this could cause a moral hazard for controlling shareholders at the expense of minority shareholders. The main issue of an armed equilibrium is whether the controlling shareholders shift firm value into their own pockets. See Barca & Becht (n 28).

[49] Andrei Shleifer & Robert W. Vishny, 'Large shareholders and corporate control' (1986) 94(3) Journal of Political Economy 461.

[50] See Barca & Becht (n 28).

[51] A similar argument can be formulated for common ownership and institutional investors. See Anna Tzanaki, 'Varieties and Mechanisms of Common Ownership: A Calibration Exercise

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of minority shareholders and attract new investors, strengthening (and not weakening) competition in the capital market. In other words, under certain conditions, the concentration of corporate ownership could be a protection not only for the controlling shareholder but also for minority shareholders, increasing the forces of competition in the market for corporate shares.

To sum up, competition in capital markets may be influenced not only by explicit, legal protections (minority shareholders' protections) but also by implicit protections such as those deriving from the concentration of corporate ownership. In this respect, the presence of controlling shareholders *both* reflects a poor legislative framework (particularly minority shareholders' protections), which discourages forces of competition in the capital market, *and* represents a mechanism that, by limiting managers' discretion, protects investments of controlling shareholders and, potentially, of minority shareholders, attracting new investors and encouraging (and not discouraging) competition in the capital market.

3.2 Competition in Labour and Product Markets

Because controlling shareholders have lower information, organization and lobbying costs than dispersed agents such as minority shareholders, the controlling shareholder is not only better able to monitor the conduct of managers (by reducing agency costs) but also to affect the choice of the rules by the rule-makers more than a minority shareholder.[52] In general terms, the power of controlling shareholders often includes the power to influence law and policy.[53]

One should observe higher barriers to entry into product markets in contexts where corporations are characterized by controlling shareholders than in contexts with corporations characterized by minority shareholders. Barriers to entry, moreover, create oligopolistic quasi-rents that increase the benefits of control and encourage the concentration of corporate ownership. Because controlling shareholders provide firms with financial resources without accessing external capital markets (even in an underdeveloped financial system), controlling shareholders enjoy oligopolistic quasi-rents for financing, call for trade protectionism and oppose the development of financial development and pro-competition policies.[54]

Although this is not prima facie a labour-oriented explanation, it could become so. Indeed, since in a functioning democracy the controlling shareholders do not necessarily get their way with the polity if voters do not agree, labour can play a role in buttressing the controlling shareholders. If labour obtains a portion of the rents that accrue to firms that lack sharp competition, then this sector of labour also disfavours financial development, which would

for Competition Policy' (2021) 18(1) Journal of Competition Law and Economics 168 (illustrating how 'concentrated' and 'diffuse' common ownership affect managerial and shareholder control).

[52] George J. Stigler, 'The theory of economic regulation' (1971) 2(1) Bell Journal of Economics and Management Science 3.

[53] Curtis J. Milhaupt, 'The (geo)politics of controlling shareholders' (2023) ECGI Law Working Paper 696.

[54] For instance, Raghuram Rajan and Luigi Zingales show that controlling shareholders often want to suppress financial market development, particularly if product market competition is weak, because easier access to financing for upstarts would more likely erode controlling shareholders' benefits of control. Raghuram G. Rajan & Luigi Zingales, 'The great reversals: The politics of financial development in the twentieth century' (2003) 69 Journal of Financial Economics 5.

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threaten their rents. They ally with controlling shareholders, either directly or more likely via political coalitions, to defeat financial liberalization:

> [W]ith the monopolies in place in a democracy, the benefited owners have to get other players' political support. Union and employee benefits, instead of being "grabs", could be "pay-offs" from owners, to keep political and internal support strong for hampering competitors. Or, slightly differently, employees and owners can coalesce politically, aiming to weaken competitors, both domestic and foreign, via blocking rules, subsidies and trade barriers.[55]

In other words, if controlling shareholders are not powerful enough to affect politics, then they could rely on other incumbent groups, such as organized labour. Economists have long acknowledged the potential role of labour unions as rent-seeking organizations. Since human capital risk cannot be diversified, workers will thus be induced to exert political influence not only at the level of worker claims but also in their riskiness, by choosing policies against unstable contestable markets. Large owners and incumbent workers can ally politically to reduce the force of competition in markets.

However, one piece of literature affirms that the species of corporate governance is complementary to the type of innovation.[56] In particular, armed corporate governance, which is characterized by controlling shareholders and a high level of workers' protection, supports activities with a 'modular' step-by-step progression (i.e., incremental innovation) that requires 'cooperation' among corporate actors. On the other hand, disarmed species of corporate governance, such as that in the US, characterized by dispersed owners and weak employee protections, stimulates all-or-nothing innovation (i.e., radical innovation), providing greater flexibility of work and capital.[57] Hence, in armed equilibrium, actors should be more willing to invest in *specific* and *co-specific assets* a la Williamson,[58] while in disarmed equilibrium, actors should invest more extensively in *switchable assets*. This is derived from the fact that the armed equilibrium provides "more institutional support for the strategic interactions required to realize the value of co-specific assets, whether in the form of industry-specific training, collaborative research and development, or the like".[59] In a few words, specific investments require committed factors of production (both capital and labour). In more general terms, to minimize the risk of hold-ups related to specific investments, it is desirable for the emergence of an environment with rigidity, for example, markets with a low level of competition. This suggests a (circular[60]) causation between the species of corporate governance and the level

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[55] Roe (n 7) 139.

[56] Colin Mayer, 'Ownership matters' (2000) (inaugural lecture, Bruxelles: Université Libre de Bruxelles); Hall & Soskice (n 7); Wendy Carlin & Colin Mayer, 'Finance, investment, and growth' (2003) 69(1) Journal of Financial Economics 191; Cf also Vatiero (n 43); and Puca & Vatiero (n 26).

[57] See Hall & Soskice (n 7).

[58] Namely, investments which are costly to redeploy in alternative economic relationships. See Oliver E. Williamson, *The Economic Institutions of Capitalism* (The Free Press 1985).

[59] Hall & Soskice (n 7) 17; see also Vatiero (n 6).

[60] If the aforementioned causation exists from the corporate governance regime to the development of a kind of innovative sector, it occurs both ways. Nations with more developed radical sectors have more flexible productive factors (labour and capital). In contrast, in nations with more developed incremental sectors than radical ones, economic agents require a higher level of protection and stability of their assets (both capital and labour). That is, while incremental sectors are

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of market regulation. Armed corporate governance is more stable and, therefore, stimulates specific investments, while disarmed corporate governance is more flexible and, therefore, supports general-purpose and switchable investments.

This leads to two sets of results, one concerning competition in the labour market and the second one regarding competition in the product market. First, the possibility of higher rents, deriving from protections of the labour market, encourages investments in human capital, leading to more skilled workers who compete in the labour market (with respect to contexts with low protections), increasing the *quality* of competition in that market. Several empirical studies have shown this positive relationship between employment protection and investments.[61] This implies that, because firms compete for talent, more protections (although representing transaction costs, such as hiring and firing costs) in the labour domain might improve the supply of labour and increase (and not decrease) competition.[62] In this respect, high labour protections, on the one hand, symbolize friction that has a negative impact on the forces of competition in the labour market; on the other hand, they denote an incentive to make investments in human capital, potentially encouraging (and not discouraging) competition in the labour market.

The second set of results concerns competition in the product market. We have seen that restrictions in the product market can protect and spur specific investments, and hence those restrictions could stimulate competition in that product market, rather than reduce it, for products that need these specific investments. In this respect, controlling shareholders, high labour protection and high barriers to entry *all* represent transaction costs that discourage forces of competition in the product market, *and* imply an incentive to make investments in products, potentially encouraging (and not discouraging) competition in the product market – markets with firms that have made specific investments will experience (more) competition based on the quality of products rather than on their price.[63]

These mixed arguments on competition in the financial capital, human capital, and product markets in different species of corporate governance and capitalism are quite similar to the ones we can provide in Section 4 when we deal with the pursuit of prosocial goals.

4. SPECIES OF CG AND CAPITALISM AND PROSOCIAL CORPORATE PURPOSES

In this section, we investigate why and how different species of capitalism (armed vs. disarmed capitalism) may differ in pursuing prosocial corporate objectives. Note that *if* the corporation

based on committed assets (both capital and labour), radical sectors are characterized by more flexibility of assets. See Hall & Soskice (n 7).

[61] For instance, Viral V. Acharya, Ramin P. Baghai & Krishnamurthy V. Subramanian, 'Labour laws and innovation' (2013) 56(4) Journal of Law and Economics 997; and Viral V. Acharya, Ramin P. Baghai & Krishnamurthy V. Subramanian, 'Wrongful discharge laws and innovation' (2014) 27(1) Review of Financial Studies 301.

[62] Scandinavian species of capitalism may represent an exception in some of these abovementioned aspects, however. Cf Bob Hanckè (ed), *Debating Varieties of Capitalism: A Reader* (Oxford University Press 2009).

[63] Hall and Soskice (n 7). See also Vatiero (n 6).

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can self-correct and realign its corporate purpose to social objectives, then state intervention is no longer necessary.

4.1 Large Corporations in a Disarmed Capitalism may Pursue Prosocial Corporate Purposes

There are several arguments *for* disarmed capitalism which can be advanced. Large corporations in disarmed capitalism may pursue prosocial objectives because they are more exposed to competition for attracting investors, talent, and consumers who pay attention to social, ethical, and environmental issues. So more competition leads to more prosocial objectives. This is supported by two recent facts. First, there has been a rise in demand for prosocial corporate purpose by investors, workers and consumers.[64] Second, this demand is related to and amplified by the spread of digital technology that permits individuals, especially young ones (i.e., millennials), to use technology and populate online communities (e.g., Reddit, WhatsApp, Twitch, X, Facebook) to share economic choices and thoughts, overcome traditional collective action problems, and, for instance, invest (e.g., via Robinhood).[65]

According to Sergio Gramitto Ricci and Christina Sautter, by 2030 millennials will inherit approximately $68 trillion in the greatest intergenerational wealth transfer in history, while Gen Zs' spending power will surpass that of millennials by the early 2030s.[66] More than preceding generations, these young agents are willing to receive a lower economic return if the firm promotes sustainability.[67] As investors, by gathering online and forming a community bond, "wireless investors" are able to act collectively, and for this reason, they want to be involved in corporate decision-making processes, in particular through shareholders' meetings.[68] That is, these investors may threaten entry to engage with voice (especially in shareholders' assembly) or threaten to exit. The situation is similar but with some differences for consumers and workers. Consumers and workers, coordinated by social media, can *only* threaten to exit to punish a firm that does not follow prosocial objectives. For example, in the palm oil boycott, coordinated and facilitated by social media, bar owners and workers banned the use of palm oil in shops and consumers removed palm oil from their baskets.[69] Then, corporations in disarmed capitalism may pursue prosocial objectives because they are more exposed to competition than corporations in armed capitalism for attracting young investors,

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[64] See Barzuza et al. (n 9) (showing the rise in demand for prosocial objectives).

[65] However, digital technology can also produce negative consequences: Financial influencers or "finfluencers" have dangerously spread misleading financial information that has harmed millennial investors. See Tamra Manfredo, 'How to make $1 million in thirty seconds or less: the need for regulations of finfluencers' (2023), available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4398463.

[66] Sergio Alberto Gramitto Ricci & Christina M. Sautter, 'The wireless investors movement' (2022), available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4033921.

[67] See, e.g., Sergio Alberto Gramitto Ricci & Christina M. Sautter, 'Corporate Governance Gaming: The Collective Power of Retail Investors' (2021) 22 Nevada Law Journal 51; Gramitto Ricci & Sautter (n 66); and Barzuza et al. (n 9).

[68] See Gramitto Ricci & Sautter (n 66).

[69] For instance, see Oliver Balch, 'Meet the people and businesses boycotting palm oil' *The Guardian* (London, 10 March 2015) online version available at: https://www.theguardian.com/sustainable-business/2015/mar/10/people-businesses-boycotting-palm-oil-sustainability.

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workers and consumers coordinated by social media that are more concerned about social and environmental objectives than traditional investors and consumers in the past. In a context more exposed to competition in the capital, human capital and product markets, firms are expected to take more voluntary steps to increase their prosocial objectives to attract these agents.[70]

In addition, large corporations in disarmed capitalism may pursue prosocial objectives because minority shareholders may be concerned about social and environmental issues. Reformulating and extending some insights of Elhauge,[71] Hart and Zingales *assume* that shareholder welfare could call for prosocial behaviours and/or ethical activities by the public company (e.g., a reduction of externalities).[72] For Hart and Zingales, since shareholder welfare (to be distinguished from market value, which is only about profit and dividends) also includes social and moral concerns or considerations, such as the reduction of externalities, the vote in the shareholders' meeting may determine the pursuit of prosocial goals as well.[73] Hart and Zingales, therefore, advocate a strengthening of the powers of the shareholders' meeting to pursue prosocial objectives.

4.2 Large Corporations in a Disarmed Capitalism may not Pursue Prosocial Corporate Purposes

However, there are also arguments *against* disarmed capitalism. Considering Friedman's doctrine, shareholders have a single objective: the maximization of market value.[74] The famous acquisition of Twitter/X by Elon Musk seems to confirm this view. Prior to the Musk acquisition, Twitter/X had long promulgated commitments to look after the welfare of its employees – the so-called "tweeps". Instead, just a week after closing the Twitter deal, Musk executed mass layoffs, firing about 50% of the company's workforce of 7,500 employees. Also, for

[70] For sure, in capital markets, one can find both investors solely interested in profit and investors interested in prosocial objectives. According to Hart and Zingales (n 10), the presence of the former could reduce or eliminate ("amoral drift") the pressure of the latter in pursuing prosocial goals.

[71] Elhauge (n 9) writes, "maximizing shareholder welfare is not the same thing as maximizing shareholder profits" (at 783). For this reason, "some shareholders derive nonfinancial benefit from having corporate activities further their social and moral views, or that they would suffer social or moral sanctions from corporate violations of social or moral norms" (at 783).

[72] In their model, Hart and Zingales (n 10) consider a shareholder who assigns a 'weight' of 1 to social, environmental, and moral considerations. If the weight is 0, then the shareholder only considers profit, while a weight of 1 indicates the shareholder considers only prosocial goals (and follows a Kantian categorical imperative).

[73] In line with this hypothesis, see Malcolm Baker, Mark L. Egan, & Suproteem K. Sarkar, 'How Do Investors Value ESG?' (2022) NBER working paper, available at: https://www.nber.org/papers/w30708.

[74] Friedman (n 12). According to Friedman, pursuing prosocial objectives involves the "diversion" of other people's resources: to the extent that if the manager chooses to reduce dividends to follow prosocial objectives, he or she is spending shareholders' money, and workers' and customers' money. Social responsibility is a bit like, Friedman writes, as if the manager imposes taxes and decides how to spend them (without there being a political mechanism giving the manager a public legitimization for that and defining the limits).

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users, the acquisition of Twitter by Elon Musk implied a decline in the quality of information (evidence: prior to Musk's acquisition, Twitter/X suspended Trump's account for incitement of violence related to the attack on Capitol Hill; after Musk's acquisition, Trump's Twitter/X account returned).[75] According to Lucian Bebchuk, Kobi Kastiel and Anna Toniolo, when negotiating the deal, Twitter/X's shareholders (and managers) chose to *push their stakeholders under the* [Musk] *bus*.[76] Indeed, Twitter/X's shareholders (and managers) obtained large monetary gains from Musk, but they disregarded other stakeholders' interests, in particular Twitter/X's employees and Twitter/X's users. This is an example of the fact that disarmed corporate governance characterized by small shareholders could not lead to objectives that are beyond the maximization of market value.

In addition, corporations in disarmed capitalism may not pursue prosocial objectives because competition in the capital and product markets (more than in armed capitalism) does not leave room to abandon market value maximization. Indeed,

> [i]n robustly competitive economies, firms cannot deviate much from profit maximization for expensive corporate purpose programs […] In economies with slack competition, in contrast, monopolistic and oligopolistic firms can accommodate purpose pressure from their excess profits […] in competitive markets, the profit-oriented but purpose-pressured firm has no choice but to refuse the purpose pressure […] while in monopolistically organized industries, the purpose-pressure firm has more room to maneuver.[77]

The idea is that competition drives firms and managers toward profit-based purposes, limiting managerial discretion for prosocial objectives. More specifically, if we follow Friedman's doctrine, competition for corporate control then will not lead to non-profit objectives – while if we follow 'Hart and Zingales's assumption,' then competition may also pursue prosocial goals (see section 4.1).

4.3 Large Corporations in an Armed Capitalism may Pursue Prosocial Corporate Purposes

Large corporations in armed capitalism may pursue prosocial objectives because controlling shareholders are also concerned about social and environmental concerns. Indeed, if 'Hart and Zingales's assumption' holds for minority shareholders, this argument is even more relevant in the presence of a controlling shareholder. Consider a firm whose stock is 100% owned by an individual who pays attention to ethical, social, and environmental issues. The presence of a controlling shareholder reduces agency costs and makes the pursuit of prosocial objectives easier than in a diffused corporate ownership structure. In the clear words of Elhauge:

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[75] Cf Lucian A. Bebchuk, Kobi Kastiel & Anna Toniolo, 'How Twitter pushed stakeholders under the bus' (2023) 28 Stanford Journal of Law, Business, and Finance 307; and Adi Robertson, 'What Elon Musk's Twitter "free speech" promises miss' (April 15 2022) The Verge https://www.theverge.com/2022/4/15/23025120/elon-musk-twitter-free-speech-government-censorship. See also Caley Petrucci & Guhan Subramanian, 'ESG amnesia in M&A deals,' available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4594776.

[76] Bebchuk et al. (n 75).

[77] Roe (n 13), abstract.

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> For companies with a controlling shareholder, that shareholder is exposed to social and moral sanctions and has incentives to act on them, and thus controlling shareholders are well-placed to decide when to sacrifice corporate profits in the public interest. In contrast, the structure of large publicly-held corporations insulates dispersed shareholders from social and moral sanctions and creates collective action obstacles to acting on any social or moral impulses they do feel.[78]

Note that controlling shareholders can even be interested in prosocial objectives because they want to escape direct intervention by the state. In other words, if the firm follows prosocial objectives, it can reduce the probability of state intervention and regulation, which could be more severe.

In addition, large corporations in armed capitalism may pursue prosocial objectives because workers may support such prosocial objectives. In armed corporate governance, workers have a relevant role in the governance of the firm (see Figure 3.1, column B on workers' voice). They could collect and encourage issues that are beyond the maximization of profits and that also include workers' interests. In line with this view, Jean Tirole advanced the idea of generalized codetermination, wherein the governance of the corporation involves *all* corporate actors that are exposed to externalities produced by the firm (workers, consumers, local community, etc.).[79] By this generalized codetermination, stakeholders would be able to correct externalities without an explicit intervention of the state.

Also, corporations in armed capitalism may pursue prosocial objectives because oligopolistic rents in the product market may leave room to abandon market value maximization and open the door to prosocial objectives. Indeed, barriers to entry and oligopolistic rents (which are characteristics of armed capitalism) may leave room to abandon market value maximization and open the way for prosocial objectives. As Einer Elhauge underlined years ago, for following prosocial objectives – "to sacrifice corporate profits in the public interest"[80] – managers need competition not to limit their discretion excessively. Mark Roe collects considerable evidence supporting this hypothesis. Managers at firms "in weak competitive markets work less assiduously for shareholder value than at firms facing more severe product market competition […] Weak competition gives more executives more leeway and more freedom from shareholders […]"[81] That slack gives a manager more room to manage and, in that case, to follow prosocial objectives. In this respect, Roe adds,[82] the manager can also decide to follow prosocial objectives to limit direct intervention by the state. Hence, even if weak competition does not alone cause an increased uptake of prosocial purpose, prosocial purpose can succeed more often in a less competitive context (as armed capitalism) than in a more competitive one (as disarmed capitalism).

4.4 Large Corporations in an Armed Capitalism may not Pursue Prosocial Corporate Purposes

There are also several arguments *against* armed capitalism. First, corporations in armed capitalism may not pursue prosocial objectives because controlling shareholders are concerned

[78] Elhauge (n 9) 733–734.
[79] Tirole (n 20).
[80] Elhauge (n 9) 738.
[81] Roe (n 13) 19–20.
[82] Roe (n 13).

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only about private interests, i.e., money and profits. This is a reformulation of Friedman's doctrine (which is in opposition to the abovementioned Hart and Zingales's assumption): if the controlling shareholder has only profit objectives, then, because agency costs are reduced, it is (more) likely that the firm will not follow prosocial objectives (than a large corporation with diffused corporate ownership). Indeed, after the acquisition of Twitter, Elon Musk, the new controlling shareholder, fired about 50% of the company's workforce and diminished the quality of information for users.[83]

In addition, as the agency costs are reduced (due to the presence of a controlling shareholder), corporations in armed capitalism may not pursue prosocial objectives because managerial discretion is reduced. According to Blair and Stout's theory,[84] only if the manager serves as an independent arbiter or outsider (implying higher agency costs) among stakeholders will the manager follow and safeguard the interests of all stakeholders, including the local community, workers, etc. This implies that armed corporate governance reduces the discretion of managers more than disarmed corporate governance, limiting their potential pursuit of prosocial corporate objectives.

Finally, corporations in armed capitalism may not pursue prosocial objectives because workers (or other stakeholders involved in corporate governance) may support only private groups' objectives (instead of social objectives). Some years ago, Williamson noted the risk that labour unions could conspire with one group of employers to improve wage rates, while also disadvantaging new entrant employers.[85] By doing so, workers obtain private benefits (higher wage rates), but social costs are created, such as barriers to entry for new entrants and a higher price for consumers. More generally, this suggests the risk that workers may support Mancur Olson's group interests[86] (higher wage rates and job stability) even if it may imply social costs. In this respect, armed corporate governance, where workers play a pivotal role, can reduce (instead of increase) prosocial corporate purposes.

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[83] Cf Bebchuk et al. (n 75); and Robertson (n 75). Even if, quite ironically, in an interview, Elon Musk said that his offer to acquire Twitter/X had been made for the public interest: "Twitter has become kind of the de facto town square. So it's just really important that people have both the reality and the perception that they're able to speak freely within the bounds of the law," Mia Sato, 'Buying Twitter 'is not a way to make money,' says Musk in TED interview' (April 14, 2022) The Verge https://www.theverge.com/2022/4/14/23025343/elon-musk-twitter-takeover-ted-talk-quote-stock-buyout.

[84] In Blair and Stout's theory, the firm is a nexus of specific investments by stakeholders (including workers and the local community). The manager should serve as an independent arbiter or outsider among stakeholders (mediating hierarchy). If the manager is an outsider, s/he will protect and encourage firm-specific investments in team production by all team members (including workers and the local community). This corporate governance structure increases (and does not reduce) agency costs to protect specific investments by all stakeholders. See Blair & Stout (n 17).

[85] Oliver E. Williamson, 'Wage rates as a barrier to entry: The Pennington case in perspective' (1968) 82(1) Quarterly Journal of Economics 85.

[86] Olson (n 16).

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5. CONCLUDING REMARKS

Because large corporations compete in financial capital, human capital and product markets, might they self-correct their corporate purposes, aligning their purposes to the interests of the whole society (and eliminating the necessity for state intervention)? This chapter argues that there is no one-size-fits-all answer because the preferences of economic agents – whether solely focused on profits or also interested in prosocial objectives – matter in the pursuit or lack of pursuit of prosocial goals.

The corporation will pursue prosocial corporate objectives *if* shareholders have prosocial interests (as in Hart and Zingales's assumption), and they can direct the firm. In this sense, armed corporate governance with a controlling shareholder (because it reduces agency costs) should work better than disarmed corporate governance. However, the answer is no *if* the shareholders (minority or controlling shareholders) may be concerned only with profits (as the Twitter/X case seems to confirm), in accordance with Friedman's doctrine. Moreover, one should also consider the identity of the controlling shareholder. State-owned companies present a noticeable case. On the one hand, a state that strives to reduce externalities (e.g., pollution) in its jurisdiction would also be expected to put companies it controls on a more sustainable path. On the other hand, when a state that is currently unwilling or uncommitted to reducing those externalities is a controlling shareholder, achieving prosocial corporate purposes in companies controlled by that state becomes more difficult.

In addition, disarmed corporate governance leaves a degree of discretion to the managers (because there is not a controlling shareholder), and managers with a degree of discretion may pursue objectives that are beyond profits. Instead, armed capitalism may work better to pursue prosocial objectives than disarmed capitalism because workers in the former have enough power to affect corporate purposes and extend its objectives towards prosocial purposes. However – and this is a limit that can characterize armed capitalism – workers may pursue private interests instead of social purposes.

Finally, given the interplay of agents' (e.g., shareholders', investors', workers', consumers', managers') prosocial preferences and competitive forces, under certain conditions, oligopolistic rents in the product markets (as in armed capitalism) may leave room for prosocial objectives. Under other conditions, more competitive product markets (as in disarmed capitalism) may push firms to attract (a young and digitally coordinated class of) prosocial consumers, leading to an increase in prosocial objectives.

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4. Corporate Governance and Antitrust: Lessons from Japanese Occupation Policy

J. Mark Ramseyer

At root, corporate governance and competition policy involve distinct and largely unrelated issues. Governance goes to the way men and women associated with the firm decide what it will do. Competition policy goes to the relations among firms in an industry. Governance involves decisions internal to the firm – primarily among shareholders, senior officers, and boards of directors. Competition policy involves relations external to the firm – primarily among firms in the same or adjacent industries.[1]

Unfortunately, after the Second World War, the Allied (primarily U.S.) forces in Japan confused governance and competition. With the thought that diversified conglomerates exploited consumers, they dissolved the largest of the conglomerates. Based on the thought that those who owned multiple firms (in any industry) exploited consumers, they banned holding companies.

I begin by detailing the nature of the concepts of governance and competition (Section 1). I then discuss the way Allied forces confused the two ideas (Section 2). We conclude with a summary of the resulting implications for post-war Japanese growth (Section 3).

1. GOVERNANCE AND COMPETITION: THE LOGIC

1.1 Governance

Some people have money, but not the ideas or skills they would need to use that money to make more money. Some people have the ideas and skills, but not the money. Sometimes, the two groups decide to work together. The former put up the funds. The latter use the funds to create and run a profitable business.

To engineer this collaboration, people typically use a legally organized firm. Most commonly in the West and in Japan, they structure their firm as a corporation. Less commonly, they might structure it as a partnership or a limited liability company. But whatever the legal form, the people with the money usually agree to act as what economists once called the "residual claimants". The people with the ideas and skills agree to work (e.g., as "officers") for wages (all or at least partially fixed). The firm will usually pay the people with ideas and

[1] As Florence Thépot elegantly put it: "Competition law is oriented towards the defence of consumers' interests in the market, while corporate governance rules are designed to protect the interests of shareholders." Florence Thépot, *The Interaction Between Competition Law and Corporate Governance: Opening the 'Black Box'* (Cambridge University Press 2019) 1. Please understand that I base some of this material on (and borrow from) both my own prior work and my joint work with Professor Yoshiro Miwa.

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skills first, and the people with the money will agree to stand last in line for their share of the firm revenue.

Should the people involved decide to use the corporate form, the investors will become the "shareholders". They will decide fundamental issues such as whether to merge or liquidate the firm, and will choose the team of people to supervise it. That team – called the board of directors – will then use the funds advanced by the investors to hire the officers who will run it day-to-day.

"Corporate governance" concerns the rules and principles by which the investors on the one hand, and the board and officers on the other, work together to run the firm. Under the default terms of U.S. corporate law, every year shareholders elect people to the board of directors. They do so under one-share, one-vote rules. In turn, the elected board then makes most of the major decisions itself (or delegates some to committees). By majority vote, it hires and fires the salaried officers. They, in turn, make operational decisions, and hire the other employees.

Japanese corporate law gives roughly similar terms. Shareholders vote on mergers and liquidations, and elect the members of the board. The board hires the officers. Subject to a variety of constraints, the board can opt to hire a statutory auditor, and opt to use committees.

In both the U.S. and Japan, investors can decide to work through general partnerships rather than corporations. In both the U.S. and Japan, under the default terms of the law, they can then participate directly in operational management. And in both countries, investors tend to use the partnership form more readily for small firms than for large.

1.2 Governance and Competition

This discussion leads to several basic observations about corporate governance and competition. First, the former concerns a firm's operations internally, while the latter concerns its relations with other firms externally. Second, simple logic suggests no reason why any particular governance arrangement under corporate law would have any determinate impact on competition.

The arrangements by which investors and the officers agree to make decisions might plausibly affect affairs internal to the firm. It is not obvious why they would affect the way that firm competes against other firms in the market. The governance rules could sometimes affect the way a firm competes. The compensation structure for the officers could affect the strategies they adopt. One investor might urge more aggressive pricing structures than the others, and the firm's governance rules might affect the impact he or she has on that firm. One officer might be more cerebral than another, and the governance rules might affect her power to change firm policy. The governance structure could potentially change a firm's market behavior, in other words, but it is not clear why any structure would have a *determinate* effect.

1.3 Governance and Firm Boundaries

If corporate governance reaches the boundaries of the firm, consider where investors and managers might choose to locate those boundaries. Investors and managers need not place their productive activities within a single firm. As Coase pointed out nearly a century ago, they could decide instead to cooperate across firm boundaries.[2] Suppose that a productive

[2] Ronald H. Coase, 'The Nature of the Firm' (1937) 4 Economica 386.

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operation touches two distinct sectors. The sectors might involve distinct products, distinct geographical areas, or distinct market segments.

On the one hand, the investors and managers might decide to place the two-sector operation within a single firm. They could produce the product (or service) as part of general, undifferentiated firm operations. Alternatively, they might target the two sectors through separate divisions within the same firm, with the board overseeing both. They might hire one set of senior officers to supervise both production processes, or they might hire two separate sets of officers for the distinct processes.

On the other hand, the investors and managers might choose to place the productive operations targeting the two sectors in two distinct corporations. They could arrange the two firms in a wide variety of ways. For example, all of the investors could each own shares of both of the two firms. Alternatively, the investors could decide to limit their direct investment to one firm, and have that firm own all of the shares of the other. Or the investors might decide to form a third firm. They would own the stock of this third firm, and that firm in turn would own the shares of the other two firms. We would then call this third firm a "holding company".

Again, the competitive consequences of these various structures are not obvious. The investors could own a firm that has two divisions. They could own two firms directly, with each operating one of the distinct operations. They could own one of the firms with a distinct operation, and have that firm own the stock of a separate firm that operates the other distinct operation. Or they could own a holding company that owns the stock of the two operating companies, each with one of the distinct operations.

In all of these variations, one group of investors will hold the residual interests in all of the productive operations and will control the main decision-making processes. The accounting rules that apply to the productive structure may differ. The tax consequences may differ. Regulatory restrictions may differ. But whichever structure the owners decide to use, the same group of people will hold ultimate control over the same operations. To state the obvious: holding constant the identity of the investors and the identity of the managers (and recognizing the ability of parties to the transactions to adjust legal obligations by contract), it is not clear why the location of the firm boundaries should have any determinate effect on how a given productive operation competes in a market – it could have a wide variety of effects, but it is not clear why it would necessarily have any particular determinate effect.

1.4 Make or Buy

Now suppose that a firm makes only one product, but that the product requires several component parts. The investors and officers have a choice: they can make those component parts themselves, or they can buy them from separate component-making firms. Restated a bit differently: the firm could buy (or form) a component-making firm (i.e., vertically integrate, and bring production in-house), or it could buy the components from another firm as a free-standing supplier. As stated in classic industrial organization terms: the firm can make or buy.

Suppose investors own a firm that makes automobiles. To make a car, it needs an engine, a car body, assorted electronic components, wheels, and many other parts. It could make all of those components itself. Alternatively, it could buy the engines from an engine maker, the bodies from a coachmaker, the electronic components from an electronics firm, and the wheels from yet another firm.

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It is not obvious what strategy a firm should choose. It could make its own engines, or it could buy its engines from an independent engine-making firm. Neither strategy necessarily dominates the other. As Ronald Coase (again) explained it, the choice turns on the relative transaction costs of contracting within the firm and contracting across the market. Both sets of costs are non-trivial, and neither necessarily is higher than the other.

For the most part, Japanese car makers tend to buy their components from wholly or partially owned corporate subsidiaries. American car makers have tended to make their components themselves. But exceptions abound. The British company Lotus has bought engines from Toyota, and Toyota has bought engines from Subaru. Toyota has also bought engines from BMW, and Lotus has bought engines from Cosworth and Mercedes-Benz. From time to time, Cosworth itself has been independently owned, owned by Ford, and owned by Volkswagen.

To return again to the question at stake: it is not obvious why any of these choices would have any determinate effect on market competition. If a firm can make a better (and cost-effective) engine for its cars itself than it could obtain from another firm, it will make it itself. If it can buy a better engine from another firm, it will buy its engines. But economists explained decades ago why – in general – firms cannot cost-effectively leverage any monopoly power in one segment of the market into another.[3] Whether a firm makes or buys components should not – in general – affect market competition.

2. THE ALLIED OCCUPATION CHANGES

2.1 Introduction

When the Japanese economy slipped into depression during the 1920s and 1930s, several wealthy families seemed to do better than most. In fact, they had not adopted any particular strategy. They were not investing in military-related products more than most firms. They were not bribing politicians more than most firms. In competitive economies, some firms succeed where many firms fail. For whatever idiosyncratic reasons, these were simply the firms that succeeded.

When the American-controlled Allied occupation arrived in 1945 to reconstruct Japanese society, they brought a populist suspicion of wealthy investors. Some of the wealthy families had used holding companies to coordinate their investments. Like Japanese populists of the

[3] Aaron Director & Edward H. Levi, 'Law and the Future: Trade Regulation' (1957) 51 Nw. U.L. Rev. 281, 290–92.

> Suppose two products, X and Y, have value only when used together, and that firm A has a monopoly on product X. In this scenario, A cannot increase its monopoly rent by trying to monopolize the market for Y. First, because X and Y have value only when used together, there is a profit-maximizing monopoly rent that can be charged for the two products combined. Second, A's control over X necessarily serves as a choke-point. As a result, A can add that entire monopoly rent for the combined two-product set to the price it charges for X. In other words, if A controls the output of X, A will add to the price it charges for X an amount that includes the maximum monopoly rent that can profitably be charged for the combined X-Y set. Necessarily, A earns no additional profit from monopolizing Y as well.

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time, the occupation officials decided that the family-owned conglomerates must have been exploiting consumers in the end markets. They also decided that the governance arrangements among these firms had enabled them to manipulate those end markets. To stop the exploitation, they dispossessed the families, and shuttered some of their firms. Determined to prevent any resurgence, they banned holding companies.

2.2 Zaibatsu

2.2.1 The groups

By the mid-1930s, several family-owned conglomerates had grown to the point that they played unusually large roles within the economy. Each of the conglomerates had little in common with the others. They had all gained their prominence primarily through market competition. In any economy, many firms fail, some survive, and a few thrive. Over the course of the first three decades in 20th century Japan, these were the firms that happened to have thrived. And as they did, they had expanded into other industries.

But by the 1930s, Japan was mired in its segment of the international depression. Muckraking journalists went looking for people and firms to blame, and these family-owned conglomerate firms that happened to have thrived presented easy targets. The journalists came to call them "financial cliques" (zaibatsu), but "robber barons" would be the idiomatic equivalent. The term was not technical, was not economic, and was not legal. It was simply the pejorative term that populist journalists invented for those firms on which they decided to blame the depression.

Of these conglomerates, four were particularly well-known. Given the informal nature of the "zaibatsu" epithet, one could easily add another half dozen, but most observers have focused on Mitsubishi, Mitsui, Sumitomo, and Yasuda. Mitsubishi had begun as the Iwasaki family's ocean-shipping enterprise in the late 19th century. From there, it expanded into finance and manufacturing. Mitsui, controlled by the Mitsui family, had roots in a 17th-century fabric store. Sumitomo, controlled by the Sumitomo family, had its roots in a 16th-century copper-working operation. Both Mitsui and the Sumitomo expanded into finance and manufacturing as well. The Yasuda conglomerate was smaller, dated from a 19th-century currency trader, and operated primarily in finance.

In each of the four conglomerates, control rested with a holding company. Generally, the family owned the holding company, and through it invested in the component firms. The holding company could be a corporation or a partnership, and many (if not most) of the firms generally grouped within the conglomerate were only partially owned (directly or indirectly) by that holding company.

It is worth noting the extent to which all this varied. By the time of the occupation's dissolution program, the Iwasaki family no longer owned its holding company. Instead, in 1940 it had sold off half of the stock in the holding company to 20,000 investors. It was no longer a family operation at all.[4] After 1942, the Mitsui holding company was no longer owned only by the family either.

[4] E.g., Matao Miyamoto, 'Sangyoka to kaishaseido no hatten [Industrialization and the Development of the Company System],' in Shunsaku Nishikawa & Takeshi Abe (eds), *Sangyoka no jidai [The Age of Industrialization]* (Iwanami shoten 1990) 351, 387.

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As in most modern societies, some of the wealthy industrialists associated with the zaibatsu tried to cultivate ties with politicians and government leaders. For the most part, however, they did not support the war effort enthusiastically. They understood the (fairly obvious) point that war with the U.S. was not likely to end well. For their perceived mercenary rather than patriotic commitments, rightist terror groups targeted several zaibatsu leaders during the 1930s. An assassin from the "Blood Pledge Corps" shot and killed Takuma Dan, the CEO of the Mitsui operations, in 1932. Two Mitsubishi senior executives and two other Mitsui senior executives were on its hit list as well, and two months later another group tried (unsuccessfully) to bomb the Mitsubishi Bank.[5]

From time to time, writers have claimed that the zaibatsu conglomerates succeeded by manipulating the credit market to their advantage. The conglomerates did indeed own banks and insurance companies. But the member firms had not succeeded because of any resulting preferential access to credit. For the most part, the conglomerate firms simply did not borrow heavily. A variety of financial variables held constant, they did not rely on debt more than other firms. Instead, they relied less. More generally, the successful firms in prewar Japan did not borrow heavily; they relied instead on the stock market.[6]

2.2.2 Happenstance

In most societies, the allocation of assets is in part – sometimes a large part – an artifact of the tax program in place either currently or in the past. Within the U.S., business profits are taxed at the firm level if the firm is incorporated, and at the investor level if it is a partnership. When personal tax rates are high but corporate rates are low, investors tend to place their assets in corporations and reinvest the firm's earnings. When corporate rates are high but personal rates are low, they sometimes turn to partnerships.

During the 1905 war with Russia, the Japanese government raised taxes. Partnerships and corporations with 20 or fewer shareholders faced a graduated tax of 4 to 13 percent. Corporations with 21 or more shareholders faced a flat 6.25 percent rate.[7]

Predictably, the 1905 tax led firms (whether zaibatsu or otherwise) to incorporate, and to sell shares broadly. During the 1910s, incorporations rose. The Mitsubishi partnership spun off its internal divisions as separately incorporated entities. In 1916, the Sumitomo Bank sold 30,000 shares to the public. In 1919, the Mitsui Bank sold 800,000 shares to the public.[8]

In 1920, the government imposed higher graduated rates on all firms. As it did, the relative share of partnerships among business firms again rose. The 1920 reform also taxed distributions from a corporation at the investor level. Predictably again, wealthy investors formed holding companies to park their dividend distributions.[9]

The shareholdings that the zaibatsu dissolution program attacked did not just reflect the economic success of a few wealthy investors. In part, they also reflected decisions by those investors about whether to make or to buy, and if to make, whether to make within a divisional structure or through wholly or partially owned corporations. And they further reflected more

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[5] John C. Roberts, *Mitsui* (Weatherhill 1989) 276–78.

[6] Yoshiro Miwa & J. Mark Ramseyer, 'Banks and Economic Growth: Implications from Japanese History' (2002) 45 J. Law & Econ. 127.

[7] Miyamoto (n 4) 381.

[8] Ibid 381–83.

[9] Ibid 384–86.

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basic tax planning: the various ways that those investors had responded to the fluctuation in tax rates and tax laws over the preceding half century.

2.3 The Mitsui Family[10]

As an example of the way a zaibatsu operation could evolve, take the quintessentially Japanese Mitsui enterprise. Among the pre-war conglomerates, the Mitsui was the largest and one of the oldest.[11]

The Mitsui traced their lineage to the 16th-century samurai Mitsui Takayasu. Having fought on the losing side of the battles against warlord Oda Nobunaga, Takayasu settled inconspicuously in Ise province near what is now the metropolitan Nagoya city. There in Ise, Takayasu's son Takatoshi would brew sake, make miso, and run a pawn shop. According to standard Mitsui lore, Takatoshi was not an especially talented merchant, but had married well. His wife (birth name unknown, posthumous name of Shuho) came from a merchant family and instinctively understood what it took to succeed in business. After Takatoshi died young, it fell to Shuho to run the family businesses and raise their children. That the family stayed in business at all is something that the Mitsui histories attribute to Shuho's talent.

Takatoshi and Shuho had four sons and four daughters. Of the sons, one was adopted into another family and one died young. That left two. The oldest, Toshitsugu, moved to the capital of Edo (now Tokyo) and started a drapery store, and the youngest, Takatoshi (written differently from his father), followed him to Edo to learn the business.

As Shuho grew old, Takatoshi returned to Ise to care for her. He went back to Edo in 1673. More talented than his older brother, he now built a thriving business both in textiles and in finance. For his drapery establishment, Takatoshi set three unconventional rules: fixed prices (no haggling), payment in cash (no credit), and cloth cut to measure (his competitors insisted that buyers buy full bolts). In time, Takatoshi's drapery establishment would grow into the Mitsukoshi department store.

Takatoshi's financial operation also thrived. Crucially, he and his successors tried to avoid lending to the daimyo (the military and political overlords). The returns on these politically tied loans were high when times were good, but the daimyo sometimes defaulted. When they did, their creditors routinely went insolvent.

Upon his death in 1694, Takatoshi left his assets to his seven children. He specified the fractional interests of each, but instructed them to operate the family business collectively in unpartitioned form. Over the next several centuries, the seven component families would grow to eleven, but they continued to run the family operation in undivided form.[12]

To manage their collective business, Takatoshi's heirs formed a partnership called the "Mitsui omotokata." They did not use it as a holding company. Rather, they ran their various operations directly through the firm. The several family branches maintained a financial interest in the Omotokata, and (formally) had equal say in business decisions.

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[10] The history is well-known. See generally, e.g., John C. Roberts, *Mitsui* (Weatherhill 1989); Kamekichi Takahashi, *Nihon zaibatsu no kaibo [A Dissection of the Japanese Zaibatsu]* (Chuo koron sha 1930); Hidekichi Wada, *Mitsui kontsuerun dokuhon [The Mitsui Konzern Reader]* (Shunju sha 1937).

[11] This follows the standard Mitsui history.

[12] Miyamoto (n 4) 355–56.

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In 1868, several outlying domains launched a coup d'etat and ousted the Tokugawa regime. Nominally, they returned the title to the imperial family. In function, they created what would become a modern oligarchy (the Meiji regime). During the next decades, they would introduce a western (non-democratic) constitution, western-style courts, and German-based Civil and Commercial Codes.

The various Mitsui operations changed formal legal character several times. At one time, the component families had exercised their control through the Omotokata partnership. In due course, their Meiji successors transformed the firm into the Mitsui gomei gaisha (1909; this too was a partnership). These successors turned the family financial operations into Japan's first private bank, the Mitsui Bank (1876). Concomitantly, they created what would become the crucially important international trading firm, Mitsui Bussan.

Through these and other firms, the Mitsui promoted a wide variety of innovative new ventures. The Bussan website describes its pre-war predecessor as a "venture capital" firm.[13] Some of the family's enterprises failed, some succeeded, and a few succeeded spectacularly. The Mitsui bought the Miike coal mines in northern Kyushu. Through the Mitsukoshi department store, they invested in the Kanegafuchi (then Kanebo) cotton spinning firm. They invested in the predecessor to what would become the Toshiba electronics firm. They promoted (both through finance and as sales agent) the Toyoda weaving machine manufacturer that became the predecessor to Toyota Motors.[14]

The Mitsui family owned stakes in the various firms, but did not actually run the firms themselves. Instead, they hired the best talent they could, and rewarded success lavishly. Even the partnership at the apex of the operations (Mitsui gomei) was entrusted to non-family talent.

The Mitsui family did not use the Mitsui gomei partnership to constrain competition. They simply did not control substantial shares in multiple companies in the same industry. Neither did they (primarily) maintain a holding company to economize on Coase's transaction costs.

Instead, the Mitsui family invested through the Mitsui gomei primarily to coordinate and economize on their supervision costs. Together, the family members owned controlling stakes in firms in a wide variety of industries. To make their strategic decisions about investing or withdrawing funds, they wanted to act together. And to monitor the various firms, they needed talented and economically sophisticated business executives.

Toward these ends, the Mitsui family members invested collectively in the Mitsui gomei firm, and then hired the most talented executives. Hikojiro Nakamigawa helped to shift Mitsui out of unprofitable, politically connected finance, and into heavy industry. Takashi Masuda grew Mitsui's international commerce. And Takuma Dan – an MIT-trained mining engineer – promoted what was then the expanding, modern-at-the-time, coal mining industry.

On behalf of the family, the trained business executives invested in new firms, new ventures, and new technologies. As appropriate, they withdrew from what they saw as increasingly unprofitable industries. They borrowed, sold stock, and bought equipment, properties, and firms. But through the holding company, the family members acted together and under the direction of the best talent they could buy.

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[13] https://www.mitsui.com/jp/en/roots/1209870_7253.html.

[14] https://www.mitsui.com/jp/en/roots/1209872_7253.html.

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2.4 The Occupation

Yet this was not how occupation officials described the zaibatsu. Occupation official T.A. Bisson was among the most vocal of the zaibatsu critics. "[A]t the center of each of the economic empires controlled by Mitsui, Mitsubishi, Sumitomo, and Yasuda," wrote Bisson, "is a great bank with deposits running into billions of yen. From these four banks, with their associated or subsidiary trust, insurance and holding companies, radiates the corporate network which owns the factories, the mines, the shipping firms, and the commercial enterprises of Japan." Indeed, he continued, "[e]ight Zaibatsu concerns, together with the Emperor ... and some 3,500 big landlords, have held the country and its people as their economic fief."[15]

Bisson was also a spy for the Soviet Union. Hauled before Senate hearings and fired from an untenured post in Berkeley in 1954, he has played the martyr in academic hagiography ever since. Indeed, as a "progressive" scholar who stood by his principles at all costs, he earns an entire chapter in Schonberger's Occupation history.[16] But if some of the other occupation officials (most prominently E.H. Norman) possibly worked for the Soviets, Bisson leaves no doubt.[17] Instead, decoded wartime Soviet cables released in the 1990s forthrightly report his passing war-related documents to his handler from Soviet military intelligence.[18]

In 1946, economist Corwin Edwards led a team that would dissolve the conglomerates. That dissolution itself was not in question. As the "Edwards Mission" noted in its own report, its "assignment was to recommend ... the basic objective of destroying the power of the great Japanese combines ... ."[19] The families that owned the "zaibatsu," Edwards claimed, had fashioned an economy in Japan that "ends to hold down wages, to block the development of labor unions, to destroy the basis for democratic independence in politics." As a result, they were "to be regarded as among the groups principally responsible for the war."[20] Legal scholar John Haley observes that Edwards "and the other members of the mission did not discover undue concentration in any industry, nor did they find any pattern of effective price-fixing or production controls."[21]

That Edwards did not understand the Japanese economy did not matter. In 1947, the Occupation ordered 83 firms dissolved (or to have the shares they held transferred).[22] They included the big four holding companies, major firms like Nakajima Aircraft, secondary and

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[15] T.A. Bisson, *Japan's War Economy* (Institute of Pacific Relations 1945) vii.

[16] Howard B. Schonberger, *Aftermath of War* (Kent State University Press 1989) ch 3.

[17] See, e.g., James Barros, *No Sense of Evil* (Deneau 1986).

[18] See, e.g., Venona cable of June 16, 1943, available at www.nsc.gov; see also June 17, 1943 and June 24, 1943.

[19] Corwin D. Edwards, 'Report of the Mission on Japanese Combines', Part I (Dept. State Pub. No. 2628, Far Eastern Series 14, Mar. 1946) iii.

[20] Ibid at iii, vii; see generally Miwa & Ramseyer, 'Banks and Economic Growth' (n 6) 133.

[21] John O. Haley, *Antitrust in Germany and Japan* (University of Washington Press 2001), 30; see generally Yoshiro Miwa & J. Mark, 'The Good Occupation', Harvard John M. Olin Center for Law, Econ. & Bus. D.P. 514, May 2005; Miwa & Ramseyer, 'Banks and Economic Growth' (n 6).

[22] Kenji Sanekata, *Dokusen kinshi ho [Antimonopoly Act]* (Yuhikaku 1992, rev. ed.) 31.

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tertiary zaibatsu firms, and so forth.[23] Of these 83 firms, 42 were either liquidated or merged into other firms.[24]

To accomplish the dispossession of the families, the occupation required them to sell their stock to a "Holding Company Liquidation Commission." In return, it gave them national bonds payable 10 years in the future – and then promptly inflated the currency.[25]

Some members of the occupation pushed for far more than zaibatsu dissolution. Edward Welsh, an economics Ph.D., planned to shut down approximately 500 of the largest firms for the simple sin of being big. Obviously, this entailed closing some of the most successful Japanese industrial firms. He did indeed close the Mitsui and Mitsubishi trading companies. They had specialized in international trade, an obvious benefit for a society newly entering the international market. Washington intervened to stop him before he was able to close any more, but it is a mark of the cavalier approach that the occupiers took in the early years that he and a few compatriots were able to make such radical choices on their own.[26]

2.5 The Holding Company Ban

In 1947, the Occupation also banned all holding companies. That year, it imposed on Japan an antitrust statute. In Section 9 of the statute, it provided that:[27]

> The establishment of a holding company shall be prohibited.

In turn, in Subsection (c) of Section 9, it defined the holding company as:[28]

> [A] company whose principal business is to control the business activities of a company or companies in Japan by means of stockholding (including partnership share).

Given that the "control" over another company was part of the definition, the ban did not include companies that operated simply as investment vehicles.[29]

Japanese grammar being what it is, the statute did not specify whether a firm violated the Antimonopoly Act if it had stockholding as *a* principal business, or only if that stockholding was *the* principal business. The Japanese Fair Trade Commission (FTC) interpreted Section 9 to ban only "pure" holding companies. It banned firms that did nothing other than hold stock.

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[23] Eleanor M. Hadley, *Antitrust in Japan* (Princeton University Press 1970) 184; Ikuo Hattori, 'Kigyo kyoso no kihonteki ruru [The Basic Rules of Firm Competition]' in Michio Hamada (ed), '*Nihon kaisha rippo no rekishiteki tenkai*' *[A Historical Perspective on the Establishment of Japanese Company Law]* (Shoji homu 1999) 613, 641.

[24] Hattori (n 23) 641-2.

[25] Miwa & Ramseyer, 'The Good Occupation' (n 21); Yoshiro Miwa & J. Mark Ramseyer, 'Does Ownership Matter? Evidence from the Zaibatsu Dissolution Program' (2003) 12 J. Econ. & Mgmt Strategy 67, 73; Hadley (n 23) 183–84.

[26] Miwa & Ramseyer, 'The Good Occupation' (n 21).

[27] As quoted in Michiko Ariga & Luvern V. Rieke, 'The Antimonopoly Law of Japan and Its Enforcement' (1964) 39 Wash. L. Rev. 437, 462.

[28] As quoted in Mitsuo Matsushita & James L. Hildebrand, 'Antimonopoly Law of Japan -- Relating to International Business Transactions' (1972) 4 Case Western Res. J. Int'l L. 124, 147.

[29] Sanekata (n 22) 98.

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It did not preclude firms that had a substantial business from also holding large stakes in other firms. Given that the FTC implemented the statute, if the FTC decided not to challenge firms with major equity stakes in other firms, the interpretation held.[30]

An interpretation that banned a firm from having stockholding as *a* principal business would also have affected the internal organizational choices that a firm might make. Suppose a firm manufactures a product that involves several processes. It could organize itself with multiple divisions. Alternatively, for administrative reasons, it might want to place the various processes in wholly owned subsidiaries. To induce the managers of some of the processes to keep "skin in the game," it might want to place the processes in a partially owned subsidiary with the managers owning shares in them. An interpretation banning stockholding as *a* principal business would have precluded these choices.

Note that the FTC's decision to ban only those firms for which stockholding was *the* principal business transformed the holding company ban into only a minor inconvenience. To avoid the ban, a shareholder who wanted to coordinate his or her (or its, if a corporate shareholder) investments could form a holding company. Into it, he or she could place an operating business. Ergo, they could now avoid the ban.

By late 2022, Section 9 had been amended to read:[31]

> No company may be established that would cause an excessive concentration of economic power due to shareholding ... in other companies in Japan.

Section 10, however, provided:

> No company may acquire or hold shares of any other companies if the acquisition or holding of shares substantially restrains competition in any particular field of trade ....

In many ways, Section 9 is now largely redundant.

For all the fury with which the occupation government attacked the zaibatsu, the putatively crucial holding company ban of 1947 would not have applied to the Mitsui holding company anyway. The Mitsui family owned substantial land, primarily in Hokkaido, Korea, and Taiwan. Rather than place this land in a wholly or partially owned subsidiary, it managed this real estate portfolio directly out of Mitsui gomei itself. Because gomei had a "principal operating business" (real estate), it would not have constituted a "holding company" under the terms of the 1947 ban.

2.6 The Governance Effects of Zaibatsu Dissolution

Consider the effect of the dissolution program. Recall that it affected not just the four holding companies, but several dozen others. Given that most of the firms within each zaibatsu were in different industries, this dissolution did not affect either price-fixing or competition. Instead, the program potentially affected a firm's make-or-buy decision. First, if a firm had

[30] See generally Matsushita & Hildebrand (n 28) 174; Yoshio Kanazawa, *Keizai ho [Economic Law]* (Yuhikaku 1983, 2nd ed.) 165; Masahiro Murakami, *Gaisetsu dokusen kinshi ho [Antimonopoly Act Explained]* (Yuhikaku 1996), 48–49; Sanekata (n 22) 96–97.

[31] Act on Prohibition of Private Monopolization and the Maintenance of Fair Trade, Act. No. 54 of 1947, available at: https://www.jftc.go.jp/en/policy_enforcement/21041301.pdf.

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been vertically integrated, the zaibatsu dissolution did not affect the way it operated. The dissolution did not affect the internal operations of the firm and thus would not have touched intra-firm transactions. Second, if a firm had bought its component products or services from an independent firm across the market, the dissolution would not have affected its operations either.

Third— instead— the zaibatsu dissolution program disrupted transactions in which a firm bought (or sold) components and services from (or to) another firm wholly or partially owned by the same shareholder. In other words, suppose that a firm needed three inputs to manufacture its product. If it had produced the three inputs internally, the zaibatsu dissolution would not have affected its production. If it had bought the three inputs on the market, the program would not have affected its operation. However, if it had assigned each input to a wholly or partially owned subsidiary, then the Occupation may have (effectively) confiscated the input-manufacturing operation.

Put another way, firms that had chosen to structure their production across firm boundaries sometimes found their facilities confiscated. If a firm maintained a vertically integrated production process, the dissolution program did not disrupt its activities. If it maintained divisional structures within the firm, the dissolution program did not disrupt it. But if it had structured its production through a set of wholly or partially owned subsidiaries, then it potentially lost those facilities. Use divisions, and a firm kept its assets. Use subsidiaries, and the otherwise identical firm could lose its assets.

2.7 Postscript on the Keiretsu

It may be worth noting that nothing here has anything to do with any "keiretsu."[32] Sometime in the mid-1950s, the presidents of the former zaibatsu firms began meeting for lunch. The firms were now independently owned and operated. They never held more than trivial amounts of stock in each other. But the presidents had worked their way up their firms at a time when the firms were part of the same conglomerate. They apparently missed each other enough to meet for lunch from time to time. In time, journalists christened them the "keiretsu."

These formerly zaibatsu, now called keiretsu firms, continued to act as independent firms. They were – it is worth stressing – independently owned and operated. They sometimes made collective charitable donations and had a few common trade mark decisions from time to time. But otherwise, they met for a social gathering. One guess (just a guess): having climbed to the pinnacle of their firms, they enjoyed eating with people willing to tell them that a stupid comment was a stupid comment. For all the academic fascination with cultural variation, the appreciation for honesty and candor is at root universal.

The lunches could not have affected product market competition. A few of the firms (a steel company, a rubber company, a trading company) sold to other members of these presidential lunch clubs. But otherwise, they mostly sold into markets that did not overlap.

From time to time, observers (usually critics) have described the Japanese automobile firms as a "vertical keiretsu." Japanese automobile manufacturers have long bought their components from other firms. These other firms are separate corporations, and often the

[32] E.g., Michael L. Gerlach, *Alliance Capitalism: The Social Organization of Japanese Business* (University of California Press 1997).

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manufacturer holds a modest equity stake in them. The component makers often buy supplies from still other firms, and often hold an equity stake in these as well.

As of 2000, Honda bought components from about 280 firms. It maintained long-term relations with about 80 of the firms, and owned stock in a third of the 80. Many of these 280 suppliers were significant firms themselves.[33]

As of 2000, Honda bought its shock absorbers from three firms. Its most significant supplier had 2,800 employees itself, and bought its inputs from 200 suppliers. Some of these were small (e.g., stamping and machining firms). Others were large (e.g., steel producers). The tiered relationships continued down several layers.[34]

At root, for most of the post-war decades, the U.S. automobile manufacturers were vertically integrated in a way that their Japanese counterparts were not. The U.S. firms were more likely to "make." The Japanese firms were more likely to "buy." The decision reflects a wide range of basic decisions that trace their roots to Ronald Coase in 1937.[35] None of them had any obvious and determinate consequences for competition in the end-market.

3. GOVERNANCE, COMPETITION, AND JAPAN

3.1 The Context

Firms in Japan invested and traded in ruthlessly competitive markets during the half century leading up to the Second World War. As noted earlier, many firms failed and disappeared. Those entrepreneurs who had led the most successful firms invested those earnings across the economy, and muck-raking journalists christened them the "zaibatsu." They had invented the term themselves, and the idiomatic equivalent in English: robber baron.

For the most part, these successful entrepreneurs (the zaibatsu) did not invest in firms that monopolized an industry. Neither did they invest in multiple competing firms within a given industry. The industries that thrived during the pre-war decades in Japan were competitive industries, and that is where the zaibatsu leaders made their money. [36]

The Second World War decimated the Japanese economy. It left most firms either insolvent or nearly so, whether large or small. Formerly wealthy families lost their fortune, and the occupation government expropriated much of what was left. From the zaibatsu families, it expropriated their stock holdings. From middle- or upper-class farmers, it expropriated agricultural real estate.[37]

What Japan had left at the end of the war was human capital. It had experienced and sophisticated businessmen. It had experienced and sophisticated engineers. It had well-educated citizens who respected the economic opportunities that competitive markets provided and

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[33] Yoshiro Miwa & J. Mark Ramseyer, 'Rethinking Relationship-Specific Investments: Subcontracting in the Japanese Automobile Industry' (2000) 98 Mich. L. Rev. 2636, 2646.

[34] Ibid 2646.

[35] Coase (n2).

[36] See generally Miwa & Ramseyer, 'Does Ownership Matter?' (n 25); Yoshiro Miwa & Ramseyer, 'Banks and Economic Growth' (n 6).

[37] See generally J. Mark Ramseyer, 'The Fable of Land Reform: Leases and Credit Markets in Occupied Japan' (2015) 24 J. Econ. & Mgmt Strategy 934.

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elected politicians who largely maintained that market structure. Through those politicians, Japan maintained an environment in which the government protected private claims to scarce resources, enforced transactions involving these claims, and otherwise hesitated to intervene.

During the half century that followed the war, firms mostly invested and traded in competitive markets. As had happened before the war, many failed, some survived, and a few thrived. Government bureaucrats largely left firms alone.[38] Banks played little or no part in corporate governance.[39] The industries that thrived were mostly competitive, and that is where the successful entrepreneurs made their money.

3.2 The Story Told

Unfortunately, this is not the account of the Japanese economy that we read in the West. For most of the second half of the 20th century, Japanese economics departments staffed themselves overwhelmingly with Marxists. These men and women wrote about the economy themselves, and trained journalists who wrote about the economy. Neither understood market competition.

Western scholars who travelled to Japan to study the economy mostly came from political science departments. Back at their home universities, they were (this being the 1970s, 1980s, and 1990s) feuding for funds and posts with the economics departments. They did not understand market competition either.

The accounts of the Japanese economy that we read illustrate the way late 20th-century Marxist economists and economically illiterate political scientists might imagine a successful economy. Company presidents sometimes met for lunch; their firms must have cooperated (and for these firms, the economists and journalists coined the word "keiretsu"). Firms parked funds in the market; they must maintain cross-shareholding arrangements. Executives never discussed these cross-shareholding arrangements; the arrangements must be "implicit." Some

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[38] See generally Yoshiro Miwa & J. Mark Ramseyer, 'Capitalist Politicians, Socialist Bureaucrats? Legends of Government Planning from Japan' (2003) 48 Antitrust Bull 595; Yoshiro Miwa & J. Mark Ramseyer, 'Directed Credit? The Loan Market in High-Growth Japan' (2004) 13 J. Econ. & Mgmt Strategy 171.

[39] See generally Yoshiro Miwa & J. Mark Ramseyer, 'The Implications of Trade Credit for Bank Monitoring: Suggestive Evidence from Japan' (2008) 17 J. Econ. & Mgmt Strategy 317; Yoshiro Miwa & J. Mark Ramseyer, 'The Beguiling Appeal of Banks' (2007) 75 Univ. Cincinnati L. Rev. 1005; Yoshiro Miwa & J. Mark Ramseyer, 'The Legislative Dynamic: Evidence from the Deregulation of Financial Services in Japan' in Dan Foote (ed.), *Law in Japan: A Turning Point* 153 (University of Washington Press 2007); Yoshiro Miwa & J. Mark Ramseyer, 'Japanese Industrial Finance at the Close of the 19th Century: Trade Credit and Financial Intermediation' (2006) 43 Explorations Econ. Hist. 94; Yoshiro Miwa & J. Mark Ramseyer, 'Does Relationship Banking Matter? The Myth of the Japanese Main Bank' (2005) 2 J. Empirical Legal Stud. 261; Yoshiro Miwa & J. Mark Ramseyer, 'The Multiple Roles of Banks? Convenient Tales from Modern Japan' in Klaus Hopt et al. (eds.), *Corporate Governance in Context* (Oxford University Press 2005) 527; Yoshiro Miwa & J. Mark Ramseyer, 'Financial Malaise and the Myth of the Misgoverned Bank' in Curtis J. Milhaupt (ed.), *Global Markets, Domestic Institutions: Corporate Law and Governance in a New Era of Cross-Border Deals* (Columbia University Press 2003) 339; Yoshiro Miwa & J. Mark Ramseyer, 'The Myth of the Main Bank: Japan and Comparative Corporate Governance' (2002) 401 Law & Social Inquiry 27.

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directors served on the boards of several firms; the firms must have had overlapping directorates. Some firms named a senior executive from their principal bank to their board; the banks must tell the firms what to do. Banks sometimes lent extra funds to financially constrained debtors; they must maintain implicit insurance agreements. Bureaucrats announced plans and goals; they must run the country.

The point is basic: The empirical claims about Japan that dominated the Western literature for decades are not true. As Yoshiro Miwa and I have explored elsewhere in detail, Japanese firms were not tied together in webs of cross-shareholdings. They did not maintain interlocking directorates. They did not organize and conduct business within groupings. Banks did not insure their borrowers against failure. And bureaucrats did not direct investments. The standard claims about Japan are not overstated. They are false.[40]

3.3 Governance and Competition

Japanese firms invested and traded in competitive markets for a simple reason: it is hard for firms to do anything else. As George Stigler explained decades ago, absent regulatory intervention, collecting monopoly rents is hard.[41] Suppose you (a hypothetical firm) price your product at marginal cost. Your rivals may leave the market to you, but only because you are pricing at marginal cost and (over the long term) earning zero profits. Try to price your product above marginal cost, and rivals have an incentive to enter. The higher the price at which you sell, the more likely a rival will invest the fixed costs necessary to enter and compete away your customers.

Capturing monopoly rents by cooperating with an incumbent rival is harder still. You (a hypothetical firm) still face the risk that a new competitor will enter and steal your customers as soon as you raise prices above marginal cost. But now you face the risk that your nominal collaborator will chisel on your agreement. She has agreed to split the market with you, to be sure. But she also faces hard-edged incentives to lie, and covertly undercut your prices. Before you know it, she has stolen your customers away.

None of this turns on the firms being Japanese. European firms, American firms, Canadian firms – all invest and trade subject to the same principles.

None of this turns on timing. Firms invested and traded subject to these principles before the war. They invested and traded subject to them after the war.

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[40] See generally Yoshiro Miwa & J. Mark Ramseyer, *The Fable of the Keiretsu: Urban Legends of the Japanese Economy* (University of Chicago Press 2006); Yoshiro Miwa & J. Mark Ramseyer, 'Asking the Wrong Question: Changes of Governance in Historical Perspective' in Klaus Hopt et al. (eds.), *Corporate Governance in Context* (Oxford University Press 2005) 73; Yoshiro Miwa & J. Mark Ramseyer, 'Who Appoints Them, What Do They Do? Evidence on Outside Directors from Japan (2005) 14 J. Econ. & Mgmt Strategy 299; Yoshiro Miwa & J. Mark Ramseyer, 'Conflicts of Interest in Japanese Insolvencies: The Problem of Bank Rescues, Theoretical Inquiries in Law' 2005) 6 Theoretical Inq. L. 301; Yoshiro Miwa & J. Mark Ramseyer, 'The Value of Prominent Directors: Corporate Governance and Bank Access in Transitional Japan' (2002) 31 J. Legal Stud. 273; Yoshiro Miwa & J. Mark Ramseyer, 'The Fable of the Keiretsu' (2002) 11 J. Econ. & Mgmt Strategy 169; Miwa & Ramseyer, 'Rethinking Relationship-Specific Investments' (n 33); Yoshiro Miwa & J. Mark Ramseyer, 'Corporate Governance in Transitional Economies: Lessons from the Pre-War Japanese Cotton Textile Industry' (2000) 29 J. Legal Stud. 171.

[41] George J. Stigler, 'A Theory of Oligopoly' (1964) 72 J. Pol. Econ. 44.

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And none of this turns on any theory of corporate governance. Corporate governance concerns relations internal to the firm, while competition policy turns on relations outside a firm. Governance addresses the way that one set of principals in the firm (shareholders) contracts with a set of agents (directors and officers); through the agreement, the agents run the firm on the principals' behalf. Competition addresses the way that independent firms contract or otherwise structure their affairs with entities outside the firm.

One can imagine connections between governance strategies and competitive outcomes, but rarely can one imagine connections with determinate outcomes. For the most part, corporate governance strategies proposed for real-world firms can have anti-competitive consequences in some situations, no such consequences in others, and bring entirely unrelated positive managerial effects across the board.

One can imagine two conspiring firms using board interlocks to police a price-fixing agreement. But given a finite stock of knowledgeable retired business executives with expertise in a given industry, one can imagine two firms hiring some of the same men or women to their boards – and being better managed for it.

One can imagine colluding firms using a common bank to monitor each other. But given the small number of banks with a sophisticated understanding of a given industry, one can imagine multiple firms borrowing from the same bank – and obtaining better terms for it.

One can imagine that a firm's "high-powered" executive compensation plan might create incentives for its executives to fix prices. But given the pervasive risk of shirking, one can imagine that in many industries firms will maintain high-powered incentives – and run more efficiently for it.

Certain forms of governance may facilitate certain types of anticompetitive conduct. Certain types of market structure may create incentives for certain forms of governance. But the matches are loose at best. The same governance structure that can facilitate anticompetitive conduct at one firm can generate substantial shareholder value at another. Corporate governance and competition outcomes may be related. But rarely are the relations determinate.

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5. Markets, Competition, and Fairness

Eliana Garcés and Giuseppe Colangelo

1. COMPETITION, MARKET POWER, AND FAIRNESS: AN UNEASY CONNECTION[1]

Fairness considerations are increasingly evoked in economic policy and have become part of the current conversation on the objectives of competition policy. The renewed policy relevance can be traced back to 2016 when a policy brief published by the White House Council of Economic Advisors in the United States raised the alarm about a decline in the level of dynamism in the U.S. economy. This decline was linked to high levels of concentration in the economy, high margins for the largest firms, and lower entrepreneurial activity.[2] The brief advocated for instilling more competition in markets in order to redress the economic harm inflicted on small businesses and consumers from the lack of opportunities and excessive concentration of rents.

A vocal intellectual movement pushing for stricter competition policy enforcement as a means to increase economic fairness, both in terms of opportunities and revenues, developed in the United States in subsequent years.[3] In Europe, over the same period, the disruptive effect of very large and mostly non-European digital platforms on traditional businesses similarly generated discontent with the seemingly unfettered economic power of very large digital players. The adoption of the Treaty on the Functioning of the European Union (TFEU) in 2007 had already explicitly stated a social dimension in its objective to create a highly competitive "social market economy".[4] In contrast to the U.S., policymakers appeared to accept that markets and the EU single market might need regulation to be socially efficient. The emergence of the Environmental, Social, and Governance (ESG) movement that grew in importance in subsequent years contributed to the sentiment that market intervention had to be put at the

[1] The opinions expressed in this paper are those of the authors and not necessarily those of any affiliated institutions or of the authors' employers.

[2] Council of Economic Advisors, 'Benefits of Competition and Indicators of Market Power' (2016), https://obamawhitehouse.archives.gov/sites/default/files/page/files/20160414_cea_competition_issue_brief.pdf (all the links were last accessed 22 September 2023).

[3] This movement includes the work of organizations such as the Stigler Center for the Study of the Economy and the State at Chicago Booth School of Business. Proponents of this approach include Columbia Law School Professor Tim Wu and Lina Khan, who gained prominent positions in the Biden administration.

[4] Article 3(3) TEU sets out a target of "a highly competitive social market economy aiming at full employment and social progress."

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service of a wide range of societal goals.[5] This set the stage for an inclusion of fairness as a vague but actionable policy objective for market regulation and competition policy.[6]

While fairness is undoubtedly an acceptable objective by itself and has its place in the history of economic regulation, its treatment in competition policy has been carefully conceptualized over the years with disciplined attempts to characterize the processes that are conducive to fair or unfair outcomes. Since its onset, the stated objective of competition policy has been fair competitive markets as a remedy to the unfairness of monopoly privilege. In recent decades, competitive markets have been mostly praised for their efficiency and their ability to deliver the most efficient production processes, as well as the best products for the lowest cost. Vibrant competition also ensures that any benefits of superior efficiency are passed on to consumers in the form of lower prices and higher quality. In this way, not only is productive efficiency achieved but consumer welfare is maximized in competitive markets. In addition, contestability in competitive markets guarantees an equal opportunity for businesses. The stylized world of perfect competition produces fairness for both citizens and businesses, as well as prosperity in the form of efficiency.

Things get more complicated with the emergence of market power. When a company acquires the ability to operate independently in a market, this conceptual equivalence between competition, efficiency, and fairness is broken – and it is broken in ways that are not easy to characterize. A company with market power may be more or less efficient than its peers, depending on the source of its market power. In all cases, a company with market power is able to retain more of the value it produces via higher prices. What this means for fairness is not clear when the company has achieved superior status by merit alone.

Proponents of including fairness as a guiding policy principle have sparked a vibrant debate on the original intention of antitrust legislation in the U.S., further sustained by the fact that there are enough judicial and congressional records to defend a variety of opinions about the nature of those original goals.[7] Since the 1980s, the predominant approach has been to be wary of competition policy decisions impairing efficient production. Intervention has clamped down on conduct that appears to deviate from competition on the merits, with a tolerance

[5] Regarding ESG considerations in competition policy, *see e.g.*, Marco Corradi and Julian Nowag, 'ESG: The Corporate and Antitrust Puzzle' in this Handbook; European Commission, Directorate-General for Competition, 'Young experts' views on the greening of competition policy' (2021) 3 Competition Policy Brief, https://competition-policy.ec.europa.eu/about/news/young-experts-views-greening-competition-policy-2021-12-10_en; OECD, 'Sustainability and Competition' (2020) https://www.oecd.org/en/publications/sustainability-and-competition_18e2061c-en.html.

[6] For an analysis of the historical background of fairness in Europe, *see* David J. Gerber, *Law and Competition in Twentieth Century Europe* (Oxford University Press 1998). For a recent application to digital markets and a review of the relevant literature, *see* Giuseppe Colangelo, 'In fairness we (should not) trust: The duplicity of the EU competition policy mantra in digital markets' (2023) 68(4) Antitrust Bulletin 618.

[7] For a discussion of the various goals of U.S. antitrust policy, *see* Louis B. Schwartz, '"Justice" and Other Non-Economic Goals of Antitrust' (1979) 127(4) University of Pennsylvania Law Review 1076; John J. Flynn, 'Antitrust Jurisprudence: A Symposium on the Economic, Political and Social Goals of Antitrust Policy' (1977) 125(6) University of Pennsylvania Law Review 1182. Goals referring to fairness, equity, or justice are more commonly mentioned before the 1980s.

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for value-enhancing conduct that might hurt competitors.[8] This approach was successfully promoted by the free-market-oriented Chicago School of Economics during the 1970s and the 1980s, which firmly established in the U.S. an unambiguous policy of non-intervention in the face of efficiency gains that improve value for consumers.[9] The policy came to be known as the implementation of a consumer welfare standard. While the EU's Article 102 TFEU mentions the imposition of "unfair trading conditions" as an abuse, the elimination of less-efficient competitors, even in the face of market power, has also not been considered unfair in recent decades but rather part of the legitimate competitive process.[10]

The embrace of the consumer welfare standard was slower in Europe due to the subsistence of an ordoliberal tradition of protecting the structure of the competitive market.[11] But after a series of court defeats in the early 2000s, European competition law adopted the more "economic approach" prevalent in the U.S., albeit more cautiously.[12]

For the last couple of decades, enforcement against "unfair methods" of competition has been guided by well-established economic theories of harm that identify the conditions that generate market power and enable abusive conduct, as well as the mechanisms by which these conducts produce anticompetitive outcomes harmful to consumers. Although primary European competition law does not foresee an objective justification defense for unilateral conduct, it is possible for an investigated company to allege as a defense that the conduct under scrutiny is efficient and creates superior value to consumers despite the negative impact on

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[8] In the U.S., Section 2 of the Sherman Act prohibiting monopolization was interpreted by the Supreme Court in *Trinko*, such that "the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive conduct." *See Verizon Communs., Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407 (2004).

[9] Robert Bork famously applied the Chicago School ideas to competition policy. *See* Robert Bork, *The Antitrust Paradox: A Policy at War with Itself* (Basic Books 1978).

[10] *See* European Commission, 'Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings' (2009) OJ C45/7, paras 1, 23: "it is not in itself illegal for an undertaking to be in a dominant position and such a dominant undertaking is entitled to compete on the merits; … intervention will target only pricing conduct capable of hampering competition from competitors which are considered to be as efficient as the dominant undertaking." However, in recent amendments, the Commission added that it recognizes that, in certain circumstances, a less efficient competitor may also exert a constraint which should be taken into account when considering whether particular price-based conduct leads to anticompetitive foreclosure: *see* European Commission, 'Amendments to the Communication from the Commission Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings' C(2023) 1923 final, para 2.

[11] Gerber (n 6).

[12] *See* Anne C. Witt, *The More Economic Approach to EU Antitrust Law* (Hart Publishing 2016). In general, EU competition authorities showed a higher propensity to enforce competition policy compared to their U.S. counterparts. Notable examples are the *GE/Honeywell* merger prohibited by the European Commission (Case M.2220, Commission Decision 2004/134/EC [2004] OJ L48/1) or, more recently, the *Google Shopping* decision (Case AT.39740, Commission Decision C(2017) 4444 final, affirmed in Case T-612/17 *Google and Alphabet v. European Commission* EU:T:2021:763), which was the response to complaints regarding Google Search around 2010 that did not generate enforcement in the U.S.

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competitors.[13] The prevailing approach so far in both the U.S. and EU has remained to abide by the consumer welfare standard, whereby the conduct is permissible if it creates value that provides a net positive effect for consumers, irrespective of its effect on less-efficient competitors or on the redistribution across businesses or between businesses and consumers.[14]

Recently, the prevalence of the consumer welfare standard as the guiding principle for competition policy has been called into question, notably in the United States, where some scholars and regulators as influential as Jonathan Kanter, the Assistant Attorney General for the Department of Justice (DOJ) Antitrust Division, and Lina Khan, the Chairman of the Federal Trade Commission (FTC), have explicitly called for its demise.[15] The argument of this "Neo-Brandeisian" movement is that the application of this standard, together with the elaborate quantification exercises it demands, has led to underenforcement and the emergence of companies that are excessively large and powerful.[16] The root of the discussion is not technical but social and political, with proponents calling for adherence to what they believe is the original intent of antitrust law: the promotion of free competition and of the competition process as an expression of economic liberty. The 1945 Supreme Court *Alcoa* decision is commonly cited in reference to what they claim is the original goal of the Sherman Act:

> Throughout the history of these statutes it has been constantly assumed that one of their purposes was to perpetuate and preserve, for its own sake and in spite of possible cost, an organization of industry in small units which can effectively compete with each other.[17]

The "protection of competition" standard is currently being proposed in policy circles as a replacement for the consumer welfare standard. It focuses less on the value impact of a particular conduct and pays more attention to its impact on the nature of competition and on the opportunities available to competitors, which implicitly become the standard of fairness.[18]

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[13] European Commission, 'Guidance on the Commission's enforcement priorities' (n 10), para 28.

[14] Although the European Commission's Guidance (n 10) paras 1, 19 mentions a special responsibility by the dominant company "not to allow its conduct to impair genuine undistorted competition," it restricts the scope of intervention to those instances where the conduct reduces consumer welfare.

[15] Jonathan Kanter, 'Remarks at New York City Bar Association's Milton Handler Lecture,' 18 May 2022, available at https://www.justice.gov/opa/speech/assistant-attorney-general-jonathan-kanter-delivers-remarks-new-york-city-bar-association; Lina Khan, 'Remarks at Fordham Annual Conference on International Antitrust Law & Policy,' (2022) https://www.ftc.gov/system/files/ftc_gov/pdf/KhanRemarksFordhamAntitrust20220916.pdf. An excellent description of this discussion can be found in analysis by Tim Wu. *See* Tim Wu, 'After Consumer Welfare, Now What? The 'Protection of Competition' Standard in Practice' (2018) Competition Policy International – CPI Antitrust Chronicle, May 2018 https://scholarship.law.columbia.edu/faculty_scholarship/2291/.

[16] The name refers to Louis Brandeis, an early 20th century U.S. Supreme Court Justice who believed monopolies were inherently harmful to the welfare of workers and business innovation. Some scholars have denounced the excessive degree of technicism in the more economic approach as generating a "democratic deficit" in the implementation of the policy. *See* Harry First and Spencer Weber Waller, 'Antitrust's Democracy Deficit' (2013) 81(5) Fordham Law Review 2543.

[17] *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 429 (2nd Cir. 1945).

[18] Marshall Steinbaum and Maurice E. Stucke, 'The Effective Competition Standard—A New Standard for Antitrust' (2020) 86(2) University of Chicago Law Review 595.

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In the EU, regulators have appeared more inclined to preserve the consumer welfare standard, with competition policy decisions so far avoiding explicit deviations from this tradition despite an increase in rhetoric around fairness and economic opportunities at the political level.[19] The various political speeches that have advocated for a renewed focus on fairness ultimately find this goal compatible with competition and the objective of efficiency.[20] The exception can be found in digital markets, where concerns about powerful digital platforms have led to a policy shift and a new goal to redress the perceived unfairness and suppression of competition that are presumed to exist in markets dominated by large online platforms. The introduction of *ex ante* regulation in the digital sector in the form of the Digital Markets Act (DMA) marks an explicit deviation from the consumer welfare standard, with the *per se* promotion of measures aiming to increase fairness and contestability and the elimination of the possibility of an efficiency justification.[21]

Competition policy enforcement in the EU may further evolve in the digital space toward the enforcement of fair value redistribution.[22] In addition, it may still adopt a more structural goal of protecting a particular competitive process. Such a goal has recently become apparent in the European Commission's amendments to the guidelines on the implementation of Article 102 TFEU.[23] In these amendments, it extends the meaning of anticompetitive foreclosure to include behavior that adversely impacts "an effective competitive structure". It also explicitly mentions objectives beyond consumer welfare, such as fairness, the competitive process, and even plurality.[24]

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[19] References to fairness in competition policy are more common in EU Commissioners' speeches than in actual Court decisions. *See* Konstantinos Stylianou and Marios Iacovides, 'The goals of EU competition law: a comprehensive empirical investigation' (2022) 42(4) Legal Studies 620. Similarly, the approach taken by the UK Government preserves the consumer welfare standard and the efficiency defense: *see* UK Government, 'A new pro-competition regime for digital markets' (2022) https://www.gov.uk/government/consultations/a-new-pro-competition-regime-for-digital-markets.

[20] Political speeches tend to present all socially desirable goals as achievable with the proper enforcement of competition policy. *See* Margrethe Vestager, 'What is competition for?' (2021), http://web.archive.org/web/20220330071246/https://ec.europa.eu/commission/commissioners/2019-2024/vestager/announcements/speech-evp-margrethe-vestager-danish-competition-and-consumer-authority-2021-competition-day-what_en: "Competition makes markets fairer, giving consumers lower prices, better products, more innovation. It makes sure that suppliers or customers aren't dependent on too few companies for the products or services – or the markets – that they need. It makes our economy more efficient, and our industry more competitive in Europe, and beyond."

[21] Regulation (EU) 2022/1925 of the European Parliament and of the Council on contestable and fair markets in the digital sector and amending Directives (EU) 2019/1937 and (EU) 2020/1828 (Digital Markets Act) [2022] OJ L265/1.

[22] Margrethe Vestager, 'Fairness and Competition Policy' (2022), https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_22_6067: "Protecting competition is about efficiency but not only … efficiency gains must be shared fairly and justly across stakeholders… [w]hen efficiency and fairness are not aligned, there is a need for intervention."

[23] European Commission, 'Guidance on the Commission's enforcement priorities' (n 10).

[24] Linsey McCallum, Inge Bernaerts, Massimiliano Kadar, Johannes Holzwarth, David Kovo, Marie Lagrue, Edouard Leduc, Luca Manigrassi, Jorge Marcos Ramos, Isabel Pereira Alves, Vera Pozzato, Pinelopi Stamou, 'A dynamic and workable effects-based approach to Article 102 TFEU'

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Ultimately, whether changes occur in competition policy with a new objective of fairness will depend on the definition of what is fair and on the accepted mechanisms to produce such fairness. For the moment, there are no settled standards for either. In the following section, we analyze the evolution of the concept of fairness in EU competition policy. The EU presents an interesting case as it has had to reconcile competition law enforcement with its original mandate to ban unfair practices and has done this throughout its evolution toward a more economic approach. The structure of the chapter proceeds as follows. In Section 3, we discuss the revival of fairness as a goal in the digital space, where it is being pursued, together with contestability, as a complementary goal to competition policy. We argue that the way fairness is being advocated still lacks concreteness and actionability and presents risks for policy makers and businesses unless it is made more precise. Section 4 discusses different approaches to the achievement of fairness, and the concluding Section 5 discusses the implications of the current adoption of fairness goals for competition policy and its impact on the economy.

2. FAIRNESS IN EU COMPETITION LAW

Fairness is not foreign to EU competition law. The Preamble to the TFEU includes a reference to "fair competition", and its antitrust provisions keep restrictive agreements or practices which, among other things, allow consumers a "fair share" of procompetitive benefits (Article 101) and prohibit any abuse of dominant position consisting of imposing "unfair purchase or selling prices" or other "unfair trading conditions" (Article 102). Yet, since fairness is nowhere defined, one must turn to actual decisions for an interpretation.

A few decisions by the Court of Justice (CJEU) and the European Commission directly address the issue of fairness of contract terms. Some important judgments link the assessment of contract terms' fairness to two factors: whether such clauses are material to the objective of the agreement and whether these clauses unjustifiably restrict the freedom of the parties.[25] The finding that a contractual clause may be unfair when it bears no relation to the purpose of the contract is asserted in *Tetra Pak II*[26] and in *Duales System Deutschland (DSD)*.[27] Moreover, unfairness has also been associated with opaque contractual conditions that weaken the position of a dominant firm's counterparties, who are not in a position to understand the actual terms of the commercial offer in question.[28]

Under EU competition law, fairness is being increasingly linked to constructive refusal to supply, understood as the imposition of unreasonable terms and conditions that prevent or

(2023) 1 European Commission Competition Policy Brief, https://competition-policy.ec.europa.eu/system/files/2023-03/kdak23001enn_competition_policy_brief_1_2023_Article102_0.pdf.

[25] *See* Case C-127/73 *Belgische Radio en Televisie and Société belge des auteurs, compositeurs et éditeurs v. SV SABAM and NV Fonior* EU:C:1974:25, para 15.

[26] *Tetra Pak II* (Case IV/31.043) Commission Decision 92/163/EEC [1992] OJ L72/1, paras 105–108.

[27] *DSD* (Case COMP D3/34493) Commission Decision 2001/463/EC [2001] OJ L166/1, para 112; affirmed in Case C-385/07 P *Der Grüne Punkt – Duales System Deutschland v. European Commission* EU:C:2009:456.

[28] *See Michelin (Michelin II)* (Case COMP/E-2/36.041/PO) Commission Decision 2002/405/EC [2002] OJ L143/1, paras 220–221 and 223–224.

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disincentivize an equally efficient competitor from competing.[29] Margin squeeze strategy – where a vertically integrated operator charges a price to competitors downstream that prevents them from pricing competitively without unduly reducing their profits – constitutes another type of abuse that is considered unfair as it undermines the equal opportunity to compete.[30] A finding of unfairness in the terms of access does not depend on the essentiality of the asset being accessed, as these conducts cannot be equated to refusals to supply.[31] Still, for a finding of abuse, European case law requires demonstrating a potential anticompetitive effect in the form of a potential exclusion of as-efficient competitors, possibly through their reduced profitability.[32]

Unfair excessive prices were revived in Europe as an anticompetitive harm in a series of cases concerning the price of medicines and the tariffs applied by collective management organizations.[33] Courts and competition authorities have developed different methods rooted in economic reasoning for identifying unfair prices. *United Brands* established that an assessment of pricing fairness needed to relate the price of a product to its cost, signaling the profit margin as a relevant measure but leaving many unanswered questions about its assessment.[34] More recently, in *SABAM*, the CJEU confirmed that the royalty rate requested by a collective society should be influenced by the economic value of the copyright work, although in this case, the economic value was linked to the value generated by the use of the copyrighted work.[35] Since *United Brands*, courts and antitrust authorities have struggled with applying the criteria set out by the CJEU to assess the unfairness of the price. As acknowledged in *AKKA-LAA*, "there is no single adequate method" with which to evaluate unfair pricing cases.[36] In that case, the CJEU suggested methods involving the selection of a benchmark price found for similar markets or companies. Nonetheless, as argued by Advocate General Wahl in his opinion in *AKKA-LAA*, it is only when no rational economic explanation (other than the mere

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[29] *Slovak Telekom* (Case AT.39523) Commission Decision C(2014) 7465 final.

[30] *See* Case C-280/08 P *Deutsche Telekom v. European Commission* EU:C:2010:603; Case C-52/09 *Konkurrensverket v. TeliaSonera Sverige* EU:C:2010:483; Case C-295/12 P *Telefónica and Telefónica de España v. European Commission* EU:C:2014:2062; Case C-165/19 P *Slovak Telekom v. European Commission* EU:C:2021:239. On the U.S. side, rejecting margin squeeze as a standalone offense, the Supreme Court in *Pacific Bell Tel. Co. v. linkLine Communs., Inc*., 555 U.S. 438 (2009) argued that it is nearly impossible for courts to determine the fairness of rivals' margins.

[31] *Slovak Telekom* (n 29), paras 50–51.

[32] In *Teliasonera* (n 30), the CJEU found that there can be an exclusionary abuse even where the margin level of input purchasers is positive, being enough that rivals' margins are insufficient; for instance because they must operate at artificially reduced levels of profitability.

[33] Opinion of Advocate General Pitruzzella, Case C-372/19 *Belgische Vereniging van Auteurs, Componisten en Uitgevers CVBA (SABAM) v. Weareone.World BVBA, Wecandance NV* EU:C:2020:598, para 21.

[34] Case C-27/76 *United Brands Company and United Brands Continental BV v. Commission of the European Communities* EU:C:1978:22.

[35] Case C-372/19 *Belgische Vereniging van Auteurs, Componisten en Uitgevers CVBA (SABAM) v. Weareone.World BVBA, Wecandance NV* EU:C:2020:959.

[36] Case C-177/16 *Autortiesību un komunicēšanās konsultāciju aģentūra v. Latvijas Autoru apvienība v Konkurences padome* EU:C:2017:689, para 49.

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capacity and willingness to use market power even when abusive) can be found for the high price applied by a dominant undertaking that the price may be qualified as abusive.[37]

Another setting rich in discussions around fairness is that of standard essential patents (SEPs), whose holders are subject to fair, reasonable, and non-discriminatory (FRAND) licensing obligations. Patents essential to a standard confer market power because the standardization process leads to the exclusion of alternative technologies and the need for standard implementers to license the patent. As a consequence, SEP owners enjoy *ex post* monopoly power that creates a risk of "holdup" by enabling them to charge excessively high royalty rates in their licensing agreements or constructively refuse to license the patents.

To address these concerns, standard-setting organizations typically require SEP holders to submit FRAND commitments. The goal is to make SEPs available at a price equivalent to what patents would have been worth in the market prior to the time they were declared essential. But what exactly that value should be is a subject of contention, and whether FRAND commitments can effectively prevent SEP owners from imposing excessive royalty obligations on licensees is a debated issue. This is due mainly to the unclear economic meaning of the FRAND commitments. In its Communication setting out the EU approach to SEPs, the European Commission did little more than reaffirm a desirable link between FRAND licensing terms and the discounted economic value of the patented technology, absent the impact of its inclusion in the standard.[38] In fact, there are no generally agreed-upon tests to determine whether a particular license does satisfy a FRAND commitment. Furthermore, there is also no consensus over its legal effects, notably as to whether FRAND commitments should imply a waiver of the general law of remedies (more precisely, injunctive relief for patent violation and other extraordinary remedies), although the Court of Justice (CJ) did establish behavioral conditions whereby an entity can be declared to be an unwilling licensee and lose any protection from injunctions.[39] Attempts to resolve FRAND disputes have oscillated between establishing valuation criteria and guaranteeing (or recreating) a fair negotiation process preventing both holdups and holdouts. The difference is not trivial, as the result of a hypothetical negotiation may be tolerant of asymmetries in information or bargaining power among parties, while a valuation approach is meant to be uniquely based on the objective economic value of the technology. In its recent proposal for a regulation on standard essential patents, the Commission is promoting the grounding of FRAND terms on the real economic value of the technology.[40] The broad uncertainty around the meaning of FRAND commitments has caused an impressive wave of litigation worldwide over the last decade.

A final attempt to investigate the fairness of terms and conditions may be made under the provisions addressing the abuse of economic dependence (also known as relative market power or superior bargaining power) that several EU Member States have adopted over the years to address large differences of bargaining power between business parties.[41]

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[37] Opinion of Advocate General Wahl, Case C-177/16 *AKKA-LAA* EU:C:2017:286, para 131.

[38] European Commission, 'Setting out the EU approach to Standard Essential Patents' COM(2017) 712 final.

[39] Case C-170/13 *Huawei Technologies v. ZTE* EU:C:2015:477.

[40] European Commission, 'Proposal for a regulation of the European Parliament and of the Council on standard essential patents and amending Regulation (EU) 2017/1001' COM(2023)232.

[41] For an overview, *see* Giuseppe Colangelo, 'The European Digital Markets Act and antitrust enforcement: a liaison dangereuse' (2022) 47(5) European Law Review 597.

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Although the abuse of economic dependence is not regulated at the EU level, national legislations on this matter are authorized by Article 3(2) of Regulation 1/2003 on the implementation of EU competition rules, which allows Member States to adopt and apply on their territory stricter national laws prohibiting or sanctioning unilateral conduct engaged in by undertakings.[42] Recital 8 of the Regulation refers specifically to national provisions that prohibit or impose sanctions on abusive behavior toward economically dependent undertakings. Many of the legislations adopted under this provision have been motivated by the desire to address the power asymmetry between parties in the retail and food sectors, where small producers often face draconian contract terms set by large consolidated distributors and where the lack of formal market dominance complicates the use of competition policy.[43] Solutions have ranged from sectoral initiatives, mostly in the food distribution sector, to inclusion of general terms regarding economic dependence or asymmetric bargaining power in contract law or competition policy legislation.[44]

Sector-specific legislation or codes of conduct addressing fairness in contractual relations generally presume unfairness in the relationship between large, consolidated trading partners and smaller counterparts and tend to include blacklists of contract terms that are considered to impose excessive risk, uncertainty, and costs on smaller counterparties.

In competition law, the finding of economic dependence is based on some economic factors such as the amount of relationship-specific investment undertaken that may lock a party into a business relationship, the presence of significant switching costs, or the extent to which a counterparty can be considered an unavoidable trading partner, perhaps because of its exclusive control over an important input. Pursuant to the interpretation provided in *Bronner*, the access to an input is considered essential if there are technical, legal, or economic obstacles capable of making it impossible, or even unreasonably difficult, to duplicate it or to create it at a scale comparable to that of the existing firm.[45] The requirement is not necessary in the case of existing relationships or in the presence of access mandated by regulation.[46]

Competition policy has dealt extensively with issues of fairness in the assessment of contract terms, prices, and access conditions. Everywhere, it has attempted to ground fairness in economic concepts. In the next section, we illustrate how the revival of the fairness objective in EU digital policy, notably in the DMA, borrows from and claims consistency with sector regulation and competition law. Yet, heightened scrutiny of incumbents' advantages with respect to their competitors can be considered a novel development.

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[42] Council Regulation (EC) 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.

[43] The European Commission explored the feasibility of establishing business-to-business unfair contract terms legislation as an alternative, but in the end, the issue was left for national legislation: *see* European Commission, 'Study on the legal framework covering business-to-business unfair trading practices in the retail supply chain' (2014), https://op.europa.eu/it/publication-detail/-/publication/c82dc8c6-ec15-11e5-8a81-01aa75ed71a1/language-en.

[44] *See, e.g.*, French Code of Commerce, art. L441-7; Italian law decree n. 1/2012, art. 62 (as enacted by law no. 27/2012); UK Groceries Code Adjudicator Bill 2013.

[45] Case C-7/97 *Oscar Bronner v. Mediaprint Zeitungs- und Zeitschriftenverlag, Mediaprint Zeitungsvertriebsgesellschaft and Mediaprint Anzeigengesellschaft* EU:C:1998:569.

[46] *Deutsche Telekom* (n 30).

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3. FAIRNESS AT THE CENTER OF COMPETITION POLICY IN DIGITAL MARKETS

The disruption caused by the entry and expansion of large digital platforms in a variety of markets contributed a great deal to the revival of the discussion of fairness in competition policy. The first wave of complaints against digital businesses arose in the area of digital media and e-commerce, with legal actions against counterfeit and copyright violations.[47] Brand manufacturers subsequently imposed restrictive clauses on online retailers to contain an unfettered expansion of digital distribution channels that put pressure on prices and threatened to harm brick-and-mortar shops.[48] Over time, economic actors integrated into large platforms' digital ecosystems and alleged unfair and discriminatory treatment, leading to a series of antitrust complaints as well as a number of sector inquiries.[49] Regulators initiated investigations and studies to characterize the novel technologies, services, and business models.[50] Due to the difficulties of mapping traditional anticompetitive theories of harm onto these new digital businesses, the catch-all principle of fairness was increasingly used to address a large variety of grievances.

Claims of unfairness underpin the forceful policy drive in recent years to redesign the relationship between platforms and their commercial partners. There are vibrant debates around the fairness of some business models and associated monetary flows. An example is the dispute between news publishers and online advertisement platforms such as Facebook (now Meta Platforms) and Google. But the fairness discussion around digital business models goes beyond disputes around compensation. The preservation of entry and growth opportunities in the markets for digital services is a priority concern for competition authorities and policy

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[47] Starting in 1999 with lawsuits against Napster (*A&M Records et al. v. Napster*, 239 F.3d 1004 (9th Cir. 2001)) and against Grokster (*Metro-Goldwyn-Mayer Studios et al. v. Grokster*, 545 U.S. 913 (2005)), the music industry sued extensively in the U.S. and lobbied in Europe for remedial actions to copyright violations by online music file-sharing services. Similarly, brand manufacturers sought to restrict online distribution of their products.

[48] *See Guess* (Case AT.40428) Commission Decision C(2018) 8455 final; *Pioneer* (Case AT.40182) Commission Decision C(2018) 4790 final; *Asus* (Case AT.40465) Commission Decision C(2018) 4773 final.

[49] A non-exhaustive list includes: *Google Shopping* (n 12); *Google Android* (Case T-604/18, EU:T:2022:541); the case opened by the German competition authorities against Booking.com after a complaint by the national hotel association (Bundeskartellamt, Case B9-121/13 (2015)); the investigation opened by the European Commission on Apple's App Store rules after a complaint by Spotify (https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1073).

[50] *See, e.g.,* UK Competition and Markets Authority, 'Online Platforms and Digital Advertising' (2019), https://www.gov.uk/cma-cases/online-platforms-and-digital-advertising-market-study; The Netherlands Authority for Consumers & Markets, 'Market study into mobile app stores' (2019), https://www.acm.nl/sites/default/files/documents/market-study-into-mobile-app-stores.pdf; Autorité de la concurrence, 'Sector-specific investigation into online advertising' (2018), https://www.autoritedelaconcurrence.fr/en/press-release/6-march-2018-sector-specific-investigation-online-advertising; Bundeskartellamt, 'Bundeskartellamt launches sector inquiry into market conditions in online advertising sector' (2018), https://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2018/01_02_2018_SU_Online_Werbung.html.

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makers, and the European Commission, for example, always stresses the dual objectives of fair competition and "fair share" with its antitrust investigations.[51]

The European Commission has gradually set up a series of instruments to address business-to-business fairness in the digital space. These are the platform-to-business (P2B) dedicated legislative initiative in 2019, the current proposal for the Data Act, and the most recent Digital Markets Act of 2022.

The first legislative initiative was the Regulation on promoting fairness and transparency for business users of online intermediation services (P2B Regulation).[52] Online intermediation services are defined as platforms connecting businesses with consumers online, such as Booking.com, Amazon, Google Search, or Zalando. The aim of this regulation is to lay down rules to ensure that business users of online intermediation services and corporate website users in relation to online search engines are granted appropriate transparency and fairness, and effective redress possibilities.[53] Indeed, according to the P2B Regulation, online intermediation services can be crucial for the commercial success of undertakings that use such services to reach consumers. Hence, given the level of dependence of business users, they often have superior bargaining power, which can enable them to behave unilaterally in a way that could be unfair and that can be harmful to the legitimate interests of their business users and, indirectly, also of consumers.[54]

The P2B Regulation does not impose restrictions on contract terms. Rather than forbidding or prescribing specific conduct, its provisions are essentially designed to enhance transparency and eliminate any unfairness from opaque and discretionary contract terms. The Regulation was widely perceived to be a first step and keeps open the possibility for further measures if its provisions prove to be insufficient for adequately addressing imbalances and unfair commercial practices in the sector.[55]

Indeed, a few months after the P2B Regulation, the Communication on "Shaping Europe's Digital Future" unveiled a scenario of further legislative intervention.[56] The intention this time was to ensure open markets and fair competition, but fairness was also stated as a goal. The initiative stated that certain online platforms, acting as "private gatekeepers to markets, customers and information," might jeopardize the fairness and openness of markets due to their economic clout and significance. Such systemic problems arising in the platform economy could not be addressed with competition policy alone, and additional rules were needed to ensure contestability, fairness, and innovation, as well as the possibility of market entry.[57] Notably, the declared policy goal was to ensure "a level playing field for businesses".[58]

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[51] For example, see Art. 101(3) TFEU, allowing restrictive agreements among undertakings that contribute to improving the production or distribution of goods or to promote technical or economic progress if, among other conditions, they allow consumers a fair share of the resulting benefit.

[52] Regulation (EU) 2019/1150 of the European Parliament and of the Council of 20 June 2019 on promoting fairness and transparency for business users of online intermediation services [2019] OJ L186/57.

[53] *Ibid*, Article 1(1).

[54] *Ibid*, Recital 2.

[55] *Ibid*, Recital 49.

[56] European Commission, 'Shaping Europe's digital future' COM(2020) 67.

[57] *Ibid*, 8–9.

[58] *Ibid*, 8.

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Against this background, the European Commission adopted the Digital Markets Act, whose rules have the purpose of ensuring "contestability and fairness" for digital markets.[59] According to the DMA, the distinctive characteristics of digital services (*i.e.*, the presence of strong economies of scale, extreme indirect network effects, remarkable economies of scope due to the role of data as a critical input, and conglomerate effects, along with consumers' behavioral biases and single-homing tendency) generate significant barriers to entry that confer to platforms entrenching their gatekeeping position and power.[60] This situation is considered likely by some to lead to serious imbalances in bargaining power and, consequently, to unfair practices and conditions for business users, as well as for end users, to the detriment of prices, quality, fair competition, choice, and innovation in the digital sector.[61] Moreover, gatekeepers frequently play a dual role, being simultaneously intermediary operators for the marketplace and sellers of their own products and services in competition with rival sellers.[62] Some parties argue that rules are required to prevent gatekeepers from unfairly benefiting from such a dual role by imposing over them a special responsibility in ensuring a level playing field, which *de facto* approaches the introduction of a platform neutrality regime.[63]

The DMA defines unfairness for the purpose of the regulation as an imbalance in the rights and obligations between business users and gatekeepers that provides a disproportionate advantage to the latter and does not allow other businesses to capture the full benefits of their contributions.[64] As regards to price and access conditions, the DMA considers unfair any condition that leads to a disadvantage for business users that provide a similar service as the gatekeeper.[65]

This definition of unfairness is very expansive compared to how unfairness from economic dependence has been treated in competition policy so far. First, it provides an interpretation of fairness that includes pure distributional issues and hence opens the door for remedies that reallocate rights and obligations and indirectly redistribute rents. Second, it equates fairness to a lack of "disproportionate advantages" for the gatekeeper's services from contractual terms and, as concerns pricing and access conditions, the lack of any advantage at all. This definition of fairness seems closer to the notion of "fair competition" but differs from the traditional competition policy interpretation in that it does not aim to protect against market power abuse alone, but rather to actively promote equal competitive conditions.

The DMA presents the fairness objective as "intertwined" with the contestability objective, stating that fairness in the rights and obligations of gatekeepers and business users will protect contestability and contestability will prevent abusive terms. In doing this, the DMA maintains the traditional competition policy equivalence between competition and fair outcomes. But its intervention remit is very much enlarged by the expansive definition of fairness and the

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[59] DMA (n 21), Recital 7.

[60] *Ibid*, Recital 2.

[61] *Ibid*, Recitals 2 and 4.

[62] *Ibid*, Recitals 46, 47, 51, 56, and 57.

[63] Colangelo (n 41). *See* also Giuseppe Colangelo, 'Antitrust Unchained: The EU's Case Against Self-Preferencing' (2023) 72(6) GRUR International 538; Oscar Borgogno and Giuseppe Colangelo, 'Platform and Device Neutrality Regime: The New Competition Rulebook for App Stores?' (2022) 67(3) Antitrust Bulletin 451.

[64] DMA (n 21), Recital 33.

[65] *Ibid*, Recital 62.

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stated aim to resolve general contestability issues and not only those emanating from abusive conduct.[66] This wider policy remit can be considered a departure from an efficiency-focused policy and a departure from the consumer welfare standard – at least in their commonly used static representations.

The enlarged remit of intervention does not come with a fully formed analytical toolkit for implementation. The regulation does not specify how to assess a "disproportionate advantage" or how to calculate the "full benefits" of a business's contribution to the platform ecosystem. The remedial provisions of the DMA are applicable *per se*, deviating also here from the current effect-based approach of competition policy. Once a platform has been designated as a gatekeeper – a designation that does not require the demonstration of dominance – the European Commission does not need to demonstrate the existence of an economic imbalance with business users or the presence of asymmetric bargaining power for any of the provisions of the Regulation to apply. In fact, the regulator does not need to determine whether it is solving for a contestability issue or a fairness one. The different provisions do not map to any one specific objective, so they can be thought of as fulfilling either one or both.

For the most part, the DMA provisions grant competing business users access to platform resources used by the gatekeeper's own services, grant business users rights to the data they generate, and aim to eliminate leveraging advantages of the gatekeeper platforms, for example, by preventing data combination and restricting tying or self-preferencing practices.[67] These provisions are indeed consistent with the approach of eliminating advantages of the designated platforms *vis-à-vis* their business users and effectively redistribute access rights to the benefit of the latter. Moreover, one could argue that the totality of the provisions implicitly promotes platform neutrality and the elimination of rights and advantages as a means to achieve both fairness and contestability.

By commingling the goals of contestability and fairness while at the same time making these two objectives distinct, the Commission grants itself enormous discretion for the justification, specification, and implementation of the different DMA provisions. This represents a clear departure from current competition policy standards, where the harm is normally well-identified and typically factually substantiated, and the objective of the remedial action is clearly defined. This lack of precision as to the concrete objective of the provisions is sustainable due to the *per se* nature of the mandated provisions of the DMA, which bypasses the problem of the lack of an analytical framework to assess fairness violations and subsequent remedies.

The very same issue emerges with regards to the recent proposal for a Data Act, which represents the latest effort of European policy makers to ensure the free flow of data and aims at fostering data sharing by unlocking machine-generated data and overcoming vendor lock-in.[68] Fairness is mentioned several times both in reference to allocative fairness (fairness in the allocation of value from data) and in relation to the competitive process (fairer and more

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[66] *See* DMA (n 21), Recital 32 where contestability is defined as "the ability of undertakings to effectively overcome barriers to entry and expansion and challenge the gatekeeper on the merit," which includes structural barriers.

[67] DMA (n 21), Articles 5 and 6.

[68] European Commission, Proposal for a Regulation of the European Parliament and of the Council on harmonised rules on fair access and use of data (Data Act), COM (2022) 68 final.

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competitive markets for data processing services).[69] There is also reference to fairness in data sharing contracts, with a goal of preventing contractual imbalances from the weaker negotiating position of smaller firms.[70] Some terms considered unfair by the Data Act are clearly inspired by the concept of abuse of economic dependence, establishing a parallel between data dependence and economic dependence.[71] It is notable that SMEs are excluded from the scope of application of the regulation, even though the abuse of economic dependence scrutinizes the unfairness of terms based on the imbalance of bargaining power between business parties, regardless of the size of the players involved.

The shortcuts adopted by the DMA or the Data Act are not intellectually satisfactory, and the need for a better framework will continue to be felt, including by advocates of the fairness objective in competition policy and market regulation. Against this background, there is a vibrant conversation on the proper way to characterize and implement fairness solutions. The next section summarizes the different approaches considered and currently being implemented.

4. REMEDIATION OF UNFAIRNESS: HAS IT STARTED AND WHAT DOES IT LOOK LIKE?

There are two straightforward ways to approach fairness. One is to look for fairness in the process of allocation of rights and privileges, and another is to focus on the fairness of the outcome.

John Rawls, the 20th-century American political philosopher, could be said to be a defender of the latter.[72] His concept of "Justice as Fairness" relied on two principles: a liberty principle guaranteeing a set of equal basic liberties for everyone, and the so-called "difference principle" that requires equal opportunities in competition for positions and privileges, together with an admissibility of inequalities as long as they benefit the weakest members of society.[73] The difference principle hence does not promote full equity, but inequality is only accepted to the extent that it provides benefits to those individuals with the least privileges. In addition, Rawls proclaimed the need to guarantee a "fair value" of the political liberties, meaning that these liberties must be meaningful and susceptible to being exercised. The "fair value" consideration puts limits on political freedom by setting, for example, a limit on the freedom

[69] *Ibid*, Explanatory Memorandum 2; European Commission, Inception Impact Assessment – Data Act, (2021) https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13045-Data-Act-amended-rules-on-the-legal-protection-of-databases_en.

[70] Data Act (n 68), Explanatory Memorandum 3.

[71] *Ibid*, Recital 51: "Where one party is in a stronger bargaining position, there is a risk that that party could leverage such position to the detriment of the other contracting party when negotiating access to data and make access to data commercially less viable and sometimes economically prohibitive. Such contractual imbalances particularly harm micro, small and medium-sized enterprises without a meaningful ability to negotiate the conditions for access to data, who may have no other choice than to accept 'take-it-or-leave-it' contractual terms."

[72] A discussion of different concepts of fairness in the competition policy context can be found in Niamh Dunne, 'Fairness and the Challenge of Making Markets Work Better' (2021) 84(2) Modern Law Review 230.

[73] David Reidy, 'Rawls, John' (2011) https://ssrn.com/abstract=1924902.

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to own the means of production.[74] Rawls's concept of fairness is anchored in the exercise of liberties and equal opportunities but contains the rationale for limits to economic rights and possible measures to guarantee an outcome where the liberties can be meaningfully exercised by all.

In contrast, another contemporaneous political philosopher, the libertarian Robert Nozick, defended a concept of liberty anchored in property rights and the right to act and dispose of one's possessions as seen fit.[75] The principle is that an entitlement will be just if it arises from a just act. A society only needs to determine what the just means for acquisition, transfer, or rectification are to counteract the unjust taking of a just holding. A situation emanating from those accepted acquisition, transfer, or rectification acts is to be considered just and in no need of rectification or redistribution.

In Europe, German ordoliberalism promoted the principle of individual freedom and the fight against illegitimate concentration of economic power, resulting in an interpretation of competition policy as the protection of the competitive process and the right to economic activity.[76] In fact, the adoption of the welfare standard and the more economic approach in the 2000s generated a discussion about whether this represented a deviation from the protection of the "freedom to compete" and from the concern about the accumulation of economic power.[77] The current discussions around fairness bring precisely those concerns back into the limelight.

The DMA and the political statements of recent years are evidence that a political decision has been taken in the EU that competition policy needs to tackle the issue of fairness, at least in the digital space. What seems to be emerging is a consensus that actively promoting contestability and the competitive process is an effective way to achieve a fair result.[78] Promoting contestability and the competitive process not only appeals to the ordoliberal tradition but also combines the principle of equal opportunities and objectivity for businesses, which is also dear to American liberal philosophers. Further, it rings true to classical economists who have long associated competition with fair outcomes for consumers. It largely avoids the controversy of explicit redistribution activities.

But what is a fair contestable market and how is it promoted? There is a difference between fighting abusive behavior to preserve market contestability, which is what competition policy does, and promoting contestability above and beyond what is delivered by the market with corrective interventions. Essential facility doctrines and utilities regulation are examples of the latter, with intervention consisting of mandated access to a facility (typically a

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[74] William Edmundson, 'What Is the Argument for the Fair Value of Political Liberty?' (2020) 46(3) Social Theory and Practice 497.

[75] Robert Nozick, *Anarchy, State, and Utopia* (Basic Books 1974).

[76] Wernard Möschel, 'Competition Policy from an Ordo Point of View' in A. Peacock and H. Willgerodt (eds.), *German Neo-Liberals and the Social Market Economy* (Palgrave Macmillan 1989) 142–159.

[77] Frank Maier-Rigaud, 'On the Normative Foundations of Competition Law: Efficiency, Political Freedom and the Freedom to Compete' in D. Zimmer (ed.), *The Goals of Competition Law* (Edward Elgar 2012) 132–168.

[78] *See, e.g.*, Jacques Crémer, Gregory S. Crawford, David Dinielli, Amelia Fletcher, Paul Heidhues, Monika Schnitzer, Fiona M. Scott Morton, Katja Seim, 'Fairness and Contestability in the Digital Markets Act' (2023) 40(3) Yale Journal on Regulation 973.

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monopolized facility) at a regulated price. Traditionally, such interventions have had the purpose of increasing market efficiency and lowering market prices by instilling competition or enabling new markets. Equity considerations were not at play. The question arises whether the active promotion of contestability for the purpose of achieving fairness, understood as the freedom to compete, leads to a lower threshold for intervention pursuing a structural rather than an efficiency objective.

Even wider discretion for regulatory intervention becomes a possibility if fairness is also understood as business users getting not only the opportunity to compete but also a "just reward for their contribution," as some scholars propose. The temptation is then to act beyond what is required for enabling entry and success and also to reallocate rights and opportunities to the benefit of ecosystem participants.[79] This concept of "just rewards" goes beyond previous contract law interventions against unfairness that clamp down on clauses that are opaque, unjustifiable because disconnected from the economic activity, or heavily skewed against the interest of the weakest party. The approach is to consider that some of the profit obtained by large players is illegitimate.

Some scholars have proposed that profits emanating from "moats", understood as barriers to entry or efficiencies from scale economies or integration, are not legitimate since they are not linked to the business's investment or innovation.[80] Such moats and related profits may emanate from the economic characteristics inherent to digital technologies and result from everyone's participation in the ecosystem. Rents may also result from unfair and abusive conduct enabled by the moats.[81] Therefore, these extraordinary rents should not be appropriated by the platform owner, and the regulator is entitled to intervene to eliminate the advantage or ensure every participant of the ecosystem reaps their "fair share." The assumption is that it should be easy to distinguish the share of profit that results from innovation efforts from that generated by moats that may develop along the way. But the lack of a concrete analytical framework and the corresponding limiting principles open the way for a policy without clear boundaries.

The latest General Court's antitrust judgments in the digital space seem to indicate an openness to forceful intervention in that direction. In its *Google Shopping* judgment, the General Court established that, even though it did not rely on this fact to affirm the infringement decision, the precedent of a legal obligation of non-discrimination imposed on internet access providers was likely to imply similar non-discriminatory access obligations on Google in relation to its search service, given its strong dominant position.[82] The stated reason was that

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[79] *Ibid,* 981: "We define fairness as the organization of economic activity to the benefit of users in such ways that they reap the just rewards for their contributions to economic and social welfare and that business users are not restricted in their ability to compete. We will show that, interpreted in this way, fairness is a useful concept that can guide policy in the right direction."

[80] *Ibid,* 982: "Network effects, especially when coupled with strong economies of scale, severely limit competition: each type of platform service will tend to be provided by one firm, or, if with enough product differentiation, by a few firms. Network effects and economies of scale shield these dominant firms from competition, enabling them to extract a significant proportion of the surplus that their presence in the market generates. This contrasts with traditional markets with no (or only small) network effects in which firms can only extract surplus to the extent that they offer a better product than their rivals."

[81] *Ibid*.

[82] *Google Shopping* (n 12), para 180.

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"a system of undistorted competition can be guaranteed only if equality of opportunity is secured as between the various economic operators."[83] The Court therefore implied that digital platforms could be subject to non-discriminatory access obligations for the sake of protecting equal opportunities and competition based on a finding of dominance alone and without any requirement for essentiality.[84] This is in fact what the DMA, subsequently adopted, sets out to do. It is notable, though, that the Court did affirm the European Commission finding that lack of equal treatment of third parties by Google on its search page represented a competition law violation under Article 102 TFEU, with no need to demonstrate the essentiality of the service at stake.

The judgment in *Google Android* is also notable for its emphasis on the problem created by the "advantage" that Google derived from the scrutinized practices, in particular the pre-installation of its apps on Android phones.[85] The Commission maintained that the pre-installation of Google's proprietary apps provided Google with an advantage "that had significant effects on competition by reducing, in particular, the choices available to consumers".[86] It asserted that the pre-installation practice raised barriers to entry, made it harder to compete by requiring resources to overcome the advantage granted by the conduct, and reduced the incentive to compete and innovate.[87] The tying angle of the case was similarly constructed on the basis that the advantage generated by the practice resulted in a restriction of competition. Interestingly, the General Court considered the question of whether competitors could theoretically overcome the advantage largely moot. It relied on the market outcome and the fact that competitors had not managed to do so in practice to find that competition had been restricted.

The following paragraph of the *Google Android* General Court's judgment affirming the European Commission decision is particularly notable:

> In addition, contrary to Google's contention, it is not appropriate to find that the contested decision is not consistent with the case-law and with previous practice in taking decisions. It is not disputed in the contested decision that downloading can in principle offset the advantage that would be conferred by pre-installation... In the present case, however, for the reasons set out in the contested decision and examined above, it is apparent that even though general search or browser apps can readily be downloaded free of charge, they are not downloaded in practice, or in any event are downloaded for an insufficient proportion of the devices concerned.[88]

The judgment goes on to specify that the Commission infringement decision does not attempt to establish anticompetitive foreclosure but to establish "first, the existence of an advantage linked to the MADA pre-installation conditions that cannot be offset by competitors, and, second, the anticompetitive effects of that advantage."[89] This can hardly be interpreted as

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[83] *Ibid*.

[84] See discussion in Pablo Ibáñez Colomo, 'Indispensability and Abuse of Dominance: From Commercial Solvents to Slovak Telekom and Google Shopping' (2019) 10(9) Journal of European Competition Law & Practice 532.

[85] *Google Android* (n 49).

[86] *Ibid*, para 68.

[87] *Ibid*, para 306.

[88] *Ibid*, para 557.

[89] *Ibid*, para 564.

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anything other than an explicit endorsement of the objective to protect competition over any consideration of efficiency arguments or consumer welfare. One could also be forgiven for interpreting this as the pursuit of a structural objective of supporting a multiplicity of players in the market.

The current consensus to intervene by redesigning the competition space is being supplemented by requests for purely redistributive fairness with a more direct reallocation of rents among the trading parties. The most notorious one relates to the dispute between content publishers and advertisement-supported platforms such as Google and Meta. Publishers and media outlets have complained that they are being unfairly compensated for the usage and redistribution of their media content on platforms such as Google or Meta. The argument is that these large platforms use news publishers' content on their own service to generate traffic for which they obtain user data and advertising revenues. Publishers are deprived of traffic going to their sites, which lowers their revenues and prevents them from developing an efficient online advertisement business.[90] The political impact of those media-related disputes has led to a series of initiatives around the globe setting mechanisms for a mandated negotiation for compensation by large online platforms (notably Google and Meta) to news publishers.[91]

In the EU, an ancillary copyright was even created for the posting of news online, leading to rights for compensation upon licensing of those rights.[92] Notably, in line with the proclaimed purpose of achieving "a well-functioning and fair marketplace for copyright", the Directive grants to publishers a neighboring right for the reproduction and making available to the public of press publications in respect of online uses by information society service providers.[93]

Digital platforms contest the economic reasoning underpinning these initiatives, arguing that the posting and resharing of media content augments the audience size and drives traffic to publishers' sites instead of diverting it.[94] This debate likely anticipates discussions around

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[90] Australian Competition and Consumer Commission, 'Lack of competition in ad tech affecting publishers, advertisers and consumers' (2021), https://www.accc.gov.au/media-release/lack-of-competition-in-ad-tech-affecting-publishers-advertisers-and-consumers. *See also* The Cairncross Review, 'A sustainable future for journalism' (2019), https://www.gov.uk/government/publications/the-cairncross-review-a-sustainable-future-for-journalism.

[91] *See* Parliament of Australia, 'Treasury Laws Amendment (News Media and Digital Platforms Mandatory Bargaining Code) Bill' (2021), https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r6652; UK Competition and Market Authority, 'CMA publishes code of conduct advice for platforms and publishers' (2022), https://www.gov.uk/government/news/cma-publishes-code-of-conduct-advice-for-platforms-and-publishers; and the recent U.S. Congress proposal for the Journalism Competition and Preservation Act (2022) https://www.klobuchar.senate.gov/public/_cache/files/0/2/02edbc26-debb-41b4-8c19-da7090159e30/60AA7BF7A217968D95D8CE417B93C06C.sil22a02.pdf.

[92] Directive 2019/790 of the European Parliament and the Council of 17 April 2019 on copyright and related rights in the Digital Single Market and amending Directives 96/9/EC and 2001/29/EC [2019] OJ L130/92, Article 15.

[93] *Ibid*, Recital 3.

[94] For an overview of the debate, see Giuseppe Colangelo, 'Enforcing copyright through antitrust? The strange case of news publishers against digital platforms' (2022) 10(1) Journal of Antitrust Enforcement 133; Giuseppe Colangelo and Valerio Torti, 'Copyright, online news publishing and aggregators: a law and economics analysis of the EU reform' (2019) 27(1) International Journal of Law and Information Technology 75.

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value flows within platform ecosystems that have so far been avoided but seem important for a proper case-specific discussion on fairness and the fair allocation of value. In 2022, the telecommunications incumbents in the EU similarly presented a report claiming they are subject to unfair conditions due to an imbalance of power and should in fact be remunerated by very large platforms using their networks.[95] In both cases, the requested or actual intervention consists of mandating a negotiation while establishing the presumption that such compensation must happen. There is no guidance given or requested as to the economic principles leading to the determination of the compensation amount, nor is there a full-fledged analysis of the value contributions and value flows within the ecosystems at stake.[96]

The DMA, in principle provides intellectual grounds for such a redistributive approach given its definition of fairness, which includes the right to obtain the "full benefits" of one's contribution. However, its current provisions provide access rights rather than compensation rights to business users. Intervention to redistribute value on the grounds of fairness runs into the problem of a lack of concrete definitions and benchmarks for "fair value" or "fair share". So far, the approach to fair prices and compensation in EU competition policy cases, which are supposed to link fair prices to economic value, has relied on market-based benchmarks and objective economic justifications.[97] It is therefore unclear to what extent to which a pursuit of fairness by competition policy will lead to the type of rent redistribution some stakeholders are advocating for and, if so, whether decisions in that direction will be based on the implementation of economic criteria and in respect of the consumer welfare standard and the economic approach.

It is likely that national regulators will provide more clarity regarding the issue of fairness in the digital space. Past and current reform proposals are looking to address up front the effect of the imbalance of power between large digital platforms and their business counterparties. In 2020, Belgium approved an amendment to its Code of Economic Law to insert a provision on the abuse of economic dependence, justifying the novelty by making specific reference to the legislative gap concerning digital platforms.[98] In 2021, alongside the new antitrust tool on undertakings of "paramount significance for competition across markets", the German legislator extended its economic dependence provision to firms acting as "intermediaries on multi-sided markets", insofar as companies are dependent on their intermediary services for accessing supply and sales markets in such a way that sufficient and reasonable alternatives do not exist.[99] Finally, in 2022, the Italian Annual Competition Law included a specific provision aimed at introducing a rebuttable presumption of economic dependence when an undertaking

[95] Axon Partners Group Consulting, 'Europe's internet ecosystem: socio-economic benefits of a fairer balance between tech giants and telecom operators' (2022), https://etno.eu/downloads/reports/europes%20internet%20ecosystem.%20socio-economic%20benefits%20of%20a%20fairer%20balance%20between%20tech%20giants%20and%20telecom%20operators%20by%20axon%20for%20etno.pdf.

[96] Tobias Kretschmer, 'In Pursuit of Fairness? Infrastructure Investment in Digital Markets' (2023) 14(7) Journal of European Competition Law & Practice 439. *See also* Giuseppe Colangelo, 'Fair share of network costs and regulatory myopia: learning from net neutrality mistakes' (forthcoming) Law, Innovation and Technology.

[97] *United Brands* (n 34); *AKKA-LAA* (n 36).

[98] Belgian Royal Decree of 31 July 2020 amending books I and IV of the Code of economic law as concerns the abuse of economic dependence, Article 4.

[99] GWB Digitalization Act, 18 January 2021, Section 20.

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uses intermediation services provided by a digital platform that plays a "key role" in reaching end users or suppliers, thanks also to network effects or the availability of data.[100]

Many of these reforms are taking place within competition policy law, and it is expected that the standards of rigor and evidentiary requirements typical of that space will lead to some analytical progress on these issues.

5. CONCLUDING REMARKS: REGULATING BUSINESS MODELS IN THE NAME OF FAIRNESS

Concerns about fairness are experiencing a revival in competition policy and market regulation. In the United States, this is embedded in a broader debate about the state of the economy and the possible risks of excessive economic concentration and uneven distribution of economic opportunities. In Europe, the appeal to more fairness has focused on the economic power of large digital platforms over their business users. In both places, the pursuit of fairness has been tied to a conversation about market contestability and economic opportunities for rival businesses.

In competition policy and the digital market regulation space, the objective of fairness is commingled with that of promoting contestability (i.e., a traditional objective of competition policy) and has been, in fact, absorbed by it, creating a new interpretation of competition policy rather than an explicit expansion of the policy's objectives. In fact, some scholars see the DMA as an instrument for supporting the traditional objective of maintaining a healthy competitive process by updating tools and with no obvious intent of redistribution.[101] But others have alerted us to the fact that the DMA constitutes an active redesign of markets and business models that amounts to an effective redistribution of rents and appears to pursue concrete structural objectives beyond the natural remit of competition policy.[102] Recent antitrust investigations and the extent of the foreseen interventions in the DMA indeed raise the question of whether the objective in the digital arena is to clamp down on abuse, more widely correct the competitive process, or achieve a particular structural outcome. For example, the DMA aims to infuse competition in various layers of a platform ecosystem where it may not organically emerge, even at the possible expense of a gatekeeper platform's ability to differentiate and compete as an ecosystem. The ultimate objective appears to be a digital space comprising more players competing at a more granular level on the platform (and with the platform) as opposed to a digital space characterized by inter-platform competition of integrated solutions. The direction of the EU Court in recent competition policy investigations and the provisions of the DMA also point to a possible *de facto* imposition of something akin to a platform neutrality policy.

This departure from traditional competition policy principles is emerging in the digital space without any equally articulated alternative concepts being proposed. The implementation process of the DMA is likely to contribute to the emergence of an analytical framework

[100] Italian Annual Competition Law, 5 August 2022, No. 118, Article 33.

[101] Heike Schweitzer, 'The Art to Make Gatekeeper Positions Contestable and the Challenge to Know What is Fair: A Discussion of the Digital Markets Act Proposal' (2021) 3 ZEuP 503.

[102] Pablo Ibáñez Colomo, 'The Draft Digital Markets Act: A Legal and Institutional Analysis' (2021) 12(7) Journal of European Competition Law & Practice 561.

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and will shed more light on the real intent of the legislation. Platforms will have to propose an implementation plan, and stakeholders will be consulted on these plans. It is expected that third parties, and notably platform business users, will put their own versions of implementation on the table, thereby providing their own visions of fairness and contestability. The extent to which their demands will have to be anchored in established concepts, or build on any analytical framework at all, as well as the inclination of the European Commission to accept these demands, will provide further clarity about both the interpretation of fairness and contestability and the purpose of the legislation.

It also remains to be seen whether the departures from traditional competition policy standards in the digital agenda will impact competition policy more generally. Will there be a further spread of the various elements found in the DMA, and, in particular the lower threshold for intervention bypassing formal dominance requirements, the appeal to presumptions of harm, the commingling of objectives, or the demise of the consumer welfare standard and related prominence of efficiency considerations? More importantly, will regulators be tempted to further regulate markets in the name of fairness, redesigning business models and markets? If that is indeed the case, are we likely to see such interventions in other markets or in pursuit of new objectives? How far are we willing to go to replace the market as the proper mechanism to allocate rents, even jointly created rents?

The coming years will tell whether we are witnessing the beginning of a metamorphosis of competition policy and market regulation to account for social and equity issues, or whether changes will be limited to the digital arena, or even be just a temporary reaction to a technology and market disruption that no one was prepared for.

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6. ESG: The Corporate and Antitrust Puzzle

Marco Corradi and Julian Nowag

1. INTRODUCTION

The debate around sustainability and the pursuance of ESG (environmental, social and governance)[1] strategies by corporations has become central in policy making.[2] Corporate law and competition law were not spared by the exponentially growing stream of literature that pushes for the inclusion of ESG into both areas of the law.[3]

In general, it might be said that while corporate law and governance typically focus on what happens within a company, competition law regulates how a company behaves externally in the market.[4] Yet, internal measures regarding organization and actions will also affect the outside behavior of a company, particularly with regard to ESG strategies. It is precisely this interaction that provides the basis for the study of this chapter on how ESG efforts are treated by the different areas of law and how this treatment affects the other area.

In corporate governance and in corporate law, the debate about ESG is in large parts about changing companies' behavior in a way that will make companies generate more ESG benefits, while limiting companies' existing negative externalities and harmful practices in ESG-related areas such as, pollution, child slavery and discrimination based on race, culture, and gender.[5] Thus, corporate law and governance set the directions for what companies will do and identify how they will develop.

[1] According to the UN, 'ESG standards: represent principles focused on environmental, social and governance impacts of businesses; apply primarily to the business sector, companies, and investors; do not have a standardised global framework.' (See UN, *Building a Sustainable Future: ESG Business Handbook*, UNDP, 2023, available at https://www.undp.org/sites/g/files/zskgke326/files/2023-08/building_a_sustainable_future_esg_business_handbook.pdf (accessed 15 December 2023) 26). Hence, there is no fully standardized definition of ESG. At the moment, ESG seem to be a rather open conceptual framework, which welcomes any contribution to social advancement in these areas.

[2] See Section 2 below.

[3] Ibid.

[4] See in this regard A Tzanaki, 'Common Ownership and Minority Shareholding at the Intersection of Competition and Corporate Law: Looking Through the Past to Return to the Future?' in Marco Corradi and Julian Nowag (eds.), *The Intersections between Antitrust and Corporate Law* (Cambridge University Press 2023).

[5] See in general T Li et al., 'ESG: Research progress and future prospects' (2021) 13 Sustainability 11663. It goes without saying that the increasing interest of the corporate world in ESG-oriented corporate strategies has raised skepticism among some top corporate lawyers. See for instance L Bebchuk and R Tallarita, 'The illusory promise of stakeholder governance' (2020) 106 Cornell Law Review 91. An alternative perspective is offered by S Gadinis and A Miazad, 'Corporate law and social risk' (2020) 73 Vanderbilt Law Review 1401, who propose the idea that,

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By contrast, competition law sets out what corporations cannot do. Thus, reforms of corporate law and of corporate governance can achieve objectives that cannot normally be achieved by competition law. Yet, competition law might prevent such achievements. For example, if a corporation concludes an agreement with other corporations as part of its ESG mission, competition law might prohibit such action. A good recent example is provided by a Uruguayan case.[6] Supermarkets wanted to reduce the amount of single-use plastic carrier bags. They agreed to charge a small amount for these bags, instead of providing them for free. The Uruguayan competition authority found this to be in violation of competition law.[7] We can thus say that competition law acts as a limitation as to where corporate law and corporate governance can lead corporations. Corporate directors will be forced to abide by competition law decisions under their duty of compliance.

In this chapter, we explore these interactions in greater detail. We examine how ESG influences corporate law and governance and how it can affect competition law. Our focus is on the mutual interaction between these two fields of law in light of the ESG movement. In Section 2, we explain some of the basic terms and assumptions upon which our analysis rests. Section 3 maps entry points for ESG considerations in the corporate and competition law systems. In Section 4, we explore how a fundamental rethink in light of ESG in one area of law would affect the other, and then how an adaptation of existing principles in these systems would affect the interaction between corporate and competition law. We argue that a fundamental rethink might require exactly that: fundamentally rethinking not only of one or the other fields, but also of their interaction and possibly of the liberty-based institutional environment as it is currently designed. The adaptation of existing principles might thus be preferable although not without challenges.

2. ESG, SUSTAINABILITY, CORPORATE LAW AND GOVERNANCE, AND COMPETITION LAW

Before delving into the substantive analysis of the relevant ESG policies pertaining to corporate law and governance and to competition law, we need to clarify a few assumptions and terms upon which this chapter rests.

Firstly, we take a wide definition of corporate law and governance, as encompassing financial markets law, and including the role of institutional investors in corporate governance. Yet, when we speak of competition law, we use a narrower definition. We mean rules addressing coordinated behavior, unilateral conduct (antitrust law) and merger rules, while we exclude

while pursuing the idea of 'doing social good', companies are presently pursuing ESG-oriented policies in order to safeguard themselves against downside risk.

[6] *Resolucion 330 / 2021 (Plastic Bags Case)* (Comisión de Promoción y Defensa de la Competencia).

[7] Contrast this with a similar case in Japan, where the only discernible difference is that the municipality was also involved in setting up the scheme to charge for the plastic bags. See OECD, 'Horizontal Agreements in the Environmental Context' (2010) DAF/COMP(2010)39, 149.

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for example State aid or other areas of law[8] that some jurisdictions might include as part of competition law.

Secondly, we acknowledge the difference between ESG and sustainability, as well as the difference in the timing of the ESG debate within the two areas of the law. Corporate practice started producing corporate social responsibility (CSR) codes in the early 1990s.[9] 'By the beginning of the [21st] century, most large companies in the U.S. and Western Europe [had] formed their own […] CSR [policies]'.[10] But CSR was not the core interest of corporate law scholars in the 20th century. Starting from the iconic piece by Jensen and Meckling,[11] and until the first decade of the 21st century, the core concern of corporate law and governance scholarship has been agency costs.[12] The second and third decades of the 21st century have witnessed an unparalleled emersion of ESG.[13] In competition law, a similar shift in focus can be observed. The last decade(s) of the 20th century were marked by a focus on economics and competition law.[14] While the debate about ESG and competition law started in the EU back in the 2000s,[15] it seems that in the past few years[16] the debate is becoming more mainstream. Overall, it might still be said that it has been a very European discussion. In Europe, the

[8] Thus, leaving aside matters like State aid/subsidies, bid-rigging, or various rules addressing specific competition challenges such as those in digital markets.

[9] F Madrakhimova, 'History of development of corporate social responsibility' (2013) 4 Journal of Business and Economic 509, 515. Note that with regard to corporate conduct, the environmental concern was seen as less pressing a few decades ago. CSR was originally intended as a positive way for the corporation to contribute to the well-being and development of society at large.

[10] Ibid.

[11] M Jensen and W Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 Journal of Financial Economics 305.

[12] J Armour and J McCahery (eds), *After Enron: Improving Corporate Law and Modernising Securities Regulation in Europe and the US* (Hart Publishing 2006).

[13] See also a collection of research papers on ESG by top scholars on the European Corporate Governance Institute's official website: https://ecgi.global/content/sustainable-corporate-governance.

[14] See e.g. A C Witt, *The More Economic Approach to EU Antitrust Law* (Hart 2016); J Blockx, 'The Limits of the "More Economic" Approach to Antitrust' (2019) 42(4) World Competition 475.

[15] See *CECED* (IV.F.1/ 36.718) Commission Decision 2000/ 475/ EC [2000] OJ L187/ 47; H Vedder, *Competition Law and Environmental Protection in Europe: Towards Sustainability?* (Europa Law Publishing 2003).

[16] See, e.g., S Kingston, *Greening EU Competition Law and Policy* (Cambridge University Press 2012); J Nowag, *Environmental Integration in Competition and Free-Movement Laws* (Oxford University Press 2017); OECD, 'Sustainability and Competition' (2020) OECD Competition Committee Discussion Paper, available at https://laweconcenter.org/wp-content/uploads/2023/03/sustainability-and-competition-2020.pdf (accessed 30 November 2023); European Commission, Directorate-General for Competition, Competition policy brief. 2021-01, September 2021, available at https://data.europa.eu/doi/10.2763/962262 (accessed 30 November 2023); OECD, Environmental considerations in competition enforcement (2021) OECD Competition Committee Discussion Paper, available at https://www.oecd.org/daf/competition/environmental-considerations-in-competition-enforcement.htm (accessed 16 February 2022), and the near exponential growth of the literature since 2020.

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Dutch and the Greek authorities had taken the lead[17] and the European Commission followed by updating its horizontal guidelines.[18] Yet, more recently, the debate takes place more globally with discussions and work at international fora such as the OECD and the International Competition Network[19] and agencies such as the Japanese[20] and the one from New Zealand[21] adopting guidelines. With ESG becoming more mainstream both in corporate and competition law, the sustainability debate is also colouring other previously 'orthodox' areas of research, at the intersection of competition and corporate law. For instance, this is the case with regard to questions on how to deal with mergers negatively affecting sustainability;[22] or the anticompetitive effects of common ownership, a theory which was originally developed exclusively based on finance,[23] and which is now heavily affected by the ESG debate.[24]

Thirdly, we recognize the problematic conflation of E-S-G – as environmental, social and governance – as forming a full-option package, ready to be installed on any pre-existing

[17] The Dutch competition agency (ACM), 2nd Draft Guidelines Sustainability agreements: Opportunities within competition law (2021) available at https://www.acm.nl/sites/default/files/documents/second-draft-version-guidelines-on-sustainability-agreements-oppurtunities-within-competition-law.pdf (accessed 30 November 2023); Greek Competition agency (HCC), Staff Discussion Paper On Sustainability Issues And Competition Law available at https://www.epant.gr/en/information/publications/research-publications/item/2706-staff-discussion-paper-on-sustainability-issues-and-competition-law.html (accessed 30 November 2023); Roman Inderst, Eftichios Sartzetakis, and Anastasios Xepapadeas, Joint Technical Report on Sustainability and Competition for the HCC and the ACM (Jan 2021) https://www.acm.nl/en/publications/technical-report-sustainability-and-competition (accessed 30 November 2023).

[18] See European Commission, Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements [2023] OJ C259/1.

[19] See OECD papers cited (n 16) above; Hungarian Competition Authority, Sustainable Development and Competition Law – Survey Report: Special Project for the 2021 ICN Annual Conference (30 September 2022) available at https://www.gvh.hu/en/gvh/Conference/icn-2021-annual-conference/special-project-for-the-2021-icn-annual-conference-sustainable-development-and-competition-law (accessed 30 November 2023).

[20] Japan Fair Trade Commission (JFTC), Guidelines Concerning the Activities of Enterprises, etc. Toward the Realization of a Green Society Under the Antimonopoly Act (31 March 2023) available at https://www.jftc.go.jp/file/230331EN_GreenGuidelines.pdf (accessed 30 November 2023).

[21] New Zealand Commerce Commission, Collaboration and Sustainability Guidelines (November 2023) available at https://comcom.govt.nz/__data/assets/pdf_file/0033/335985/Collaboration-and-Sustainability-Guidelines-30-November-2023.pdf (accessed 30 November 2023).

[22] See I Lianos and D Katalevsky, 'Merger Activity in the Factors of Production Segments of the Food Value Chain: A Critical Assessment of the Bayer/Monsanto Merger' CLES Policy Paper Series 2017/1 https://discovery.ucl.ac.uk/id/eprint/10045082/1/Lianos_cles-policy-paper-1-2017.pdf (accessed 16 February 2022); E Deutscher and S Makris, 'Operationalizing Sustainability under EU Merger Control' in J Nowag (ed), *Research Handbook on Sustainability and Competition Law* (Edward Elgar 2024).

[23] J Azar, M Schmalz and I Tecu, 'Anticompetitive Effects of Common Ownership' (2018) 73 The Journal of Finance 1513.

[24] J Azar et al., 'The big three and corporate carbon emissions around the world' (2021) 142 Journal of Financial Economics 674.

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policy agenda. The term ESG embodies great flexibility so that its exact contours are hard to define. As such, this is a strength and a weakness of the terms.[25] Yet, it is important to bear in mind that research shows that E, S and G often clash.[26] Therefore, one needs to consider the consequence of a selected policy line on each variable, E-S-G, separately. In this chapter, we mostly focus on environmental and social aspects, where the debate is currently taking place and the fields can be seen as changing recently. Fourthly, given the focus on the environmental and social effect elements of the ESG debate, we assume that they largely overlap with the sustainability debate in competition law. The debate in competition focuses mostly on environmental and social aspects of sustainability.[27]

3. ESG 'ENTRY POINTS' INTO THE PRESENT CORPORATE AND COMPETITION LAW SYSTEMS

The ESG movement is affecting the corporate and competition law debate very widely: it could be said that there is no area of the respective branches of the law that is not being explored as a potential alley for introducing ESG policies. Nonetheless, such alleys or 'entry points' are not all equal. Some may entail a revolution of the respective areas of the law, by redesigning the fundamental principles or general clauses that form the basis of each branch of the law. For instance, the for-profit function of the public company[28] or the consumer welfare objective pursued by competition law. Other 'entry points' may simply require a revision or adaptation of each system of law, leaving untouched the fundamental principles and the general clauses underlying each branch of the law.

In the following sections, we map out such entry points, placing them on a continuum between harder and softer entries. Here we use the term 'harder entries' for those that would entail a modification of the legal system at a statutory level and/or that would completely modify the core assumptions underlying the two systems of law. By contrast, we mean by 'softer entries' those modifications that are made either through soft law or through economic actors' influence (mainly investors') on corporate behavior or action.

In terms of effects on ESG goals, 'harder entries' may produce a rapid effect, once their revolutionary elements[29] are in place. Yet, it should be noted that these effects are not guaranteed, as they could remain 'law on the books and off the records'.[30] This might occur if the enforcer disagrees with the efforts of the lawmaker and if it faces strong opposition by

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[25] See Elizabeth Pollman, 'The Making and Meaning of ESG' (2024) 14 Harvard Business Law Review 403.

[26] Ibid.

[27] On the overlaps and the differences between the ESG debate in corporate law and governance and the sustainability debate in competition law, see M Corradi and J Nowag, 'ESG Policies at the Intersection Between Competition and Corporate Law' in M Corradi and J Nowag (eds.), *Intersections Between Corporate and Antitrust Law* (Cambridge University Press 2023).

[28] Or its for-profit use in the form of a listed company. Because in some jurisdictions the limited company form can also be employed for not-for-profit activity.

[29] On the revolutionary elements, see below Section 4.

[30] To paraphrase an old general theory by R Pound, 'Law in books and law in action' (1910) 44 Am. L. Rev. 12.

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economic actors. In contrast, 'softer entries' are more likely to take longer before becoming effective, as they may entail a more gradual and more acceptable reform which produces stable changes.

3.1 ESG 'Entry Points' into the Corporate Law System

Firstly, it should be remembered that corporate governance, which is itself one prong of ESG,[31] developed before what is nowadays labelled as 'the ESG debate', namely with the Cadbury Report. The UK Cadbury Report is the first corporate governance code ever to be conceived.[32] In turn, corporate governance has been employed more and more in support of sustainability, as for instance through the modification of the content of the so-called 'stewardship codes'.[33]

As set out in Figure 6.1[34], there can be a variety of potential points of entrance for ESG policies into the corporate law and governance system, ranging from a complete revolution in the basic tenets of corporate law (such as creating a general rule entailing that a corporation becomes a not-for-profit entity) to a mere duty of disclosure of ESG-related corporate actions. Or ESG policies could even be even left entirely to the action of institutional investors.

The harder way through which 'environmental' and 'social' could enter corporate law would entail a complete change of direction of the overall corporate law system. Imagine that a lawmaker decides that environmental and social aims should occupy the first rank among the objectives pursued by corporate law. This would be in total contrast with what happens nowadays in most developed economies, where the chief objective consists of maximizing shareholder value. Such a hypothetical reform could be in line with the stronger pro-ESG stances, such as those proposed by Colin Mayer.[35] This would entail the lawmaker introducing, for instance, a director's duty to advance environmental and social goals against any other

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[31] As recalled by Pollman (n 25) 413 the United Nations Environment Program Finance Initiative equates the term G ('governance') employed in ESG with 'corporate governance'.

[32] The Cadbury Report can be found at https://www.ecgi.global/code/cadbury-report-financial-aspects-corporate-governance. On the history of the Cadbury code, see L Spira and J Slinn, *The Cadbury Committee: A History* (Oxford University Press 2013).

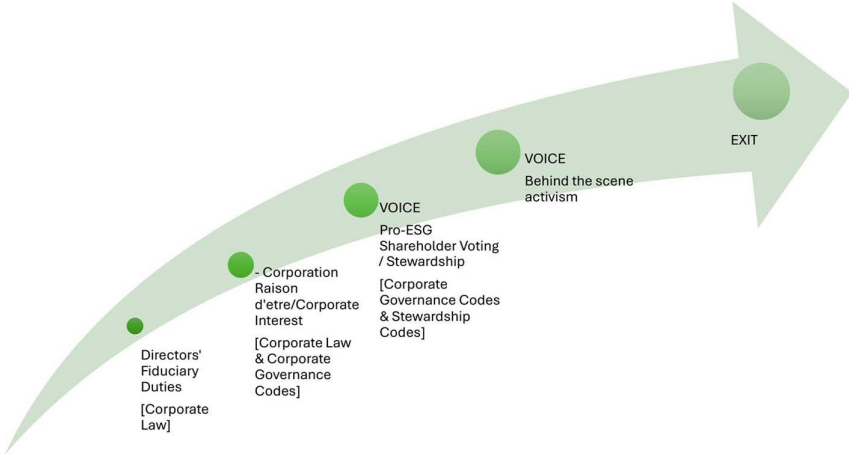
[33] See for instance, with reference to the 2020 UK reform of the UK stewardship code, P Davies, 'The UK Stewardship Code 2010-2020 from Saving the Company to Saving the Planet?' (2020) European Corporate Governance Institute-Law Working Paper 506. Stewardship codes are special corporate governance codes that were introduced with the purpose of empowering institutional shareholders in their role of monitoring corporate boards. See J Hill, 'Good activist/bad activist: The rise of international stewardship codes' (2017) 41 Seattle UL Rev. 497.

[34] In this figure, we have included some of the interventions depicted in the main text. The first three kinds of interventions are rooted in corporate law. Behind-the-scenes activism and exit are typical ways through which institutional investors interact with the corporate board. Both in the narrative and in the graphical representation, we omit the fact that clearly the actions by institutional investors vis-à-vis the corporation are supported by further rules which lie outside the corporation, namely the fiduciary rules of investment funds' managers vis-à-vis investors. On this point, see the recent paper by G Ferrarini and M Siri, 'Stewardship and ESG in Europe' (2023) European Corporate Governance Institute-Law Working Paper 743.

[35] Although the author has not proposed the introduction of such a duty, he has claimed that corporations should serve consumers first. See, for instance C Mayer, 'The future of the corporation and the economics of purpose' (2021) 58 Journal of Management Studies 887.

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variable – including the maximization of shareholder value. Hence, a business corporation would no longer be a profit-maximizer organization; it would be transformed into something completely different – a sort of enterprise pursuing social goals – through a duty that would be enforceable in front of the competent courts.[36]



Source: The authors

Figure 6.1 A progression of 'harder' to 'softer' entries of ESG goals in the corporate debate

Alternatively, such a goal might be pursued in a softer and more flexible way through the transformation of the meaning of general clauses. Such clauses, for instance the 'interesse

[36] Note that this would be a completely different approach from the one corresponding to the so-called 'enlightened shareholder value', already followed in certain jurisdictions such as the UK (see Section 172 of the UK Companies Act 2006). This consists of allowing other interests within corporate governance, insofar as they are functional to the maximization of long-term shareholder value. Note that such an approach has attracted harsh criticism for its illusory promises to shift directors' attention from shareholders' interests to stakeholders' interests, which is unlikely to happen in practice. See L Bebchuk, K Kastiel, and R Tallarita, 'Does Enlightened Shareholder Value Add Value?' (2022) 77 The Business Lawyer 731.

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sociale' in Italian law[37] or the 'intérêt social' in French corporate law,[38] i.e. general corporate law clauses referring to the 'corporation's interest'. Although presently such clauses are generally understood as corresponding to the maximization of shareholder value,[39] interpretations of such clauses encompassing a variety of different interests – i.e., stakeholder-oriented interpretations – could be adopted. As a matter of fact, such interpretations already existed in the past, especially before competition law had been introduced in Italy or in France, although of course at that time the focus was not on ESG, but on stakeholders, especially employees and, only marginally, consumers/service users.[40] Refocusing on stakeholder-oriented interpretations of these general clauses could facilitate a smoother transition toward embracing ESG objectives, as it would aim to reconcile these objectives with the maximization of shareholder value. However, it would also introduce a degree of discretion in the balancing process by courts, which in turn could prompt distorted interpretations and, in the worst scenarios, corruption.

Although the harder entry described above is possible in theory, for the time being, ESG entry into the corporate law and governance systems appears to be softer. A central role in the ESG corporate landscape seems to be occupied by corporate governance codes, which mandate ESG disclosure on a comply or explain basis.[41]

But apart from disclosure requirements, corporate directors are also, in general, increasingly subject to another recently emerged duty. In fact, ESG rules may affect directors by requiring a duty of compliance, i.e., the careful monitoring of the relevant legislation and the adaptation of the internal governance system in order to detect and prevent potential breaches of the law.[42] In this sense, for the time being, ESG policies appear to be external to corporate law, as they allowthe corporation to maximize shareholder value while complying with external ESG legislation. An example of a rule that remains external to corporate law but which will definitely affect corporations is the EU Corporate Sustainability Due Diligence Directive proposal, which is expected to be adopted soon.[43] According to the EU Commission, 'the

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[37] For Italy, see for instance P Jaeger, *L'interesse sociale* (Giuffre 1964); P Jaeger, 'L'interesse sociale rivisitato (quarant'anni dopo)' (2020) 27 Giurisprudenza commerciale 795; for France, see for instance D Schmidt, *Les droits de la minorité dans la société anonyme* (Sirey 1970) 200ff.

[38] See for instance, A Asquini, *I battelli del Reno* (Giuffre 1959); for France, see J Paillusseau and M. Y. Loussouarn, 'La société anonyme: technique d'organisation de l'entreprise' (Sirey 1967) 196ff. And see, similarly, in pre-WW2 German corporate law, the theory of the 'Unternehmen An Sich', K Geiler, 'Die Konkretisierung des Rechtsgebots der guten Sitten im modernen Wirtschaftsrecht' in *Festschrift Herrn Rechtsanwalt und Notar Justizrat Dr. jur. hc Albert Pinner zu seinem 75. Geburtstag* (De Gruyter 1932) 254.

[39] Cass. 11151/1995, Leprai v Stilgraf s.r.l. in liquidazione.

[40] See (n 30) above.

[41] P Câmara, 'The Systemic Interaction Between Corporate Governance and ESG' in *The Palgrave Handbook of ESG and Corporate Governance* (Springer International Publishing 2022) 3.

[42] Which seems to be a more articulated form of the so-called 'duty of obedience', as described by A Palmiter, 'Duty of Obedience: The Forgotten Duty' (2010) 55 New York Law School Law Review 457; S Griffith, 'Corporate governance in an era of compliance' (2015) 57 William & Mary Law Review 2075.

[43] Proposal for a Directive Of The European Parliament And Of The Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 COM/2022/71 final.

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proposal also introduces directors' duties to set up and oversee the implementation of due diligence and to integrate it into the corporate strategy. In addition, when fulfilling their duty to act in the best interest of the company, directors must take into account the human rights, climate change and environmental consequences of their decisions.'[44] The latter statement is more ambiguous, and it remains to be seen what it means in the corporate law context and how it will affect directors' duties. Note also that some European countries, such as France, for instance,[45] have adopted sustainability due diligence rules independently and before the enactment of the Directive.

Institutional investors may also be vectors of ESG policies, clearly with a different weight in corporations with a dispersed versus concentrated ownership structure. In fact, it is well-known that in companies with a concentrated ownership structure, the final decisions on matters of ESG are almost entirely in the hands of the controlling shareholder.[46]

Institutional investors' actions form another external constraint on the internal functioning of the corporate machine. A significant portion of investment funds are now ESG funds, and their weight is increasingly growing.[47] Even when investment funds are not expressly labelled as ESG funds, they tend to be active promoters of ESG policies[48] (even though this may often be functional to their long-term profit strategy, among other complex reasons).[49] Such promotion can take the form of the exercise of minority shareholders' rights, but more frequently, it can correspond to informal interventions vis-à-vis the board, which is known as 'behind the

[44] EU Commission, 'Just and sustainable economy: Commission lays down rules for companies to respect human rights and environment in global value chains', available at https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1145 (accessed 30 November 2023).

[45] The French national law on supply chain due diligence is *statute n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre* (Decree (No. 2012-557) on the Transparency Obligations of Companies in Social and Environmental Matters). Note that France has already developed ESG-oriented legislation. For listed companies, certain obligations pre-date the due diligence obligations for supply chains. For example, a duty to include environmental and social information in annual reports was established in 2001 by Law No. 2001-420. In 2010, the 2001 obligation for listed companies was extended to the largest unlisted companies, with Law (No. 2010-788) on National Commitment for the Environment (so-called "Grenelle II Act").

[46] D Puchniak, 'The False Hope of Stewardship in the Context of Controlling Shareholders: Making Sense Out of the Global Transplant of a Legal Misfit' (2024) 72 (1) American Journal of Comparative Law 106–169..

[47] According to a PWC report, 'Asset and wealth management revolution 2022: Exponential expectations for ESG' (https://www.pwc.com/gx/en/industries/financial-services/asset-management/publications/asset-and-wealth-management-revolution-2022.html?WT.mc_id=CT11-PL1000-DM2-TR2-LS4-ND1-TTA9-CN_gx-fy22-xlos-esg-awm-esg-revolution-pressrelease (accessed 30 November 2023), ESG assets are on pace to constitute 21.5% of total global assets under management in less than 5 years.

[48] M Barzuza, Q Curtis and D Webber, 'Shareholder value(s): Index fund ESG activism and the new millennial corporate governance' (2019) 93 Southern California Law Review 1243.

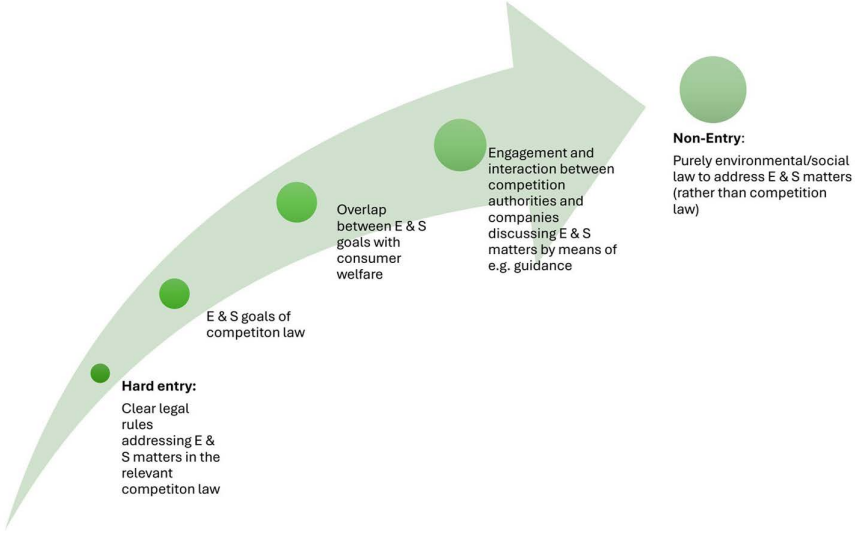
[49] K Wang, 'Why Institutional Investors Support ESG Issues' (2021) 22 UC Davis Business Law Journal 129. A literature review on investment funds' ESG activism can be found in B Gerard, 'ESG and socially responsible investment: A critical review' (2019) 33 Beta 61.

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scenes activism'.[50] All the institutional investors' actions described above clearly correspond to what Hirschman has defined as 'voice' strategies.[51] Beyond that, institutional investors that disagree with a given corporate strategy in terms of ESG can also revert to what Hirschman calls 'exit'.[52]

3.2 ESG 'Entry Points' into the Competition Law Debate

In competition law, we can equally distinguish between softer and harder entry points. In other words, the environmental and social elements of sustainability can shape the application of competition law in different ways. On the one hand, there is the possibly hardest entry point. This would involve changes to the actual hard law. On the other hand, there are calls to keep such matters completely outside the realms of competition law. In other words, there would be no entry point for such matters



Source: The authors

Figure 6.2 A progression of 'harder' to 'softer' entries of ESG goals in the competition law debate

[50] J McCahery, Z Sautner, and L Starks, 'Behind the scenes: The corporate governance preferences of institutional investors' (2016) 71 The Journal of Finance 2905.

[51] See in general A Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States* (Harvard University Press 1972).

[52] Ibid. There is some empirical evidence, at least from the PRC stock market, that fear of institutional investors' exit can actually push corporations to adopt more ESG-oriented strategies. See Y Hu and K Kim, 'Do words speak louder than actions? The effects of institutional investors and voluntary green disclosures' (2023), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4528794 (accessed 30 November 2023).

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into competition law. In the middle, we can observe different softer entry points which relate to the interpretation of the existing competition laws and their enforcement. We will explore the different harder and softer entry points as explained in Figure 6.2 in the following.

One option that always exists is to change the law to ensure social and environmental matters can be taken into account and that in specific cases they can take precedence over maintaining competition. One recent example in this regard is the amendments to the Austrian Competition Act.[53] The amendment concerns the question as to when an agreement that restricts competition is exempted from the prohibition of such agreements. The Austrian legislator changed the wording of the national equivalent to Article 101(3) TFEU (§ 2 of the Federal Cartel Act). Article 101(3) TFEU usually requires that the 'consumers' receive 'a fair share' of the benefits ('improvements to the production or distribution of goods' or the 'promotion of technical or economic progress') that result from the restriction of competition. The amendment added a provision that explains that:

> Consumers shall also be deemed to enjoy a fair share of the benefits which result from improvements to the production or distribution of goods or the promotion of technical or economic progress if those benefits contribute substantially to an ecologically sustainable or climate-neutral economy.[54]

Leaving aside the question of how this provision relates to EU law, which does not contain such a provision,[55] it helps the competition authorities to decide whether or not to consider such benefits that might well appear outside the market affected by the restriction. This question has proved rather controversial,[56] because the benefits are not necessarily[57] directly felt by the consumers of the product where competition has been restricted.

Another example is jurisdictions where the competition law proclaims to foster environmental or social goals. For instance, South Africa's competition law aims to promote 'a greater spread of ownership' in the economy, in particular, to increase the ownership stakes

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[53] For a detailed overview, see V H S E Robertson, 'Sustainability: A World-First Green Exemption in Austrian Competition Law' (2022) 13 Journal of European Competition Law and Practice 426.

[54] § 2 (1) of the Federal Cartel Act.

[55] See in this regard Robertson (n 53).

[56] On different positions regarding out-of-market efficiencies, see e.g., I Lianos and A Darr 'Hunger Games: Connecting the Right to Food and Competition Law' (2019) CLES Research Paper Series 2/2019, available at https://www.ucl.ac.uk/cles/sites/cles/files/cles_2-2019.pdf (accessed 30 November 2023) 27–47; EU Commission, 'Guidelines on the applicability of Article 101' (n 18) para 585.

[57] Such benefits are not necessarily directly felt, as there are (some) cases where the question is not so much about whether benefits are felt but rather about valuation or measurement. For example, where a car emits fewer toxins and less CO2, this has at least two benefits that can be identified for those affected by the higher prices. On the one hand, they might (subjectively) value such a car as having a higher quality. On the other hand, (objectively) we might see other benefits that they also – as part of a broader group – enjoy, such as reduction in pollution leading to benefits in terms of life expectancy or a reduction in CO2 leading to a reduction of the climate change effects/costs. See also the Commission's distinction between use, non-use, and collective benefits in the new horizontal guidelines (European Commission (n 18) paras 571–591).

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of 'historically disadvantaged persons'. This aim of competition law stems from the right to equality as protected by the South African constitution.[58]

While these are harder entry points, as they are specifically spelled out in the law, there are also more categorical approaches that mark the other end of the spectrum. This approach suggests that there are no entry points to competition law for environmental and social goals. In other words, environmental and social goals should be pursued exclusively by other areas of law, such as environmental and social laws.[59] We might identify such a conception in the recent attempts by the US to use antitrust rules to prevent companies from taking climate initiatives.[60]

In between the two extremes of the law mandating inclusion and those advocating the complete exclusion of such considerations, we can find different options of soft entries. One of these entry points is the examination of existing laws to explore in what way these can be (re) interpreted to encompass environmental and social matters.[61] In other words, competition authorities and courts examine the extent to which competition law specific notions, such as consumer welfare, overlap with environmental or social goals. One example in this regard is the protection of sustainability innovation by means of competition law. For instance, the European Commission in the *Adblue*[62] case found that the parties to a cartel had prevented (sustainable) innovation in the form of preventing the emergence of new emissions cleaning technology.

A second, maybe even softer entry point is based on agency discretion. Some agencies may decide[63] to engage with companies directly. Examples in this regard are the provision of formal and informal guidance[64] to companies who wish to pursue environmental or social objectives but fear that it may raise competition issues. This approach of guidance may also be combined in ways that make it harder or softer. On the one hand, it can be paired with the above-described attempt to identify overlaps between, for example, consumer welfare and environmental and social goals. On the other, it can employ more orthodox readings and just

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[58] See R Das Nair and S Roberts, 'Sustainability and Competition in Eastern and Southern Africa' in J Nowag (ed), *Research Handbook on Sustainability and Competition Law* (Edward Elgar 2024).

[59] For such a view, see e.g. C Veljanovski, 'Collusion as Environmental Protection – An Economic Assessment' (2022) 18 Journal of Competition Law and Economics 523; M P Schinkel and L Treuren, 'Green Antitrust: Friendly Fire in the Fight Against Climate Change' in Simon Holmes, Dirk Middelschulte and Martijn Snoep (eds), *Competition Law, Climate Change and Environmental Sustainability* (Concurrences 2021).

[60] For an overview, see Latham and Watkins, 'ESG Initiatives Face Increased Pressure From Potential Antitrust Challenges' (15 May 2023) Client Alert 3102, available at https://www.lw.com/admin/upload/SiteAttachments/ESG-initiatives-face-increased-pressure-potential-antitrust-challenges.pdf (accessed 19 November 2023).

[61] See Nowag (n 16) chapter 1.

[62] *Car Emissions* (Case AT.40178) available at https://ec.europa.eu/competition/antitrust/cases1/202146/AT_40178_8022302_3050_5.pdf (accessed 30 November 2023).

[63] The discretionary element becomes clear as other competition authorities may decide not to do so.

[64] In this regard, see e.g., G Monti, 'Implementing a Sustainability Agenda in Competition Law and Policy' in J Nowag (ed), *Research Handbook on Sustainability and Competition Law* (Edward Elgar 2024).

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advise on when agreements should be considered not to have an appreciable effect[65] on competition, for example.

3.3 ESG, Corporate and Competition Law: Incoming Revolution or Progressive Adaptation of Persisting Paradigms?

Having mapped out at least some of the potential entry points of E and S policies into competition and corporate law, we turn to exploring how the changes in one area of the law affect the other area of the law. This also helps us to explore whether corporate law and competition law are ready to welcome the urgent paradigm shift that is emphasized in the ESG literature. It also assists in evaluating in what way such a paradigm shift might be possible. In the first part, we explore the hard entry approach, involving a substantial re-think of fundamentals, and its effects; in the subsequent part, we explore the softer adaptation approach.

4. THE RETHINK/HARD ENTRY APPROACH

4.1 What Might a Complete Rethink of Corporate Law Principles Mean?

As already suggested, a revolutionary change may entail relinquishing the 'maximizing shareholder value' principle and adopting a radically different conception of the corporation, that is, re-imagining the corporation as an institution that pursues chiefly environmental and social goals. As said, strongly stakeholder-oriented models of the corporation have already existed in continental Europe – i.e., models that integrated not-for-profit objectives in the corporate agenda.[66] There are at least three series of problems in relation to the adoption of a stakeholder-oriented approach.

Firstly, in principle, a stakeholder-oriented model introduces a strong degree of discretion in corporate decision-making, especially when such stakeholders bear conflicting interests. Elizabeth Pollman has argued that S and G represent often conflicting goals.[67] Therefore, such a reform may create a high degree of confusion in corporate decision-making. Certainty of the law could be harmed to the extent that courts may support one goal against the other in one decision and vice versa in the following decision.

Secondly, there is a potential political danger intrinsic to a stakeholder-oriented approach. Stakeholderism was employed in harmful ways by pre-WW2 dictatorships. For instance, when the Italian civil code was reformed under fascism, corporate law was disciplined in Civil Code, Book V, which deals with labor law – with explicit conflation of corporate and labor interests. Such a reform was backed by a view of society which was imbued with 'corporativismo,' i.e., the idea that social classes were no longer in conflict and instead they were

[65] See, e.g., European Commission, Notice on agreements of minor importance which do not appreciably restrict competition under Article 101(1) of the Treaty on the Functioning of the European Union (*De Minimis Notice*) [2014] OJ C291/1.

[66] See text corresponding to (n 38).

[67] Pollman (n 25).

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harmoniously contributing to a common fascist developmental goal.[68] But in fascist times, this also meant that labor law disappeared as such and ended up being integrated within 'corporativismo', rendering any meaningful defense of labor rights non-viable. At present, the ESG version of stakeholderism does not seem to present the political problems that arose in pre-WW2 times, because it mainly consists of promoting non-shareholder constituencies with the hope that they will back ESG policies. Nonetheless, one should remain wary of such potential illiberal repercussions at a political level.

Thirdly and finally, stakeholderism, in contrast to shareholderism, seems rather inefficient. US corporate jurisprudence has promoted shareholderism as leading to efficient corporate decision making, based on the idea that, unlike other corporate constituencies, shareholders have homogeneous interests. Thus, where the role of the board is maximizing shareholder value, one has a very concrete and measurable objective.[69] The shareholder-centered model, based on shareholders as residual claimants, seems far from being surpassed by such rather ambiguous revivals of institutionalist conceptions in the form of stakeholder-centred models.[70]

4.2 Effect of a Corporate Law Rethink on Competition Law

Any such fundamental change in corporate law would also substantially affect competition law in its current form. Competition law relies on economic insights based on industrial organization. The economic and econometric models used in competition law depend on the assumption of the company being a rational profit-maximizer. This assumption in competition economics and law is in part built on the shareholder value maximization axiom in corporate law. Any change in corporate law would alter a whole range of ideas that would require a fundamental re-think in competition law. For instance, Maarten-Pieter Schinkel and his co-authors used a standard model to show why the pursuit of environmental or social objectives by means of cooperation between companies is rarely efficient.[71] They showed that the companies would only produce the least amount of social and environmental benefits at the highest possible cost to consumers. This finding is based on the core assumption that the companies are aiming to maximize their profit from their cooperation. Once this assumption is not in line with the actual working of corporate law, one would have to fundamentally rethink that model and with it the implications for competition law and policy. In other words, where profit maximization is not at the core of corporate law, it is difficult to use it as an assumption in economic models examining the effects of competition to inform competition law and policy.

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[68] See for instance, the writings of U Spirito: *Capitalismo, socialismo, corporativismo* (Anonima romana editoriale 1934); *Il corporativismo come liberalismo assoluto e socialismo assoluto* (Pacini Mariotti 1933); *Capitalismo e Corporativismo* (Sansoni 1934); *Dall'economia liberale al corporativismo: critica dell'economia liberale* (Principato 1939).

[69] See for instance, the seminal piece by H Hansmann, 'Ownership of the Firm' (1988) 4 The Journal of Law, Economics, and Organization 267, 269ff, and the foundational paper in corporate finance by E Fama and M Jensen, 'Agency problems and residual claims' (1983) 26 The Journal of Law and Economics 327.

[70] See Bebchuk and others (n 5).

[71] M-P Schinkel and Y Spiegel, 'Can collusion promote sustainable consumption and production?' (2017) International Journal of Industrial Organization 371; M-P Schinkel, Y Spiegel and L Treuren, 'Production Agreements, Sustainability Investments, and Consumer Welfare' (2022) 216 Economics Letters.

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It is hard to say for sure if the changes in Section 4.1 would be beneficial for both the economy and ESG. Since they would completely change the assumptions on which competition law is founded, it is tough to predict their effects. We might need to wait and see how things turn out and study the changes afterward to really understand their impact.

4.3 What Might a Complete Rethink of Competition Law Principles Mean?

A rethink in competition law in the light of environmental and social goals, the E and S of ESG, would mean abandoning the consumer welfare standard[72] and similar standards focused on the competition process. It would allow more and/or other objectives, specifically E and S objectives, to override competition law prohibitions. In other words, it would involve the (re) introduction of (at least) these public policy objectives into competition law, allowing competition authorities to balance anti-competitive effects directly against E or S benefits.

One such proposal suggests replacing the consumer welfare approach with a capability approach, which is based on the ideas of the philosopher Martha Nussbaum and the economist Amartya Sen.[73] This approach would require, in the first step the identification of all stakeholders that can be affected directly or indirectly by the possibly anticompetitive arrangement. Second, it would map out how the arrangement would affect their positions.[74] In a third step, all the effects on these different interests would be weighed against each other. This weighing would then also take into account threshold levels at which these effects take place. For example, a higher weight is put on satisfying basic needs, while the weight is lower on anything that exceeds those basic needs. To put this into a more tangible example, the ability to buy basic food items is weighted higher than buying luxury goods. Such an approach is certainly a radical departure from the current dominant approach in competition law. It would require different skill sets of the competition authorities, and many agencies would certainly struggle with identifying the different stakeholders and considering their interests. However, while such an approach seems challenging, it possibly seems more a question of proceedings and procedure, in other words, of tools. The Australian competition regime, in their assessment of whether a restrictive agreement provides a sufficient 'net public benefit' has developed some procedural tools, like open stakeholder meetings and impact assessments.[75]

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[72] On the recent debate as to whether the consumer welfare standard is still fit for purpose, see e.g. OECD (2023), The Consumer Welfare Standard – Advantages and Disadvantages Compared to Alternative Standards, OECD Competition Policy Roundtable Background Note, available at www.oecd.org/daf/competition/consumer-welfare-standard-advantages-and-disadvantages-to-alternative-standards-2023.pdf (accessed 30 November 2023).

[73] This approach is suggested by R Claassen & A Gerbrandy, 'Rethinking European Competition Law: From a Consumer Welfare to a Capability Approach' (2016) 12(1) Utrecht Law Review 1.

[74] On their ability to hold property and to contract (market-constituting capabilities); the effects on essential human requirements (consumptive capabilities) such as health, education, nourishment, housing; finally, the effects on third parties (third-party capabilities). Claassen and Gerbrandy here mention the interests of 'future generations which stand to be harmed by damage to the climate', animal welfare affected by 'intensive pig farming', or 'health of (inter alia) young people [… and] security of inner-city inhabitants' in the case of binge drinking, see ibid 5–6.

[75] See G Foster, 'Australia: Sustainability as a public benefit to be weighed against the anti-competitive detriments of competitor collaborations' in J Nowag (ed), *Research Handbook on Sustainability and Competition Law* (Edward Elgar 2024).

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4.4 Effect of a Competition Law Rethink on Corporate Law

Competition law is mandatory, and therefore managers need to take into consideration the guidelines provided by competition authorities in order to be compliant with such reforms. What may not be allowed by the principle of maximizing shareholder value may become mandatory as a consequence of competition law compliance. For instance, companies have to continue maximizing shareholder value, but competition law does not allow them to do so. For example, competition law prohibits companies from forming cartels, even though such activity may be profit-maximizing. Similarly, where competition law is changed to take account of E and S impacts, corporate action that is profitable for shareholders but leads to increased emissions or negative social impacts might be prohibited by competition law.

Where corporate law and competition law may start pursuing diverging goals, competition law would prevail under the duty of compliance. This would definitely generate an external (very expensive) pressure on corporate strategy. Nonetheless, this kind of conflict may not be new. For instance, labor laws mandating the minimum salary and protection for labor may already raise the corporation's costs, therefore making corporate profits fall. To put it differently, competition law may keep on being an externality for corporations, but it would become a more structural and pervasive one, given the totally conflicting goals of the two branches of the law. In turn, such a pervasive pressure may end up thwarting the ordinary functioning of for-profit corporations and push them to adapt to not-for-profit logics, at least in part.

There may also be an alternative reading to the potential effects of such a structural reform to competition law on corporate strategy. In fact, especially with reference to cartels, corporations may expand their potential to conclude anticompetitive agreements. For example, say that competition authorities introduce an interest-balancing procedure as described above. The corporate board may start guessing, also on the basis of the corpus of precedents, whether a given competition authority will allow them to retain an anticompetitive agreement because of the ESG benefit or not. As a consequence, they may introduce ESG goals in anticompetitive agreements instrumentally, i.e., for circumventing competition law. However, such an increased freedom of action enjoyed by corporations would not change the core of corporate law.

4.5 Tentative Conclusions on a Total Rethinking of Corporate or Competition Laws' Basic Tenets

It appears to us that a total rethinking of the main tenets either of competition or of corporate law entails substantial difficulties for the other area of law. It will make a smooth operation with the existing tenets of the other area – if not impossible, at least – substantively more complex. This conclusion might not be particularly surprising as corporate and competition law have developed alongside each other.[76] Thus, a synchronization of any changes in the two fields appears to be a sensible demand. However, the historical antecedents of such a synchronization may seem suspect. There are examples of systems that were adapted to an

[76] For an overview of numerous ways in which they have interacted and still interact, see M Corradi and J Nowag (eds) *Intersections Between Antitrust and Corporate Law* (Cambridge University Press 2023).

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institutionalist view of the corporation[77] and that, in the meantime were also highly cartelized (e.g., pre-WW2 Germany or Italy). For instance, in fascist Italy, the promoters of 'corporativismo' pushed both the stakeholder and the cartelization agenda, which they found perfectly consistent with each other.[78] In this sense, the past seems to raise a clear warning against this kind of policy line, as it may serve non-democratic political moves, even if, of course this cannot be stated *a priori*.

5. AN ADAPTION OF EXISTING PRINCIPLES

The adaptation of existing principles might also bring about certain requirements for synchronization, as we will show. In the following, we will explain what forms an adaptation of existing principles can take and how such an adaptation in one area of law would affect another. We first explore how corporate law could be adapted and what it means for competition law. Then we turn to adaptations in competition law and how they will affect corporate law.

5.1 What an Adaptation of Existing Principles in Corporate Law Would Mean?

There can be different attempts by private actors to adopt more ESG-friendly policies without requiring any reform of corporate law, i.e. by way of employing a so-called private ordering approach.[79] For instance, a now popular corporate governance article advocates for market solutions, namely a so-called 'green-pill', that is a clause included in the bylaw that would require a company to disgorge a significant sum of money to a not-for-profit entity when missing a pre-declared milestone in the pursuance of ESG goals.[80]

As already said, institutional investors' pro-ESG activism, while affecting corporate strategy, would not entail a substantial change of the rules internal to the corporation. Stewardship can be curbed to the pursuance of ESG objectives.[81] Institutional investors may express their like or dislike for ESG or non-ESG friendly policies also through exit.[82] What characterizes this kind of action is that (1) it may be discretionary (for instance a corporation or an investment fund may decide to revert to it or not); (2) it may be priced by investors (who normally bear different preferences, also in terms of ESG). Its overall effects may be rather unpredictable to some extent on a larger scale, because the adoption of such a strategy is contingent on the will of each private entity to pursue it. In the worst-case scenario, there may be no effect at

[77] What might in today's lingo be called a stakeholder-oriented approach.

[78] See for instance Spirito (n 68).

[79] J Cox, 'Corporate Law and the Limits of Private Ordering' (2015) 93 Wash. UL Rev. 257; also provided that, as explained by Moore, private ordering does not have the same reach in every single jurisdiction. See M Moore, 'Private ordering and public policy: the paradoxical foundations of corporate contractarianism' (2014) 34 Oxford Journal of Legal Studies 693.

[80] J Armour, L Enriques, and T Wetzer, 'Green Pills: Making Corporate Climate Commitments Credible' (2023) 65 Ariz. L. Rev. 285.

[81] See n 34.

[82] See n 35.

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all, unless ESG strategies are aligned with for-profit strategies.[83] Moreover, we have to keep in mind the double fiduciary layer that normally characterizes the modern public corporation.[84] Retail investors or other investment funds invest in funds of different kinds, and these in turn invest in corporations. Thus, the retail investors can be the ultimate shareholders who are also bearing interests that are third to the corporation they invested in. Recent events show that there may be a double layer of interests manifesting also in the ESG arena – corresponding to the double-layered fiduciary relationship. An interesting example is provided by Larry Finch's ESG agenda, which is not well-seen by both the Texan government and some Texas investors.[85] The fight between the two has reached a point where the Texan government has put pressure on pension funds to disinvest from BlackRock funds, because their ESG-friendliness may run counter to the interests of prospective pensioners.[86]

5.2 Effect of an Adaptation of Existing Principles in Corporate Law on Competition Law

The just-described adaptations of existing corporate law principles can have rather different effects on competition law. As we will explore in the following, these adaptations may, on the one hand, substantially change some of the underlying economic principles, depending on how they are adopted. On the other hand, they might require rather little adjustment or might invite similar, if not more pernicious, fights on the directions that corporations are allowed to advance in terms of ESG.

The adoption of private ordering, depending on how it is performed, can have a profound effect on the economic principles underlying current competition economics. Depending on the sums of money that need to be disgorged in the case that ESG goals are missed, the incentives of corporations might substantially change. As explained in section 4.2,[87] current competition economics builds its models on the assumption that companies will maximize their profit. However, the adoption of a disgorgement clause that is intended to change the incentives

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[83] For a thorough description of the relationship between profit and not-for-profit rationales within modern corporate law, see E Pollman, 'Corporate social responsibility, ESG, and compliance' in D Daniel Sokol & Benjamin van Rooij (eds.), *Cambridge Handbook of Compliance* (Cambridge University Press 2021). As the alignment between profit-maximizing and ESG goals is very unlikely in control transactions, see also J Macey, 'ESG Investing: Why Here? Why Now?' (2022) 19 Berkeley Business Law Journal 258, 287. For this reason, one may wonder whether the introduction of ESG objectives should be better demanded by the law. See Massimiliano Vatiero's chapter 'Varieties of Capitalism, Competition, and Prosocial Corporate Purposes' in this Handbook.

[84] R Gilson and J Gordon, 'The agency costs of agency capitalism: Activist investors and the revaluation of governance rights' (2013) 113 Columbia Law Review 863.

[85] See 'AG Paxton Demands BlackRock Account for its Underperforming, Potentially Illegal 'ESG' State Pension Fund Investments', available at https://www.texasattorneygeneral.gov/news/releases/ag-paxton-demands-blackrock-account-its-underperforming-potentially-illegal-esg-state-pension-fund (accessed 30 November 2023).

[86] See 'Texas Has a Warning for Its Pensions: Sever Ties With BlackRock', available at https://www.bloomberg.com/news/articles/2023-02-23/texas-esg-crackdown-targets-pension-funds-with-blackrock-ties?embedded-checkout=true (accessed 30 November 2023).

[87] See above Section 4.2 .

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of the firm would also entail a need to change this assumption. As explained above,[88] traditionally, we expect that companies provide only the bare minimum of ESG benefits where these benefits affect their profits. However, depending on the design of such a green pill disgorgement clause, the situation and the incentives change. In a specific situation, a company that is subject to a disgorgement clause may need to prioritize the ESG benefit over profit maximization even where the ESG benefits reduce its profits. The company has to compare the situation of reduced profit due to investments into ESG benefits with opting for lower ESG benefits due to their costs while taking into account the disgorgement 'fine'. In other words, it has to compare the net-profit after investing little into ESG and thus having to disgorge some profits with the net-profit after investing more into ESG but having no disgorgement.

Pro-ESG activism by institutional investors raises a different set of questions. On the one hand, we might not need to change the framework of competition law at all to let such activism take effect. On the other hand, competition law might be seen as a tool to prohibit such activism. Both of these approaches seem currently on display.

In the UK, the Competition and Markets Authority addressed investor agreements in pursuit of environmental sustainability in their Green Agreements Guidance. It explains that:

> […] An agreement between shareholders of a single business to vote in support of corporate policies that pursue climate change or environmental sustainability agreements or against policies that do not, or to lobby jointly for corporate changes that pursue environmental sustainability objectives, will be unlikely to infringe competition law.[89]
>
> Similarly, where there is an agreement (or network of similar agreements together) covering shareholders' conduct in relation to several businesses that are competitors in a market, there is unlikely to be a negative effect on competition in that market if the corporate policies, or the changes the shareholders are agreeing to, support, encourage or require the adoption of any of the categories of agreement set out in Section 3 of this Guidance.[90]

Yet, it is also possible that competition law will be another venue where States and investors battle out their political disagreements. In other words, it can also be attempted to employ competition law to stop at least joint pro-ESG activism by institutional investors. One such case is currently taking place in the US, where institutional investors who signed up for the Climate Action 100+ initiative[91] are being investigated for a violation of the Sherman Act by a group of State attorney generals (AGs), while another group of AGs writes that there are no antitrust concerns.[92]

Thus, it might be said that even a minor adaptation in corporate law and governance might have substantial effects on competition law. At the same time, depending on the approach

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[88] Ibid.

[89] UK Competition and Markets Authority (CMA), Green Agreements Guidance: Guidance on the application of the Chapter I prohibition in the Competition Act 1998 to environmental sustainability agreements (12 Oct 2023) CMA 185 available at https://assets.publishing.service.gov.uk/media/6526b81b244f8e000d8e742c/Green_agreements_guidance_.pdf (accessed 19 November 2023) para 3.24.

[90] Ibid, para 3.26.

[91] The details about this initiative can be found at https://www.climateaction100.org/ (accessed 30 November 2023).

[92] For a summary of the different AG actions, see e.g. Latham and Watkins (n 60).

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taken under competition law,[93] any corporate law changes might be substantially hampered by competition law.

5.3 What an Adaptation of Existing Principles in Competition Law Would Mean?

In competition law, the debate about adapting competition law in light of E and S is also ongoing, particularly in Europe. Yet, a certain new status has been reached with the adoption of the new horizontal guidelines by the European Commission, which now contain a specific section that addresses sustainability agreements.[94]

Overall, the debate is not so much focused on ESG. Instead, the debate takes the shape of discussing the interaction between sustainability or the sustainable development goals (SDGs)[95] and competition law.[96] As we will explore in the following, the question here is one of identifying overlaps between consumer welfare and sustainability. In light of the climate crisis, there are, moreover, discussions about providing specific rules for climate change agreements, for example easing the burden of proof.[97] Overall, this adaptation can take two strands of engagement.

On the one hand, competition authorities pursue anticompetitive practices that also have negative effects on E or S. For example, the French competition authority has fined a cartel where companies agreed not to pursue marketing campaigns based on their superior environmental performance.[98] Similarly, the European Commission has fined car manufacturers for agreeing not to compete over innovating further in terms of cleaning technology for diesel vehicles.[99] 'Green killer acquisitions' are another example frequently mentioned, where a more sustainable competitor is acquired in order to shut it or its more sustainable technology down.[100]

On the other hand, companies that jointly pursue sustainability objectives might be able to show that the pursuit of these objectives also fulfils the conditions of benefiting consumers. In other words, the conditions of Article 101(3) TFEU are fulfilled, and consumer welfare

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[93] In other words, how competition law approaches such corporate action. For differences in approach, see, for example, the UK's CMA in its guidelines (see CMA (n 89)) or the approach by some of the US AGs to Climate 100+ (see overview in (n 63)).

[94] See European Commission (n 18).

[95] The UN, sustainable development goals, available at https://sdgs.un.org/goals (accessed 30 November 2023).

[96] See with regard to the difference between ESG, SDG, and sustainability, M Corradi and J Nowag, 'ESG Policies at the Intersection between Competition and Corporate Law' in M Corradi and J Nowag (eds), *Intersections Between Antitrust and Corporate Law* (Cambridge University Press 2023).

[97] See, for example the UK's CMA approach with regard to climate agreement, CMA (n 89).

[98] See Autorité de la Concurrence, Décision 17-D-20 relative à des pratiques mises en œuvre dans le secteur des revêtements de sols résilients (18 October 2017), available at https://www.autoritedelaconcurrence.fr/fr/decision/relative-des-pratiques-mises-en-oeuvre-dans-le-secteur-des-revetements-de-sols-resilients (accessed 30 November 2023).

[99] See *Car Emissions* (n 62).

[100] See e.g. R Maximiano and C Volpin, 'Merger Control for Green Innovation' in J Nowag (ed), *Research Handbook on Sustainability and Competition Law* (Edward Elgar 2024).

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is increased by the agreement. For example, the Greek,[101] Dutch,[102] and UK competition authorities[103] suggested that CO2 reductions can offset competitive harm since they can benefit consumers. And while this debate is ongoing, a vocal minority[104] is rather critical and warns that such adaptations are inefficient. They argue that competition authorities are not well placed to balance E & S gains against restrictions of competition. The legislator should adopt specific rules to address any market failures in terms of E & S matters rather than leaving this task in the hands of companies. Companies would only provide the minimum of S & E gains at the highest possible price since they have no incentive to sacrifice their profits. As explained above, the Austrian legislator has taken up that call and changed the Austrian equivalent to Article 101(3) TFEU to include a legal presumption that climate benefits are benefitting consumers.[105] In the absence of legislative changes at the EU level, the European Commission in its horizontal guidelines seemed to have tried to adopt a middle ground. On the one hand, it states the consumers of the affected product must be fully compensated by the benefits of the agreement. On the other hand, it has changed its approach to how such benefits can be shown. The benefits now include use benefits,[106] non-use benefits[107] and collective benefits[108] such as reductions in CO2 emissions. These should normally be quantified, and it should be shown how they compensate the affected consumers. Yet, the EU Commission will also accept qualitative evidence where data is not available.[109]

Another approach that is now commonly seen with regard to such sustainability agreements and competition questions in general is a policy of an open door. Competition agencies like the European Commission,[110] the Dutch,[111] or the UK,[112]and the Japanese[113] agencies make clear that they welcome companies contacting them where they feel that competition law and their S & G aims may be contradictory. The aim of the agencies is to provide companies with informal guidance, often combined with immunity from fines where the companies comply with the guidance issued.

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101 See HCC (n 17).

102 See ACM (n 17).

103 CMA (n 89).

104 See, e.g., the literature (n 63) above.

105 For details see Robertson (n 53).

106 See European Commission (n 18) para 571–574.

107 Ibid para 575–581.

108 Ibid para 582–589.

109 See ibid para 589. This suggests that even where no detailed evidence is provided, but it is clear that the benefits are outweighing the harm by an order of magnitude, the agreement would satisfy the conditions of Article 101(3) TFEU.

110 See European Commission, Notice on informal guidance relating to novel or unresolved questions concerning Articles 101 and 102 of the Treaty on the Functioning of the European Union that arise in individual cases (guidance letters) 2022/C 381/07 [2022] OJ C381/9.

111 See ACM, 'ACM's oversight of sustainability agreements: Competition and sustainability' (4 October 2023) available at https://www.acm.nl/system/files/documents/Beleidsregel%20Toezicht%20ACM%20op%20duurzaamheidsafspraken%20ENG.pdf (accessed 30 November 2023).

112 See CMA (n 89).

113 See JFTC (n 22).

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5.4 Effect of an Adaptation of Existing Principles in Competition Law on Corporate Law and Strategy

In general, directors' conduct that might bring about competitive harm may be seen from at least two different perspectives. Firstly, if borderline and not expressly anticompetitive and if it maximizes shareholder value, it may simply show compliance with directors' duties (maximizing shareholders' value). If expressly anticompetitive, it may damage not only the directors (in case they are deemed individually liable)[114] but also the consumers because of the pass-on effect: this is the rather well-known phenomenon that leads a company that has been fined to increase its price downstream.[115] In the second case, from an economics perspective, there will be a trade-off between gains from anticompetitive practices and sanctions or damage claims imposed as a consequence of anticompetitive breaches. Now, the kind of adaptation depicted in Section (cc) might introduce a degree of ambiguity regarding what is pro- and what is anticompetitive, which could be exploited by companies for pursuing borderline anticompetitive conduct. Nonetheless, the adaptation of competition law principles to ESG objectives may also ease companies' adaptation to new non-corporate rules, such as the one provided by the EU Directive on directors' mandatory ESG due diligence on the supply chain.[116]

5.5 Tentative Conclusion on Adaption of Existing Principles

As a tentative conclusion, we can say that an adaptation of the existing principles to ESG policies may follow two distinct institutional paths in competition versus corporate law. Whereas in competition law such an adaptation would still be rooted in public action, i.e., public ordering, in corporate law it could mostly be introduced through private ordering and/or action by institutional investors through voice or exit. Although such institutional channels are clearly different, there may be a degree of convergence in such public versus private ordering activity. This path seems preferable as it promises a degree of flexibility and better synchronization of the changes occurring in both branches of the law. Yet, even such apparently soft or minor adjustments in one field might still create rather substantial effects and obstacles in the other. Thus, to ensure any effective policy, it needs to be ensured that any change in one field will not be scuppered by the other.

6. CONCLUSIONS

The interactions between corporate and competition law on one side and ESG on the other can entail revolutionizing the two aforementioned branches of the law or may simply require an adaptation, pursued either through soft regulative interventions or through private ordering.

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[114] See in this regard the chapter by JU Franck and T Seyer, 'Management Liability for Companies' Antitrust Fines' in this Handbook.

[115] And it is well-known that the passing-on effects are the cause of rather difficult policy choices. B Durand and I Williams, 'The importance of accounting for passing-on when calculating damages that result from infringement of competition law' (2017) 18(1) ERA Forum.

[116] See also above text at (n 46–49).

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Although hard entries of ESG into corporate and competition law may sound tempting to those who would like to see an energetic pursuance of ESG objectives, our chapter shows that softer entries are preferable. While not a panacea, softer entries seem to display higher flexibility, which is crucial when applying policies whose overall consequences on collective welfare are rather unknown.[117] A further point of concern in relation to harder entries is represented by the potential disruption of a system based on a liberal economy conception, which in turn is connected to the way modern democracies work – involving leaving as many choices as possible choices to private actors. A different system, where certain substantive values, such as ESG, are strongly and vertically imposed is not *per se* bad. But we need to be mindful of the dangers of the blurred stakeholder conceptions of the corporation and widespread cartelization in the pre-WW2 period, which were often functional to the suppression of labor rights on the one hand and to a centralized control over economic power on the other. Hence, harder entries, although not impossible, require a broader assessment and thorough intellectual work for conceiving rules that preserve the liberty-based institutional environment in which we live.

Yet, the use of soft entry points creates its own challenges as changes in one area affect the other. Thus, any changes in one area need to be closely monitored to ensure that the relevant consequences in the other area are explored. Only in this way can it can be ensured that one area does not counteract the pursuit of ESG in the other area of law. Unsurprisingly, the debate about the value and political desirability of ESG policies also shapes and controls the interaction between these two fields of law. In other words, one area can be used to prevent or direct any progress in the other field of law.

Our chapter provided a very preliminary overview of the basic tenets of this entangled interaction between corporate law, competition, and ESG. We hope that it will help in developing a deeper debate on the need for the coordination of ESG policies in these different branches of the law.

[117] It is known that ESG are 'good' objectives, but less is known about the negative externalities they may produce.

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PART II

THE FIRM AND ITS BOUNDARIES

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7. The Undertaking and Single Entity Doctrine in EU and UK Competition Law: Proposals for a Refined Approach

Stephen Daly and Alison Jones

1. INTRODUCTION[1]

The EU competition law rules apply to 'undertakings': Article 101 of the Treaty on the Functioning of the European Union (TFEU) prohibits certain restrictive joint arrangements between two or more undertakings (agreements, concerted practices and decisions by associations of undertakings); Article 102 TFEU prohibits abusive conduct of dominant undertakings; whilst the EU Merger Regulation prohibits certain corporate reorganisations between undertakings which would significantly impede effective competition in the internal market.[2] The concept of an 'undertaking' thus determines 'the categories of actors'[3] to which the competition rules apply, as well as which of the specific rules apply.

Despite its centrality, the notion of an undertaking is not defined in the Treaty. Rather, it has been left to the Court of Justice of the European Union (CJEU), which includes the Court of Justice (CJ) and the General Court (GC), to elucidate its meaning.[4] Settled case law of the CJEU establishes that the concept 'encompasses every entity engaged in an economic activity, regardless of the legal status of the entity and the way in which it is financed' (*Höfner*).[5] Further, that it is not necessarily synonymous with natural or legal personality but denotes a single economic entity, which may be comprised of one or more persons (it may thus encompass two or more companies with distinct legal identities).[6] This interpretation has a number of important implications.

[1] The authors would like to thank Marcos Araujo, Nigel Banerjee, Andriani Kalintiri, Winfred Knibbeler, John Kwan, Eva Lomnicka, Timothy McIver and participants at a Mannheim Centre for Competition and Innovation Workshop for their comments on previous drafts of the paper. All errors are those of the authors alone.

[2] Articles 107–109 prohibit Member States from granting unlawful state aid to undertakings, and see also Art. 106 TFEU. This chapter does not deal with the question of whether the concept of undertaking used in Articles 101, 102 and the EU Merger Regulation is the same as the concept used in the state aid provisions or, more broadly, in other areas of the TFEU.

[3] Case C-67/96 *Albany International BV (Albany) v Stichting Bedrijfspensioenfonds Textielindustrie* EU:C:1999:430, [1999] ECR I-575, Opinion of Jacobs AG, para 206.

[4] Treaty of the European Union, Art 19.

[5] Case C-41/90 *Höfner and Elser v Macrotron* EU:C:1991:161, [1991] ECR I-1979, para 21.

[6] Case 170/83 *Hydrotherm Gerätebau GmbH v Compact de Dott Ing Mario Adredi & CSAS* EU:C:1984:271, [1984] ECR 299, para 11; and Case C-97/08 P, *Akzo Nobel v Commission* EU:C:2009:536, [2009] ECR I-8237, para 55.

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First, it means that all entities – organisations[7] such as companies, partnerships, unincorporated associations, self-employed individuals, state-owned enterprises and other state or public bodies – are subject to competition law when offering goods and services[8] on a market in circumstances where that activity 'could, at least in principle, be carried on by a private undertaking in order to make profits'.[9] Thus, in order to give effect to the purposes of the rules, a functional approach is adopted. The concept captures all entities able to produce economic distortions to the market.

Secondly, the single economic entity doctrine, which looks beyond individual entities or corporate forms to a broader economic notion of a firm, impacts on the substantive application of the laws. For example, agreements made between separate legal entities fall outside the scope of Article 101 when those entities form part of the same economic unit, on the basis that no joint conduct can exist. It thus affects the substantive reach of Article 101. Further, an assessment of the market power of an undertaking(s) must take account of the position not only of the entity(ies) engaged in the conduct being analysed, but also the position of all other entities within the relevant economic unit(s).

Thirdly, and more controversially, the single economic entity concept has been relied on as a mechanism for attributing liability for a breach of the competition rules by one legal entity to another within the same economic unit on the grounds that it is the 'undertaking' as a whole that is responsible for compliance with the rules and so also for infringements of them.[10]

This chapter sets out the view that the approach to the undertaking concept in EU competition law creates a number of problems and inconsistencies, highlighted by some recent cases, which are difficult to resolve. It thus proposes a refined approach to the undertaking and economic entity concepts, which seeks to resolve these tensions, but which would not lead to a dramatic change in practice. It starts in Sections 2 and 3 by examining how the single economic unit doctrine has developed. Section 4 goes on to identify the difficulties that stem from the approach that has been adopted before Section 5 proposes an alternative approach to the issue, which is guided by principles of UK company law, but which is also rooted in EU case law. Although, in light of more recent precedent, a change of direction in the EU might seem more difficult to envisage, the proposed solution could, post-Brexit, be followed in the UK should the relevant authorities, and courts, so decide.

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[7] An entity does not necessarily have legal personality.

[8] For instance, *Höfner* (n 5).

[9] Cases C-264/01, C-306/01, C-354/01, C-355/01 *AOK Bundesverband and others* ECLI:EU:C:2003:304, [2004] I-2493, Opinion of Jacobs AG, para 27. See e.g. Case C-343/95 *Cali & Figli v Servizi ecologici porto di Genova SpA* ECLI:EU:C:1997:160, [1997] ECR I-1547. Conversely, the rules will not apply to a public, or private, body which exercises public powers in the public interest, exercises official authority, fulfils an exclusively social function, or otherwise carries out a core function on behalf of the state, *Albany* (n 3), Opinion of Jacobs AG, para 311; Cases C-180–184/98 *Pavlov* EU:C:2000:428, [2000] ECR I-6451, para 201.

[10] Given the limitations on space, this chapter does not deal with the concept of an undertaking on a dynamic basis and following corporate reorganisations.

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2. THE SINGLE ECONOMIC UNIT CONCEPT AND THE SUBSTANTIVE REACH OF ARTICLE 101

An established line of cases holds that the notion of an undertaking constitutes an economic unit consisting 'of a unitary organisation of personal, tangible and intangible elements which pursues a specific economic aim on a long-term basis and can contribute to the commission of an infringement'.[11] These cases make it clear that such a unit can be comprised of a natural person, such as a sole trader; a legal person, such as a company (made up of individuals); a group of natural and legal persons; or even a group of legal persons, such as a parent and a subsidiary (or subsidiaries), or a principal and its agent,[12] each of which may be engaged in economic activity. Indeed, precedent establishes that a parent and its subsidiary company will form a single undertaking if the subsidiary 'enjoys no economic independence'[13] or merely carries out the instructions issued by its parent company and 'has no real freedom to determine its course of action on the market'[14] – that is, where the parent is able to, and does actually, exercise decisive influence over the policy and direct the conduct of a subsidiary, so the subsidiary does not enjoy real autonomy in determining its course of action in the market.[15]

As noted in the introduction, one crucial consequence of the doctrine is that it impacts on the substantive reach of Article 101. Agreements and concerted practices between legal entities forming part of the same economic unit fall outside the scope of Article 101 – there is no joint conduct.[16] In *Viho*,[17] therefore, the CJ upheld the Commission's finding that distribution agreements concluded between Parker Pen (a manufacturer of writing utensils) and its wholly owned subsidiaries did not trigger the application of Article 101. As Parker Pen controlled the sales, advertising, and marketing policy of its subsidiaries, those subsidiaries had no real autonomy to determine their course of action.[18] Similarly, in *Hydrotherm Gerätebau GmbH v Compact del Dott Ing Mario Andreoli & C Sas*[19] the CJ confirmed that a natural person, a limited partnership, and another firm would constitute a single economic unit (and a single undertaking and party to an agreement) if they were all controlled by the same natural person; in such circumstances, the legally independent entities constituted a single economic unit and are treated as one party to an agreement. Although relatively few EU cases have dealt with the economic unit doctrine and the substantive reach of Article 101, in *Šiaulių regiono atliekų*

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[11] See Case C-407/08 *Knauf Gips v Commission* EU:C:2010:389, para 84; and Case T-11/89 *Shell International Chemical Co v Commission* EU:T:1992:33, [1992] ECR II-757, para 311.

[12] An independent agent may also form an integral part of its principal's undertaking in certain circumstances; in particular, where the agent does not take on any (or only a negligible portion of) financial and commercial risk linked to sales of goods to third parties on behalf of the principal, see Case C-279/06 *CEPSA* EU:C:2008:485, [2008] ECR I-6681, para 36.

[13] Case 22/71 *Béguelin Import Co v SAGL Import Export* EU:C:1971:113, [1971] ECR 949, para 8.

[14] Case 15/74 *Centrafarm BV and Adriaan De Peijper v Sterling Drug Inc* EU:C:1974:114, [1974] ECR 1147, para 41.

[15] Cases 48, 49, and 51–57/69 *ICI v Commission (Dyestuffs)* EU:C:1972:70, [1972] ECR 619, paras 125–146.

[16] *Centrafarm* (n 14), para 41.

[17] Case C-73/95 P *Viho Europe BV v Commission* EU:C:1996:405, [1996] ECR I-5457.

[18] ibid, para 15.

[19] *Hydrotherm* (n 6).

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tvarkymo centras and 'Ecoservice projektai' UAB[20] the CJ confirmed that where entities forming part of a single economic unit[21] (a matter to be determined by the referring court in that case) submit separate bids in a public tender process, no collusive bidding arrangement is formed for the purposes of Article 101. The CJ did hold, nonetheless, that the conduct might infringe public procurement rules set out in EU public procurement directives (including, then, Directive 2004/18) if autonomous and independent tenders had not been submitted.[22]

Utilising this idea, a series of EU Regulations and Notices accept the importance (when calculating the market shares and assessing the market power of an undertaking in a competition law appraisal) of taking account not only of the position of the relevant legal entity or entities involved in the conduct, but also that of their 'connected undertakings',[23] for example, 'undertakings' in which a party to the agreement, directly or indirectly, has the power to exercise more than half of the voting rights, or has the power to appoint more than half of the supervisory board, management or has the right to manage the undertaking's affairs.

These cases, regulations and notices recognise that, in these defined circumstances, entities within the economic unit behave like a single entity. If the subsidiary's strategy is determined by the parent, the parent and subsidiary will pursue a common course irrespective of the existence of any agreement between them.[24] The unity of purpose that they pursue thus impacts on the application of the competition law rules, including through rendering meaningless the application of Article 101 to agreements between them (where entities form part of the same economic unit, competition between the parties is impossible[25] and there is no competition to

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[20] Case C-531/16, EU:C:2018:324, para 28.

[21] But see reference to the need for the parent to have a determining influence on its subsidiaries, ibid, para. 29.

[22] Directive 2004/18/EC, now repealed by Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement [2014] OJ L94/65. Although that directive did not preclude entities forming part of the same economic unit from bidding and making separate offers in the same procurement procedure (rather such a policy would run counter to the policy of ensuring the widest possible participation in tendering procedures), and tenderers could not, in the absence of express legislative provision or specific conditions in the call for tenders, be obliged to disclose links between them to the contracting authority. Art 2 of the Directive precluded the award of a contract to a tenderer who had submitted a coordinated or concerted, rather than independent and autonomous, tenders. Consequently, a contracting authority, with evidence calling into question the autonomous and independent character of submitted tenders, is obliged to verify whether tenderers' offers are in fact autonomous and independent. See also Case C-538/07 *Assitur v Camera di Commercio, Industria, Artigianato e Agricoltura di Milano* EU:C:2009:317, [2009] ECR I-4219.

[23] See e.g. Commission Regulation (EU) 2022/720 of 10 May 2022 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices, 2022/720 [2022] OJ L134/4, Art 1(2); and Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 101(1) [2014] OJ C291/1, paras 16–17.

[24] Case T-102/92 *Viho Europe BV v Commission* EU:T:1995:3, para 50, set out at text to (n 118). See also Case T-9/99 *HFB Holdings v Commission* EU:T:2002:70, [2002] ECR II-1487, paras 54–68 and *Akzo Nobel* (n 6), para 55.

[25] *Hydrotherm* (n 6), para 11.

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be protected[26]). This approach reflects that adopted in the US, where the Supreme Court in *Copperweld*[27] held that since a parent and a wholly-owned subsidiary have a complete unity of interest, and because a parent can assert full control at any moment if a subsidiary fails to act in the parent's interest, the parent and subsidiary have a unity of purpose or common design that belies the existence of an agreement for antitrust purposes.

3. THE SINGLE ECONOMIC UNIT CONCEPT AND THE ATTRIBUTION OF LIABILITY

More contentious, however, has been the use of the doctrine in liability cases where the purpose is to hold one economic operator responsible for the conduct of another.

EU case law has long established (see especially the CJ's ruling in *Dyestuffs*[28]) that conduct of a subsidiary which infringes Article 101 (or Article 102) may be imputed to a parent (even if a non-EU parent[29]) where the 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. In these early cases, the Commission appeared to be required to demonstrate some form of involvement of the parent in the infringement before liability was attached.[30] However, in a series of cases involving serious competition law infringements – especially the conclusion of cartels – the Commission has relied on, and developed, the concept of an economic unit to hold parents jointly and severally liable for breaches committed by their subsidiaries, irrespective of any connection with, knowledge of, or personal involvement in, the infringement,[31] and even if the parent company is not actively involved in economic activity

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[26] For an interesting account of the cases dealing with this issue and the principles underpinning them, see the Opinion of Lenz AG in Case C-73/95 P *Viho Europe BV v Commission* EU:C:1996:164, paras 31–73, especially para 67.

[27] *Copperweld Corp v Independence Tube Corp*, 467 US 752 (1984).

[28] *Dyestuffs* (n 15), para 132 (where the CJ writes that the 'fact that a subsidiary has separate legal personality is not sufficient to exclude the possibility of imputing its conduct to the parent company').

[29] The doctrine is thus used to allow subject-matter jurisdiction over a non-EU company that participates in an infringement through the medium of its subsidiary. The CJ has also held that the Commission can rely on the doctrine to validly serve a statement of objections on a non-EU parent, see Case 52/69, *Geigy v Commission* EU:C:1972:73 (one of the *Dyestuffs* (n 15) cases). A more difficult question, however, is whether it allows the Commission to request information from companies outside of the EU, see e.g., discussion in Alison Jones, Brenda Sufrin and Niamh Dunne, *Jones and Sufrin's EU Competition Law: Text, Cases, and Materials* (8th edn, Oxford University Press 2023), Chap. 17, Cases C-204, 205, 2011, 2013, 217 and 219/00P, *Aalborg Portland A/S and others v Commission* EU:C:2004:6, [2004] ECR I-403, paras 61–62 and in the UK, *Competition and Markets Authority v BMW AG* and *VW AG* [2023] EWCA Civ 1506, (on appeal from Case 1574/10/12/22, *BMW AG* and *VW AG v Competition and Markets Authority* [2023] CAT 7) (see now the Digital Markets, Competition and Consumers Act 2024, s 144 and Sched 13, making it clear that written inquiries can be addressed to persons outside of the UK).

[30] See e.g. *Dyestuffs* (n 15) and Andriani Kalintiri, 'Revisiting Parental Liability in EU Competition Law' (2018) European Law Review 145.

[31] *Akzo Nobel* (n 6), paras 58–59.

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but is just a non-operational holding company[32] or there is an intermediary company between the parent and the offending subsidiary.[33] Further, the circumstances in which the parent has been found to be able to, and to actually, exercise decisive influence over the policy and direct the conduct of a subsidiary have been expanded.[34]

Although this approach has been criticised for overriding fundamental principles, including of company law (for example, limited liability), personal responsibility (that, in principle, only the person responsible for the infringement should be liable for its actions), and the presumption of innocence,[35] the CJEU has supported it. The Courts have now affirmed that, according to their interpretation of the principle of personal responsibility (which is strict[36]), it is for the undertaking, that is, the economic unit, to answer for its competition law infringement.[37] Further, that, because fines for intentional or negligent infringement of Articles 101 and 102[38] can only be imposed on an entity, generally a legal person, the Commission may freely choose which entity belonging to the undertaking that participated in an infringement to hold liable.[39] Thus, as it now appears that the rationale for liability is not the decisive influence exercised by

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[32] Case C-440/11 P *Commission v Stichting Administratiekantoor Portielje and Gosselin Group NV* EU:C:2013:514.

[33] Case T-343/06 *Shell Petroleum v Commission* EU:T:2012:478, para 52. See also Case C-90/09 P Case C-90/09 P *General Química SA v Commission* EU:C:2011:21, [2011] ECR I-001, paras 88–89.

[34] See below nn. 51–58 and accompanying text.

[35] See also Peter Whelan, *Parental Liability in EU Competition Law: A Legitimacy-Focused Approach* (Oxford University Press 2023), evaluating and challenging, the legitimacy of the attribution of liability in cases from four perspectives (justifiability, effectiveness, fairness and legality) and proposing reforms to rectify the legitimacy shortcomings.

[36] See Niklas Brueggemann, 'The unsung harmony of Sumal and the Akzo line of case law' (2022) Concurrences No 1-2022 31, 33 ('i.e., personal responsibility based not on an entity's own conduct but rather on conduct attributable to the undertaking of which the entity forms part and which is then by consequence attributable to all entities forming part of the undertaking').

[37] *Akzo Nobel* (n 6) para 56. Case C-434/13 P *Commission v Parker Hannifin Manufacturing and Parker-Hannifin* EU:C:2014:2456, paras 85–86. See also Case C-231/11 P *Commission v Siemens AG Österreich and Others*, CEU:C:2014:256, para 56 ('It follows … that the rules governing EU competition law, including those relating to the Commission's power to impose penalties, the EU law principle of personal liability for an infringement and the principle that the penalty must be specific to the offender and the offence, which must be complied with when the power to impose penalties is being exercised, relate only to the undertaking per se, not the natural or legal persons forming part of the undertaking').

[38] See Council Regulation (EC) 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 [now Articles 101 and 102 TFEU] [2003] OJ L1/1, Art 23(2).

[39] Case C-882/19 *Sumal, SL v Mercedes Benz Trucks España, SL* EU:C:2021:800, para 63. But see Case T-146/09 *Parker ITR v Commission* EU:T:2013:258, paras 123–126 where the GC held that although it is possible to attribute the unlawful conduct of a subsidiary to its parent company (on account of the latter's control over the former), the position was different where the Commission intends to attribute liability to a subsidiary the responsibility of its parent company (for the unlawful conduct of another of its subsidiaries). Although the Commission could penalise either the infringing subsidiary or its controlling parent, another subsidiary may not be penalised instead of the parent company unless it itself participated in the infringement.

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a parent over its subsidiary nor its involvement in the breach, but the personal responsibility attached to the economic unit, liability is not based on fault or participation in the infringement. Further, the doctrine can be used both to shift liability upwards to parents of an infringing entity and downwards to hold a subsidiary liable for the infringing conduct of its parent. In *Sumal SL v Mercedes Benz Trucks España*[40] the Grand Chamber of the CJ confirmed that the concept of an undertaking entailed joint and several liability among the entities making up the economic unit at the time the infringement was committed, albeit with an important caveat – a subsidiary can only be held responsible for its parent's conduct where it engages in activities connected, or linked to, the subject matter of the infringement. Thus, although a parent is liable whenever it is able to, and does actually, exercise decisive influence over its subsidiary, the subsidiary is only liable for the parent's (or presumably a sibling's[41]) infringement where it occurred in an economic field connected with its own activity.

It is easy to comprehend why the Commission supports use of the economic unit notion in this way. Not only does it maximise the chance of recovery of fines by minimising the risk of insolvency,[42] but it also increases the level of the possible fine both by augmenting its maximum cap (10% of the turnover of the undertaking as a whole (and not simply that of the infringing entity)[43]) and by enhancing the risk of an uplift for recidivism where one of the entities in the unit has previously been involved in a cartel.[44] It also allows the conduct of a subsidiary operating in the EU to be linked to the conduct of a parent outside of the EU, so allowing a fine to be imposed on a foreign entity for infringing EU competition law.[45] Further, as the CJ has now clarified that the concept of an undertaking has the same scope and meaning in the context of an action for damages brought before a national court as it does in relation to a case concerning the imposition of fines by the Commission (see *Sumal*[46]), the doctrine also maximises the chance of recovering damages by allowing a claimant to bring civil proceedings[47] not only against the infringing legal entity but also a parent, or subsidiary,[48] forming part of the economic unit at the time of the infringement.

The underpinning objective of the single economic entity doctrine as utilised in this line of cases is different from that in substantive reach cases. The focus is not on identifying a unity of purpose between the distinct legal entities, but on increasing the effectiveness, and

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[40] Ibid, para 38.

[41] Although the CJ did not deal with this scenario, the reasoning of the Court suggests that liability could also be imputed to a sibling company. But see n 39.

[42] See for instance *Dyestuffs* (n 15).

[43] Case T-112/05 *Akzo Nobel NV v Commission* EU:T:2007:381, [2007] ECR II-5049, para 90.

[44] See for instance Case T-341/18 *NEC v Commission* EU:T:2021:634, paras 108–109, 123 and 136.

[45] See n 29 and accompanying text.

[46] *Sumal* (n 39). See also Case C-724/17 *Skanska Industrial Solutions* EU:C:2019:204 (recognising that the same principles are to be applied in private proceedings as those governing economic units and dealing with economic continuity in EU cases concerning penalty payments).

[47] Many actions are now being based on the EU Damages Directive, Article 1 of which requires Member States to ensure full compensation to those harmed by an antitrust infringement by an undertaking: Directive 2014/104/EU on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union [2014] OJ L349/1.

[48] Or, presumably, a sister company; see n 41.

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strengthening the workings, of EU competition law by discouraging infringements, enhancing the deterrent effect of the rules, and maximising the chances of successful recovery of fines or damages and the level of fines that can be imposed.[49] This objective has encouraged the adoption of an expansive interpretation of the economic unit concept.[50] Indeed, not only has the CJ held that a parent company is presumed to exercise decisive influence over its subsidiary where it holds all, or almost all, of the capital or shares of a subsidiary (see especially, *Akzo Nobel*[51]),[52] but it has confirmed that decisive influence may also be demonstrated 'on the basis of a body of factual evidence, including, in particular, any management power exercised by the parent company or companies over their subsidiary'.[53] Firms may therefore be found to form part of the same economic unit where, for example, the parent holds a majority interest in a subsidiary,[54] a minority interest which is allied to rights greater than those normally granted to minority shareholders,[55] or even where two or more parents of a joint venture (JV)[56] cooperate to determine the JV's commercial policy – that is, in situations where the

[49] *Sumal* (n 39), paras 35–36. But the link between the content of the economic unit doctrine and the deterrence principle is not entirely clear or convincing, see Whelan (n 35), 233. Rather, it is arguable that the approach adopted does not actually achieve deterrence in practice, especially as it may result in the stigmatisation of firms irrespective of their culpability, e.g. a parent company engaged in genuine compliance efforts may be held liable for the conduct of its subsidiary (see e.g. Case C–501/11P *Schindler Holding v Commission* EU:C:2013:522, para 114, where the CJ confirmed that the fact that a parent company had introduced a compliance programme, which had been implemented by its subsidiaries, suggested that the company did in fact supervise the commercial policy of its subsidiaries, even if employees of the subsidiaries did not comply with it) and a parent or subsidiary may be held liable irrespective of its involvement in, or knowledge of the infringement, or its ability to control it (it may result in the imposition of liability on parents (e.g. minority shareholders) or subsidiaries when they do not have the power to ensure compliance by the infringing entity), see Florence Thépot, *The Interaction between Competition Law and Corporate Governance* (Cambridge University Press 2019), sec. 4.2.2.3.

[50] Although it has also been held that a principal may be liable for the conduct of an agent, when they form part of the same economic entity, see e.g. Case T-66/99 *Minoan Lines* EU:T:2003:337, paras. 121–129, in Case C-680/20 *Unilever Italia Mkt, Operations Srl v Autorità Garante della Concorrenza e del Mercato* EU:C:2023:33, the CJ declined to apply the economic unit doctrine when considering whether a producer could be held responsible for the conduct of an independent distributor. Rather, it found other means for holding that the conduct of a distributor could be imputed to the producer, see n 131 and accompanying text.

[51] *Akzo Nobel* (n 6), para 60. Joint and several liability for the parent firm thus follows unless it adduces sufficient evidence to show that the subsidiary acted independently, a difficult burden to meet in practice. However, see in the UK, Cases 1407-14/1/12/21, *Allergan v Competition and Markets Authority* [2023] CAT 56 (where the Competition Appeal Tribunal held that the existence of a hold separate regime could displace the presumption of decisive influence).

[52] See, e.g., Case T-299/08 *Elf Aquitaine v Commission* EU:T:2011:217, [2011] ECR II-2149.

[53] See Case T-132/07 *Fuji Electric v Commission* EU:T:2011:344, [2011] ECR II-4091, para 181.

[54] Case T-141/89 *Tréfileurope Sales SARL v Commission* EU:T:1995:62, [1995] ECR II-791. See also Cases 6 and 7/73 *Istituto Chemioterapico Italiano SpA and Commercial Solvents Corp v Commission* EU:C:1974:18, [1974] ECR 223.

[55] *Fuji Electric* (n 53), para 183.

[56] The term JV can be used to describe a wide spectrum of commercial arrangements between firms. In competition law, it is frequently used to describe an entity which (a) constitutes a separate

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parents have the power to exercise, and have actually exercised, *joint control* over a JV[57] (so including situations of both positive and negative control). Further, although evidence of both the ability to, and the actual, exercise of decisive influence is theoretically required, in many scenarios the question of whether power has actually been exercised seems to be inferred from the potential/power to do so (not only in cases where the parent owns 100%, or a de minimis amount less, of the shareholding in the subsidiary), meaning that the power to exercise decisive influence often appears to be the determining factor in fact.[58]

4. DIFFICULTIES STEMMING FROM THE ECONOMIC UNIT DOCTRINE

This approach to, and interpretation of, the economic unit concept creates some difficulties, tensions and complexities, however.

4.1 Tension Between the Distinct Definitions of an Undertaking

One immediate issue is that the notion that the economic unit constitutes a single undertaking is not entirely easy to reconcile with the concept of an undertaking as any entity engaged in economic activity. The latter concept suggests that a parent company and its subsidiary company constitute separate undertakings if each is engaged in economic activity. The former, however, dictates that, even if they are both engaged in economic activity, they may form part of the same undertaking and economic entity understood 'as designating an economic unit even if in law that economic unit consists of several persons, natural or legal'.[59]

If it is correct that an economic unit constitutes a single undertaking, however, it is hard to explain why various Regulations and Notices define the term 'undertaking' to include the undertaking's respective 'connected undertakings', such as 'undertakings' in which a party to the agreement, directly or indirectly, has the power to exercise more than half the voting rights, or has the power to appoint more than half of the supervisory board, management or has the right to manage the undertaking's affair,[60] as these connected undertakings will, in most cases, form part of the same economic unit/undertaking as the party to the agreement. Even if the definition of connected undertakings in these provisions may be designed to provide legal certainty, the language used within them is confusing, as it suggests an approach to the concept of undertaking (focused on persons engaged in economic activity) which is not

business entity, and (b) is jointly controlled by at least two parents.

[57] See for instance Case T-77/08 *The Dow Chemical Co v Commission* EU:T:2012:47; Case C-179/12 P *The Dow Chemical Co v Commission* EU:C:2013:605 (in this case the Commission found that Dow and EI Du Pont were jointly and severally liable for an infringement by their JV. Amongst other things, it found that they had the power to jointly control their JV and that, in the light of all the economic, legal and organisational links, control had *actually* been exercised). See also Case C-623/15 P *Toshiba Corp v Commission* EU:C:2017:21.

[58] See Alison Jones, 'The boundaries of an undertaking in EU Competition Law' (2012) 8(2) European Competition Journal 301.

[59] *Akzo Nobel* (n 6) para 55.

[60] See n 23 and accompanying text.

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consistent with the notion of an undertaking as an economic unit, which may be comprised of a number of natural and legal persons. Further, if each legal person within the economic unit is not a separate undertaking, but is just a part of the responsible undertaking, it is unclear why the Commission can choose to impose a fine on any such legal entity but why it could not, it appears, impose a fine on a natural person, such as an individual employee, who, even if not engaged in economic activity, also forms part of the responsible undertaking.

4.2 Tensions Created by the Notion that an Undertaking is an Autonomous (and Uniform?) Concept of EU Law

Another tension is created by the CJ's ruling that the notion of an undertaking constitutes an autonomous concept of EU law.[61] This suggests that it should be interpreted uniformly in all scenarios (including, both in relation to substantive reach and attribution of liability cases). A uniform concept may not, however, easily be able to reflect the different objectives underpinning the interpretation of the concept in the different lines of cases, so potentially undermining those discrete goals. Indeed, the policy underpinning the concept in substantive reach cases (that exceptionally takes arrangements between entities which are in any event bound to pursue a common policy on a market outside the scope of Article 101), supports a relatively narrow approach to the economic unit. In attribution of liability cases, in contrast, driven by the aim of dissuading violations[62] and maximising the level of fines and chance of recovery, the economic unit has been found to encompass a broad range of relationships, including those between parents and subsidiaries, and parents and JVs.[63] The tendency in these latter cases has thus been to expand the concept and to focus on the question of when it is appropriate, or efficient, to ignore the legal personality of the entity that committed the infringement and to impose liability for that infringement on another entity within the corporate group (so disregarding limited liability and not allowing the different entities within the group to exploit it).[64] If a uniform approach is adopted, however, the more expansive interpretation of the economic unit adopted in attribution of liability cases potentially results in an overly-broad spectrum of agreements between members of a corporate group, and JVs and their parents, being put beyond the reach of Article 101.[65] Further, the steps taken in *Sumal* to limit the circumstances

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[61] *Sumal* (n 39), para 38 and *Skanska Industrial Solutions* (n 46), para 47. See also Cases T-68 and 77–78/89 *Società Italiana Vetro SpA v Commission* EU:T:1992:38, [1992] ECR II-1403, paras 357–358; *Hydrotherm* (n 6), para 11; *Dyestuffs* (n 15), paras 132–136 and *Viho* (n 17), para 16.

[62] But see n 49 and text.

[63] See Section 3.

[64] See Carsten Koenig, 'An Economic Analysis of the Single Economic Entity Doctrine in EU Competition Law' (2017) 13(2) Journal of Competition Law and Economics 281.

[65] It has been questioned whether, in particular, negative control over a subsidiary or JV is sufficient to ensure that a parent and that subsidiary/JV pursue a common course of conduct so that the conduct escapes scrutiny under Art 101; see Jones (n 58). Application of the concept so as to exclude such conduct from the scope of Art 101 might raise concerns that the conduct of an entity controlled by a group of competitors, and used as a vehicle for cooperation between them, could be put beyond the scope of Art 101. Such an interpretation would also seem to conflict with decisions adopted by the Commission in cases which specifically dealt with the application of Art 101 to arrangements between parent and joint venture. See, for example, COMP/32.732, *IJsselcentrale* [1991] OJ L28/3; COMP/32.186, *Gosmé/Martell-DMP* [1991] OJ L185/21, and with

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in which a subsidiary may be held responsible for the conduct of its parent, appear to mean that agreements between a parent and a wholly-owned subsidiary, or between two ore more subsidiaries, only fall outside the scope of Article 101 if they are engaged in connected or linked activities.

4.3 Difficulties with the Conclusion that Personal Responsibility for an Infringement Attaches to the Economic Unit

The CJ had held that the explanation for holding an entity liable for another entity within the same group is the personal responsibility attached to the economic unit for the infringement. This finding of personal responsibility sits uncomfortably, however, with the presumption of innocence and the reality that a company within the economic unit can be held liable, irrespective of its personal involvement in, or knowledge of the infringement, or even of its ability to control or prevent it.[66] Further, if the basis for liability is purely the personal responsibility of the economic unit as a whole, it is unclear why the CJ in *Sumal* restricted the circumstances in which a subsidiary might be liable for the conduct of its parent to cases where it operates in the same sphere of activity as its infringing parent (but where it is not the case vice versa). Rather, it would seem that the connection between the companies should, as in the case for the parent, be irrelevant.[67] The specific link limitation imposed nonetheless seems to reflect the CJ's uneasiness about pushing its explanation to a logical conclusion and having to recognise that the doctrine expands beyond the attribution of liability upwards to parent companies found to be capable of exercising, and to have actually exercised decisive influence (even if too readily presumed or inferred), over the infringing subsidiary, to the shifting of liability downwards (or sideways) in circumstances where the subsidiary does not control a parent's behaviour (the link thus operates to establish the requisite connection or unity of purpose). The CJ observed that 'the same parent company may be part of several economic units made up, depending on the economic activity in question, of itself and of different combinations of its subsidiaries all belonging to the same group of companies. If that were not the case, a subsidiary within such a group could be held liable for infringements committed in the context of economic activities entirely unconnected to its own activity and in which they were in no way involved, even indirectly.'[68]

Because the economic unit concept has to be translated into a legally comprehensible form for enforcement purposes (decisions and fines cannot be imposed on economic units), the

jurisprudence dealing with 'associations of undertakings' which have generally interpreted this concept broadly to encompass entities used as an institutionalised mechanism for coordinating the members/shareholders' conduct. See also discussion of *Unilever* (n 50) and accompanying text. The broad approach could also inadvertently put certain transactions beyond the reach of the EU merger control rules; see Jones (n 58).

[66] See Whelan (n 35), 549, concluding that the doctrine is unfair as it fails to ensure that the member of the corporate group is sanctioned only when it is actually responsible for the breach and in a proportionate manner, relating to its own contribution to the infringement.

[67] So, suggesting that even if a parent is considered to be part of the same economic unit as the subsidiary, that subsidiary may not be treated as part of the same economic unit as the parent. But see Brueggemann (n 36).

[68] *Sumal* (n 39), para 47.

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separation of the undertaking concept from (in most cases legal) personality can also create procedural, due process, and jurisdictional concerns. Indeed, a number of cases have had to deal with questions relating to rights of defence and, for example, which entities must comply with requests for information, whether the Commission can fine a legal entity that has not been addressed in the statement of objections, and how fines are to be calculated.[69] Further, one implication of the judgment in *Sumal*, recognised and addressed by the Court itself,[70] is that a subsidiary company may be held liable for damages in proceedings which follow on from a European Commission, or national competition authority (in that jurisdiction),[71] decision finding a breach of the rules by its parent, even though it took no part in the public enforcement proceedings and so had no opportunity to defend itself or to challenge the finding of liability.[72]

4.4 Tension with Principles of Corporate Law

A final difficulty is that the approach adopted in the attribution of liability line of cases is inconsistent with general principles of corporate law in many jurisdictions (and has not been adopted in other areas of EU law[73]). It has thus been criticised for undermining well-established principles of separate legal personality (SLP) and limited liability in many systems of company law.

In UK company law, for example, the general rule is that companies are treated in law as persons, whose shareholders have limited liability, and which have SLP (shareholders are not liable for company debts). These two separate,[74] but closely related, principles combine to affect the rights of creditors in company law as the principle of limited liability of shareholders is predicated upon separate legal personality.[75] Further they mean that courts are reluctant,

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[69] See, e.g., Case C-176/99 P, *ARBED SA v Commission* EU:C:2003:524; *BMW AG* and *VW AG* (n 29); and Chapters 8 and 10 below.

[70] *Sumal* (n 39), paras 51–56.

[71] See Regulation 1/2003 [2003] L1/1, Art. 16 and Directive 2014/104/EU on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union [2014] OJ L349/1, Art 9.

[72] Contrast *ARBED SA* (n 69), para 21.

[73] Koenig (n 64).

[74] SLP means that the assets and liabilities of the company belong to the company and not its shareholders, and limited liability means shareholders do not have to contribute personally to the company's assets to enable it to pay its debts. Not all companies have shareholders, and not all shareholders of companies have limited liability, however: see Companies Act 2006, s 3.

[75] See Cases 6 and 7/73 *Istituto Chemioterapico Italiano S.p.A. and Commercial Solvents Corporation v Commission of the European Communities* ECLI:EU:C:1974:5, [1974] ECR 223, Opinion of Warner AG, p 263 ('Basically that doctrine exists in order to preserve the principle of limited liability. It is concerned with the rights of creditors in the context of company law.'). For the view that the rights of involuntary or non-contractual creditors (such as antitrust or other claimants in tort) should override these principles in certain circumstances, see Henry Hansman and Reiner Kraakman, 'Toward Unlimited Shareholder Liability for Corporate Torts' (1991) 100 Yale Law Journal 1879; Mariana Pargendler, 'Regulatory Partitioning as a Key Function of Corporate Personality' in E. Pollman & R. Thompson (eds.) *Research Handbook on Corporate Purpose and Personhood* (Edward Elgar 2021). See further Section 5.

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save in exceptional circumstances and where necessary to do justice, to disregard the separate corporate form – to 'pierce the corporate veil' – or to otherwise attribute a company's legal obligations (or rights) to its shareholders (that is, its owners). Rather, the legal principle of SLP is considered to be of paramount importance[76] which prevails – even if, in economic terms, the group could be viewed as one.[77] Separating the liability of a company from its owner is 'what incorporation is about'.[78]

For this reason, perhaps, the single entity doctrine has not been utilised in the US as a means for imputing liability for a subsidiary's conduct to its parent. Indeed, in *Copperweld,* Chief Justice Burger did not suggest that the doctrine could be used broadly. Rather, he made it clear that the Court's inquiry in the case was limited 'to the narrow issue squarely presented: whether a parent and its wholly owned subsidiary are capable of conspiring in violation of 1 of the Sherman Act.'[79] Corporate (criminal) fines are not, therefore, imposed automatically on parent companies but only if they are directly involved in an antitrust infringement. Even in private, civil law suits, the US courts uphold the principle of limited shareholder liability and usually reject claims that are raised against parent companies, except on the basis of direct involvement or corporate law doctrines of piercing the corporate veil.[80]

5. REFINING OR RETHINKING THE ECONOMIC UNIT DOCTRINE

5.1 The Need for a New Approach

The discussion in the section above suggests a need for a refinement, or even a rethinking, of the economic unit and undertaking concepts in a way which, whilst allocating liability where necessary to do justice, would better reflect the underpinning objectives of the rules, iron out the tensions and inconsistencies that exist, and better accord with principles of personal responsibility and company law.[81] Sections 5.2 and 5.3 below consider whether principles as elucidated through UK company law may help to provide guidance on how a more nuanced and coherent approach to the concepts could be shaped.

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[76] *Salomon v Salomon* [1897] AC 22.

[77] *Bank of Tokyo Ltd. v Karoon* [1987] AC 45, 64.

[78] *Prest v Petrodel* [2013] UKSC 34, [2013] 2 AC 415 [34] (Lord Sumption). See also the approach set out in the Bribery Act 2010, s 8, which contains a specific provision holding corporations strictly liable for failing to prevent bribery anywhere in the world by an employee or agent of the commercial organisation which includes another corporate person or subsidiary – unless it can show it had adequate procedures in place to prevent it, and further Section 5.

[79] *Copperweld* (n 27), 767.

[80] See Koenig (n 64) and Anna Tzanaki, 'Antitrust's Increasingly Long Arm: (Minority) Private Equity Investors Beware' (2022) CPI Antitrust Chronicle on 'Private Equity' 6–9.

[81] See text to (n 65) above.

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5.2 The SLP Principle in UK Company Law and Piercing the Corporate Veil

'"Piercing the corporate veil" is an expression used rather indiscriminately to describe a number of different things. Properly speaking, however, it means disregarding the separate personality of the company'[82] where the company is used as a means of evading the law (it is being used for a deliberately dishonest purpose to evade an existing obligation):

> The court may then pierce the corporate veil for the purpose, and only for the purpose, of depriving the company or its controller of the advantage that they would otherwise have obtained by the company's separate legal personality.[83]

Although there are few[84] instances where the corporate veil has been pierced in practice, there is also 'a range of situations in which the law attributes the acts of property of a company to those who control it, without disregarding its separate legal personality.'[85] At least three groupings emerge:[86] where there is a particular relationship which means that liability is properly imposed on the owner (e.g., where the controller is liable for something that the company has done as its agent or as a joint actor); where the contractual matrix suggests that the parent is liable for the actions of the subsidiary; or where a statute, purposively interpreted, necessitates liability (e.g., where for statutory purposes a company's legal responsibility is engaged by the acts or business of an associated company).[87]

5.2.1 Relationship

The relationship between the company and its shareholders/owners may give rise to scenarios which mean that the legal separation between the two does not operate to insulate the company from the obligations of its owner(s) (or vice versa). In these scenarios, the separate legal personalities of the companies are not ignored, but liability arises because of the *relationship* that exists between the two. This relationship might, for example, be one of agency or trusteeship or derive from tort liability principles.

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[82] *Prest v Petrodel* (n 78) [16] (Lord Sumption). In *Hurstwood v Rossendale* [2021] UKSC 16, [2022] AC 690 [71], the Supreme Court cast doubt also on whether 'piercing the veil' was a coherent principle or rule of law at all, though it noted that 'this is not the occasion for reaching any final view'. Whether it is a principle, rule of law, or some helpful 'label' (*Prest v Petrodel* [106] (Lord Walker)), what is important for present purposes is that it captures a phenomenon whereby the corporate form can be ignored in certain (exceptional) circumstances.

[83] *Prest v Petrodel* (n 78) [35] (Lord Sumption). Even then, it has been doubted that the evasion principle could ever operate to disregard separate legal personality in order to impute liability from a company to its owner, as opposed to the other way around: *Hurstwood* (n 81) [72]–[73].

[84] *Prest v Petrodel* (n 78) [74] where Lord Neuberger categorises the usage of the doctrine and suggests that there has not been a case where the doctrine has been properly used to pierce the corporate veil.

[85] *Prest v Petrodel* (n 78) [16].

[86] *Adams v Cape Industries* [1990] Ch 433, 539 (Slade LJ).

[87] Looking to the purpose of the underlying law is used in many regulatory contexts with the effect that SLP is ignored. See Mariana Pargendler, 'Veil Peeking: The Corporation as a Nexus for Regulation' (2021) 169 University of Pennsylvania Law Review 717.

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In *Gilford Motor Co Ltd. v Horne*[88] for instance, an injunction was granted to prevent Mr Horne from avoiding compliance with a non-compete clause by forming a new company through which he could work in competition with his previous employer. Lord Neuberger in *Prest v Petrodel* found that the injunction was 'amply justified' because the company constituted Horne's agent for the purpose of carrying on the business.[89] Where the nature of their relationship allows for the eliding of the responsibilities of the owner and the company in this way, it may also be possible to attribute liability upwards. Thus, in *Firestone Tyre and Rubber Co. Ltd. v Lewellin*,[90] the House of Lords found that where a subsidiary was carrying on the business of the parent as its agent, the tax liability arising out of the subsidiary's conduct could be attributed to the parent. Further, in *Prest v Petrodel* itself, the Supreme Court ordered a husband (in a matrimonial dispute) to transfer properties to his ex-wife even though they were legally vested in a separate company. The properties in this case were held by the company (the legal owner) on trust for the husband as beneficial owner and controller of the company. Because the Court found that the husband was entitled beneficially to the properties, it was able to use the Matrimonial Causes Act 1973 to make orders in the ex-wife's favour.

Similarly, a parent, or company's owner, may be held liable at common law or in equity for the actions of a subsidiary, where liability is imposed as a result of a relationship between the two (e.g., where the parent has procured the wrong by its subsidiary[91]) or for a failure to exercise due care in respect of the actions of its subsidiary (in negligence). Indeed, a parent may owe a duty of care to a victim of a subsidiary's wrongful conduct, where it has failed to exercise control over a subsidiary which it knows engages in risky activities.[92] In *Vedanta v Lungowe*[93] and *Okpabi v Royal Dutch Shell*,[94] the Supreme Court considered the issue of whether a parent company could owe a duty of care in tort for the actions of its subsidiary. Though the Court did not make a determination in either case as to whether a duty of care did arise on the facts, as the Court merely needed to determine jurisdiction to hear such a case, it nevertheless found that parent company liability could arise. Whether such a duty of care would arise on the facts would depend on the specific context, such as the level of managerial intervention on the part of the parent.[95] The decisions therefore further point to the existence of this avenue for attributing liability to a parent by virtue of the nature of its relationship with a subsidiary.[96]

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88 [1933] Ch 935.

89 *Prest v Petrodel* (n 78) [71].

90 [1957] 1 WLR 464.

91 In such a case, the subsidiary will be primarily liable and the parent secondarily liable. See *Lumley v Gye* [1853] EWHC QB J73, applied in *Kawasaki Kisen Kaisha Ltd v James Kemball Ltd* [2021] EWCA Civ 33, [2021] 3 All ER 978.

92 See *Lubbe and Others and Cape Plc. and Related Appeals* [2000] 1 WLR 1545.

93 [2019] UKSC 20, [2020] AC 1045.

94 [2021] UKSC 3, [2021] 3 All ER 191.

95 *Vedanta* (n 93) [44].

96 These cases are relevant to a more general debate about attributing liability to parent or holding companies for harms caused by subsidiaries in the context of environmental damage. For an overview of the issues, see: Policy Department for Citizens' Rights and Constitutional Affairs Directorate-General for Internal Policies, Environmental liability of companies (May 2020), available at: https://www.europarl.europa.eu/RegData/etudes/STUD/2020/651698/IPOL_STU(2020)651698_EN.pdf accessed 25 October 2022.

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A parent company may also be liable where it itself has also participated in the wrongful conduct (e.g., where a company and its owner have used unlawful means in order to harm a third party).[97]

5.2.2 Contract

Where a contractual matrix makes it clear that the company has no independence from its owner, the corporate veil will not operate to prevent different components of the group from being treated as forming one unit. In *Harold Holdsworth & Co (Wakefield) Ltd v Caddies*,[98] the contractual duties of the director of a parent company related solely to its subsidiaries. That director, Robert Caddies, failed in his argument that the subsidiaries were separate legal entities and as such the parent could not assign any duties in relation to the management of the subsidiaries. The subsidiaries were contractually[99] 'bound hand and foot to the parent company'[100] and it was appropriate to treat the entities as one unit.[101]

As the different component companies are treated as one, the obligations of a subsidiary *can* be attributed to its owners, or vice versa, in instances of wrongdoing.[102] This principle is especially important where there has been 'concealment'. In *Prest v Petrodel*, the Court confirmed that the concealment principle would be engaged where a company, or perhaps several companies, has been interposed to conceal the true nature of an arrangement.[103] Where the true nature reveals that contractually the owner and the company are one and the same, and that the company's sole purpose is to conceal, the courts have been willing to impose the responsibilities of the company on its owner(s), or vice versa, by applying ordinary legal or equitable principles. In *Jones v Lipman*,[104] the defendant agreed to sell his house to the claimant. He changed his mind and transferred the house to a company which was under his 'complete control'.[105] Specific performance, an equitable doctrine which may be available to compel the sale of the house, was ordered by the court by virtue of the fact that the company was a 'device and a sham'.[106]

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[97] See *JSC BTA Bank v Khrapunov* [2018] UKSC 19, [2020] AC 727.

[98] [1955] 1 WLR 352.

[99] The parent owned the whole share capital of the subsidiary, and under the agreement of 1947, the directors of this company were to be the nominees of the parent. 'So, in fact,' the parent 'could control the internal management of their subsidiary companies.' *Harold Holdsworth* (n 98), 467 (Lord Reid).

[100] *D.H.N. Food Distributors Ltd. v Tower Hamlets London Borough Council* [1976] 1 WLR 852, 860 (Lord Denning).

[101] *Adams v Cape* [1990] Ch. 433, 536 (Slade LJ).

[102] This will not be of use where there has been no wrongdoing per se, as in *Salomon* (n 76).

[103] *Prest v Petrodel* (n 78) [28].

[104] [1962] 1 WLR 832.

[105] ibid, 835.

[106] ibid, 836. See the different interpretations of the case adopted in *Prest v Petrodel* (n 78), see e.g., Lord Sumption [30] (a true piercing of the veil as against the company but concealment as against Lipman), but contrast Lord Neuberger [73] and Lady Hale [91].

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5.2.3 To give effect to the purpose of a statute

The case of *D.H.N. Food Distributors Ltd. v Tower Hamlets London Borough Council*[107] illustrates that the purpose of a statute, analysed in context, may also dictate that it is appropriate to look beyond the strict legal separation between an owner and a company. In this case, compensation was being sought under the Land Compensation Act 1961, which entitled an owner to compensation for disturbance in respect of its possession and enjoyment of land. Two heads of loss could be claimed – loss in respect of the value of the land and loss contingent upon the loss of use of the land. The problem for the group was that the land was not owned by the group but instead by one of the subsidiaries, which incidentally did not use the land at all other than to lease it to another company in the group (which *did* use it). The Court of Appeal nevertheless held that the group should be entitled to compensation for both the loss of the land and for losses contingent on the loss of the use of the land, because the group ought to be treated as a single unit. Lord Justice Goff was convinced of the need to treat the three companies as one entity not just because their businesses were so intertwined, but also in order to give effect to the purpose of the statute which focused on the disturbance of an owner's 'possession and enjoyment' of the land.[108]

Because legislation makes it possible to look behind the legal separation of a company and its owner(s) in this way, it should follow that the company's liability can also be attached to its owner. In the case of *Hurstwood*,[109] the Supreme Court was prepared to look beyond the strict corporate form in order to give purposive effect to the Local Government Finance Act 1988. In this case, a scheme had been devised to avoid the payment of business rates (taxes, essentially) payable by the property's 'owner', by setting up special purpose vehicles (to whom the real, registered owners granted leases on the properties). The Supreme Court did not disregard the separate legal identities of the relevant companies and their owners,[110] but interpreted the word 'owner' in the legislation to mean the underlying beneficiaries – the registered owners – of the properties rather than the companies that leased the properties. It was the beneficiaries that were 'entitled to possession'[111] of the land, not the special purpose vehicles. To hold otherwise and to identify 'the person entitled to possession' as the person with the immediate legal right to possession of the property would defeat the purpose of the legislation.[112] It was appropriate as a result to impose liability for the business rates on the beneficiaries – the (assumed for the purposes of the case)[113] ultimate owners of the special purpose vehicles.

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[107] *D.H.N.* (n 100).

[108] See also *Re FG (Films) Ltd* [1953] 1 WLR 483 where at issue was the interpretation of the word 'maker' in sections 25 (1) (a) and 44 (1) of the Cinematograph Films Act 1938. The court held that the 'maker' of a particular film, Monsoon, was the US parent rather than the UK subsidiary. The UK subsidiary was a shell company, and therefore it would have been 'contrary to all sense and reason' (486, per Vaisey J) if the subsidiary were to be deemed the 'maker' of the film.

[109] *Hurstwood* (n 82).

[110] ibid [63]–[76].

[111] Local Government Finance Act 1988, s 65(1).

[112] *Hurstwood* (n 82) [48].

[113] See *Rossendale Borough Council v Hurstwood Properties (A) Ltd & Ors* [2019] EWCA Civ 364, [2019] WLR 4567 [27].

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5.3 A Refined Approach

UK company law suggests that companies within a legal group are to be treated as distinct legal persons, and that, unless the special circumstances outlined in section 5.2 above exist, the separate legal personality of a company operates to segregate the obligations and liabilities of companies and their owners. This section argues that similar principles and ideas to these are reflected in some of the EU case law, and could be used to shape a new approach to the concepts of an undertaking and economic unit in EU competition law. This would have the benefit of eradicating many of the tensions arising from the current case law described in section 4 above, and provide a more convincing rationale for attributing liability for infringements of competition law from one member of an economic unit to another.

5.3.1 The undertaking and economic unit as distinct concepts

Many of the tensions acknowledged in Section 4 arising from the detachment of the undertaking concept from persons, legal or natural, or other organisations, engaged in economic activities, would be avoided if it were recognised that the concepts of an undertaking and an economic unit are distinct, albeit related. This interpretation, which is supported by early EU case law at least[114] and legislation,[115] would have the advantage of clarifying that an undertaking, the addressee of the competition rules, constitutes an entity – whether a company, partnership, unincorporated association, a self-employed individual, SOE or state body (and whether or not a legal or natural person or state entity) – engaged in economic activity and is not made up of two or more distinct entities engaged in economic activity, even if they form part of the same economic unit.

The concept of the economic unit would, however, remain important. The idea could be relied upon to ensure that in identified circumstances the separate legal personalities within the economic unit may be elided or ignored, for example, where, as in the UK, it is necessary to give effect to the purpose of the competition laws, or where otherwise necessary to do justice or to reflect the special relationship, or contractual matrix, existing between the persons. This approach would not, therefore, preclude responsibility for an infringement of competition law committed by one company from being imposed, additionally, on another. Rather, it would seek to provide a rationale for such liability, which provides greater consistency with the principles of personal responsibility and corporate law (balancing competition and corporate law objectives), and which avoids existing tensions and inconsistencies in the law.

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[114] Especially early cases such as *Centrafarm* (n 14), and see e.g., *Viho* (n 24), Advocate General Lenz, paras 48–73; Case 66/86, *Ahmed Saeed Flugreisen and Others v Zentrale zur Bekämpfung Unlauteren Wettbewerbs* EU:C:1989:140, para 35 ('Article [101] does not apply where the concerted practice in question is between undertakings belonging to a single group as parent company and subsidiary if those undertakings form an economic unit within which the subsidiary has no real freedom to determine its course of action on the market'), Cases T-68, 77 & 78/89 *SIV and Others v Commission* EU:T:1992:38, para 357.

[115] See n 17 and accompanying text.

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5.3.2 Using the single economic entity concept to ensure that the purpose, or logic, of the competition laws is respected

If a similar approach is followed, an important starting question is whether there are circumstances where the purpose of the competition law rules suggests that it may be necessary to look beyond the separate personality of the relevant undertaking(s) involved. Two scenarios clearly emerge where this may be required to ensure that the purpose, or logic, underlying the competition law system is reflected.

First, it is required to ensure that the fundamental distinction drawn between joint and unilateral conduct in Articles 101 and 102 respectively, is respected. Article 101 focuses on concerted, or other collusive, conduct between undertakings, which represents a joining of two independent sources of economic power and which 'deprives the marketplace of the independent centres of decision making that competition assumes and demands'.[116] Because it is not intended to extend to wholly unilateral conduct, or the internal workings, of a single firm (governed rather by Article 102), it does not make sense to apply it to agreements and concerted practices between corporations and their subsidiaries (or divisions) when they form part of a single economic unit or enterprise which have a 'unity of purpose'. In these circumstances, as recognised by the US Supreme Court in *Copperweld*, the separate entities act for the benefit of each other, with or without a formal agreement or other concertation between them. Even if therefore an agreement exists 'there is no sudden joining of economic resources that had previously served different interests'[117] or justification for scrutiny under Article 101. The entities are incapable of conspiring and the agreement does not deprive the market of independent centres of decision making or raise the dangers that Article 101 was intended to prevent: 'the unified conduct on the market of the parent and its subsidiaries takes precedence over the formal separation between those companies as a result of their separate legal personalities.'[118] The logic of Article 101 thus dictates that parent and subsidiary arrangements should be excluded from the scope of Article 101 where the subsidiary does not act independently as the parent is able, as a result of its shareholding or other rights and powers, to exercise decisive influence over its conduct. Similarly, arrangements between sibling companies should also be excluded from the scope of Article 101 where decisive control is exercised over them by the same parent company.

Secondly, as the conduct of an economic entity is viewed as unilateral (not joint) conduct, it is necessary to look beyond the legal personality of an entity to ensure that substantive competition analysis reflects its true market power. A core purpose of the competition laws is to prevent conduct that will harm competition and consumer welfare by allowing the undertaking(s) at issue to acquire, strengthen or exercise market power. To ensure that this appraisal reflects true market power, it is crucial to take into account not only the market position of the relevant undertaking(s) involved, but also that of other entities within the economic unit which pursue the same unity of purpose. Assessment of market shares, market power, and dominance[119] must therefore take account of the position of all entities within the economic unit. It has

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[116] *Copperweld* (n 27), 769 (albeit in the US context). In general, Art 101 treats joint conduct more sceptically than single-firm conduct, which is prohibited under Art 102 only where abusive and concluded by an undertaking holding a dominant position.

[117] ibid, 769.

[118] *Viho* (n 24), para 50.

[119] See e.g., *Commercial Solvents* [1972] OJ L299/51, aff'd Cases 6&7/73, etc. EU:C:1974:18.

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already been seen that this fact is recognised in a number of EU Regulations, Notices and Guidelines, dealing with the application of aspects of the EU competition law provisions. For example, the Commission's Notice on agreements of minor importance,[120] and many block exemptions[121] apply only to situations where the parties to the relevant agreement do not exceed specified market shares. Their provisions specifically require that, when calculating market shares, the shares of all entities closely connected (as defined therein) to the entity that actually entered into the agreement must be taken into account.

The logic of the competition rules does not, by way of contrast, dictate or require that the entire economic unit be held liable for the infringement by an entity within it (so that parents should be held liable for the conduct of their subsidiaries (or vice versa)). On the contrary, the EU enforcement system already provides for a range of significant consequences for an undertaking (and in some Member States, its employees or directors[122]) found to have infringed Articles 101 and 102, which are designed to ensure that unlawful conduct is brought to an end, is sanctioned, that future infringements are deterred, and that those who have been harmed by it obtain compensation. Thus, as a result of public enforcement by the Commission or national competition authorities (NCAs) of the Member States, or private litigation in the national courts, an infringing undertaking may be required to bring its infringement to an end, be exposed to fines, and become liable to pay damages to victims of its infringement (it may also be debarred (or excluded) from participating in public procurement processes). It is true that automatically extending liability beyond an infringing corporation to all members of the corporate group would maximise fines and the chance of recovery, and may provide an extra deterrent effect to the rules, but there is nothing inherent in the competition law rules per se, as distinct from other areas of law where corporate liability might arise, which would seem to demand this. Rather, the basis for the CJEU's conclusion that it is the economic unit as a whole that is personally responsible for competition law infringements rests not on the rationale underpinning Articles 101 and 102, but on the, arguably fallacious,[123] choice of the CJEU in some, but not all, cases to identify the notion of an undertaking with an economic unit. (It is for the latter reason that Lord Sumption in *Prest v Petrodel* provided the competition laws as an example of a statute specifically providing for the possibility of the entire economic unit being responsible for infringements – and the relevant statute dictating that a 'company's legal responsibility may be engaged by the acts or business of an associated company'.[124]) This is consequently an area where an *alternative* means arguably needs to be found to justify the imposition of liability on another entity, and to balance better the need to deter infringements of the competition law and to respect corporate law principles of SLP and limited liability.

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[120] See for instance, Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 101(1) [2014] OJ C291/1, para 16.

[121] See e.g. Commission Regulation (EU) No 2022/720 of 10 May 2022 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices [2022] OJ L134/4, Art 1(2).

[122] In some Member States, legislation also provides separately for civil or criminal liability of individuals working for the undertaking.

[123] Kalintiri (n 30).

[124] *Prest v Petrodel* (n 78) [16].

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5.3.3 Attribution of liability: balancing competition and corporate law principles

Even if the competition law rules do not demand it, UK law illustrates that a company may be found liable for the conduct of an associated company, where justified by the special or contractual relationship between them, e.g., where a subsidiary is carrying out work on behalf of the owner/parent or where the parent has breached its duty of care in respect of the actions of its subsidiary (in negligence), for example, because the parent exercised de facto control over the subsidiary and knew, through its directors, of the risk, or where it itself has also participated in the wrongful conduct. Indeed, this approach bears resemblance to early EU case law, which conditioned parental liability on the existence of some sort of connection between the control exercised by the parent company over its subsidiary and the committed infringement,[125] and to other EU case law, which recognises (without reference to the economic unit principle) that, in certain circumstances, one firm may be held responsible for the conduct of another.

A company should thus be liable for conduct committed by another where it has had some actual involvement in the infringement. For example, where a subsidiary with no real autonomy to determine its course of action in a market[126] and as in *Dyestuffs*[127] – the parent directed or ordered the subsidiary to engage in conduct infringing the rules or otherwise participated in it (it was the 'mastermind'[128] of the violation and the real perpetrator). Similarly, a parent company may be liable where the parent was otherwise implicated in the breach, such as when the same persons held key management positions in both the parent and subsidiary, making the parent aware of the subsidiary's anticompetitive behaviour[129] and intending to contribute to it.[130] Similarly, without invoking the undertaking concept, the CJ has held that the conduct of a distributor may be imputed to a producer of the goods supplied and distributed, where it is established that the distributors' actions were not adopted independently but formed part of a policy decided unilaterally by the producers and implemented through the distributors.[131]

Liability should also attach where a company is able to exercise decisive influence over the conduct of another, but fails to exercise vigilance and to prevent the breach, or it had access to information about the company's behaviour and the power to prevent or address missteps.[132] Indeed, in *Remonts*[133] the CJ has recognised that a company may be held responsible for the conduct of its third-party service provider where it could reasonably have foreseen the anti-competitive acts, and was prepared to accept that risk.[134] A parent company may thus be

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125 See discussion of these cases in Kalintiri (n 30).

126 *Dyestuffs* (n 15), paras 125–146.

127 See also Case 107/82 *AEG Telefunken AG v Commission* ECLI:EU:C:1983:293, [1983] ECR 3151.

128 Kalintiri (n 30).

129 Cases T-109 etc/02 *Bolloré v Commission* EU:T:2017:15.

130 Case C-542/14 *SIA 'VM Remonts' (formerly SIA 'DIV un KO') and Others v Konkurences padome* EU:C:2016:578.

131 *Unilever* (n 50), paras 29–33.

132 Kalintiri (n 30). See also Thépot (n 49), 4.2.2.3, proposing an approach by which liability is imposed on the basis of incentives and ability, unless it can be demonstrated that adequate steps were taken to prevent the occurrence of the infringement (thereby embracing the standard of negligence).

133 *Remonts* (n 130.).

134 See ibid, paras 29, 31 and 33.

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legally accountable – in both public and private proceedings – for its failure to be 'sufficiently watchful for indications of the unlawful behaviour' and proactively 'ensuring that its subsidiary was conducting itself on the market in compliance with competition law'.[135] If accepted, a framework could be developed to ensure that liability is evaded only where a parent company can establish that it has taken adequate steps to prevent the occurrence of an infringement[136] and there is no element of fault.[137] This would ensure that parent companies are incentivised to ensure that their subsidiaries comply with the competition laws.[138]

To be clear, therefore, the fact that members of a corporate group should sometimes have responsibility for the actions of others within it is not disputed. It is recognised that these entities can internalise the 'cost' of the externality, namely antitrust violations, and that linking entities to the actions of others can discourage anticompetitive behaviour, incentivise greater monitoring and controlling[139] of actions within a corporate group, and protect involuntary creditors – in this case, the victims of anticompetitive behaviour – from having to bear the cost of the externality. It is contended nonetheless that responsibility and liability should not be automatic. They should only be imposed in instances where a nexus can be proved by looking at the contractual matrix or the relationship between the entity and the offence. There, the cost should be internalised, and sanctions should be applied, as those entities have either signed up to this (by contract), or they cannot be said to have had no role or benefit (by relationship).

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[135] Kalintiri (n 30) 160.

[136] See Thépot (n 49), 4.2.2.3. See also Reg. 1/2003, Art 23, which provides for the imposition of fines for intentional or negligent infringements of Arts 101 and 102.

[137] One question which could arise is whether this would allow an argument that adequate steps have been taken, as an effective compliance programme (designed to prevent and detect infringements) is in place. However, some authorities may be reluctant to allow this as a defence to liability where it has not prevented a breach; see also *Schindler* (n 49 and text) (the existence of a compliance programme appeared to expand rather than narrow the possibility of liability). Although in some jurisdictions the existence of a compliance programme may be taken into account when making charging decisions or when imposing penalties, the European Commission does not list the adoption of a compliance programme as a mitigating factor to be applied when calculating the appropriate level of a fine; see its 2006 Guidelines on the Method of Setting Fines [2006] OJ C 210/10, para. 29 (see also CMA73, CMA's guidance as to the appropriate amount of a penalty, 16 December 2021).

[138] Thépot (n 49), 4.2.2.3.1-3. See also the approach adopted in the consumer protection law provisions of the UK's Digital Markets, Competition and Consumers Act 2024, Part 3 (applying an interconnected bodies corporate regime instead of using the undertaking concept). Broadly, under this regime, the Competition and Markets Authority may extend requirements imposed on a body corporate to all other interconnected members of the group where it is 'just, reasonable, and proportionate' to do so (see especially ss 176 and 200), e.g., where any other group member had been the brains behind the infringement, other group members have benefited from the infringement, or where the infringing body corporate has insufficient funds to pay the penalty (see Explanatory Notes on the Bill of 22 November 2023).

[139] Control is often regarded as the determinant for attributing liability: e.g., Carsten Koenig, 'The Boundaries of the Firm and the Reach of Competition Law: Corporate Group Liability and Sanctioning in the EU and the US' in Marco Corradi and Julian Nowag (eds), *Intersections Between Corporate and Antitrust Law* (Cambridge University Press 2023) 64; Thépot (n 49) 58.

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6. CONCLUSIONS

This chapter has proposed refinements to the economic unit and undertaking concepts developed in EU law. It proposes that, rather than equating the concept of an economic unit with an undertaking, the two concepts should be regarded as distinct. The notion of an undertaking should focus on the economic activity carried out by an organisation or person (legal or natural), whilst the economic unit or single economic entity idea should be applied to look beyond the legal personality of those individual entities in certain circumstances – in particular where necessary to reflect the purpose of the competition laws or the relationship between the separate undertakings.

This approach, although a departure from current case law, would not lead to significant change in practice but would largely reflect the status quo – agreements between entities within an economic unit would remain beyond the reach of Article 101, the market position of all entities within the economic unit would remain relevant to substantive competition law assessment, and entities or companies could be held responsible for the conduct of associated companies in certain, albeit, slightly more limited, circumstances. At the same time, the proposed approach would have the advantage of resolving some current inconsistencies in, and tensions created by, the case law.

For example, it would ensure that the undertaking and economic unit concepts are not in tension, but are consistent with one another and with the language used in EU Regulations and Notices. It would also ensure that the desire to expand liability and deter infringements does not put beyond the reach of Article 101 agreements between separate persons, except when the parties to the agreement pursue a unity of purpose. Finally, it would allow a more convincing rationale for holding one firm responsible for a violation committed by another, providing greater consistency with the principles of personal responsibility and corporate law. The purpose of the proposed approach is not, therefore, to insulate firms from the application of the competition rules, but to provide a more principled explanation for the imputation of liability from one corporation to another.

The foundations for such a solution exist in the EU case law. It would, however, require a change in direction from that set out in some recent cases. In particular, in 2021 the Grand Chamber of the CJ stressed in *Sumal* the importance of the concept of an undertaking to the working of the EU rules and discouraging infringements of them, and that the Treaty had chosen 'the concept of an undertaking to designate the perpetrator of an infringement of competition law, who is liable to be punished by application of that provision, rather than other concepts such as those of "company" or "legal person"'.[140] It thus reiterated that it is for the economic unit, in accordance with the principle of personal responsibility, to answer for the infringement of any legal entity within it.

The proposed approach could also be followed in the UK, irrespective of a change at the EU Level. Although the competition law prohibitions of anticompetitive agreements and abuse of dominance set out in the Competition Act 1998 (CA98) are modelled on EU Law, the UK has, since 1 January 2021, left the EU and the EU competition system. EU law is no longer directly effective in the UK, and the UK authorities have greater scope to interpret the CA98 in a way

[140] *Sumal* (n 39), para 39.

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which diverges from EU law.[141] Indeed, section 60A of the Act allows for inconsistency, and divergence, between UK and pre-Brexit EU law in defined cases, including where necessary to reflect differences between UK and EU markets or the particular circumstances under consideration. This means that, over time, the UK has the scope, should it wish to do so, to diverge from EU law and practice, and to bring the notions of an undertaking and an economic unit in competition law more closely into line with principles of UK company law.

[141] Originally, Competition Act 1998, s 60 provided for broad consistency between the Act and EU law where possible. This provision was revoked by the Competition (Amendment etc.) (EU Exit) Regulations 2019, which also introduced s 60A. See e.g. *Umbrella Interchange Fee Claimants v Umbrella Interchange Fee Defendants*, [2023] CAT 49 (and see also the approach adopted in relation to the consumer protection provisions of the Digital Markets, Competition, and Consumers Act, n 138). But see the judgment of the Court of Appeal in *BMW AG* and *VW AG* (n 29), especially paras 84–88.

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8. The Single Economic Entity Doctrine

Thomas K. Cheng

1. INTRODUCTION[1]

The expansion of the single economic entity doctrine under EU competition law has been unstoppable. From its humble origin in the early *Beguelin* case,[2] where the doctrine was invoked in a defensive manner to shield intra-group activities from scrutiny, it has grown beyond recognition. The *Imperial Chemical Industries* case was the first instance when the Court applied the doctrine to the detriment of the undertaking to exercise jurisdiction over a parent company that was incorporated outside of the EEC.[3] An undertaking is defined under EU law as "any entity, whether it is a legal or a natural person, that performs an activity, relevant from the economic point of view, relating to the supply of goods and/or services on the market, irrespective of its legal status (whether of a private or public nature) or its financing methods."[4] Established case law holds that an undertaking should be understood as an economic entity consisting of "a unitary organisation of personal, tangible and intangible elements which pursues a specific economic aim on a long-term basis and can contribute to the commission of an infringement".[5]

What should have been a watershed moment was largely overlooked as a natural progression of the doctrine. After all, there is arguably no reason why the concept of an undertaking should be construed only in a manner favorable to the defendant as a defense against cartel allegations (i.e., for agreements among companies of the same group). The legal implications of the concept can and should go both ways, resulting in detriment to the undertaking concerned (i.e., attribution of liability for affiliate companies' violations of competition rules). In any case, the significance of the decision was limited to a jurisdictional matter. The parent company was directly involved in the offending cartel and thus liability could have been imposed on it without resorting to the doctrine.[6]

The next quantum leap in the development of the doctrine took place in the *Stora* and *AKZO* cases, where the court instituted a rebuttable presumption for decisive influence on the part of

[1] The Author would like to acknowledge the generous assistance of the Research Grants Council of the HKSAR Government for this project under project number 17621523.

[2] Case 22/71 *Béguelin Import Co v GL Import-Export SA* [1971] ECR 949, paras 8 and 9.

[3] Case C-48/69 *Imperial Chemical Industries Ltd v Commission* [1972] ECR 619.

[4] Marco Pasqua, 'The Liability of Corporate Groups for Violation of EU Competition Law' (2023) JECLP 235, 237.

[5] Stephen Daly and Alison Jones, 'The Undertaking and Single Economic Entity Concepts in EU and UK Competition Law: Proposals for a Refined Approach' in Anna Tzanaki and Florence Thépot (eds.), *Research Handbook on Competition and Corporate Law* (Edward Elgar forthcoming) 3.

[6] Vibe Ulfbeck, 'Vicarious Liability in Groups of Companies and in Supply Chains—Is Competition Law Leading the Way?' (2019) MCLR 107, 109–10.

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a parent over a wholly owned subsidiary for the purpose of parental liability.[7] This has been followed by a creeping expansion of the doctrine. As the case law evolved, it became apparent that the presumption turned out to be anything but rebuttable. Successful rebuttals were few and far between. In *Knauf*, the General Court had refused to apply the doctrine to the entities involved on the ground that the parent entities at issue did not constitute undertakings.[8] This is distinct from the abovementioned rebuttal as the entities at issue were not deemed to be undertakings at all. This turned out to be a pyrrhic victory for the defendants as the decision was subsequently overturned by the Court of Justice.[9] In most other instances the Court has invoked the doctrine liberally to impose parental liability. The doctrine was gradually relaxed such that 100 percent share ownership was no longer strictly required.[10] Something close to it was enough. It was later decided that full share ownership was not necessary for the imputation of liability. Voting rights equivalent to (almost) full equity ownership would suffice.[11]

The final frontier of the doctrine is arguably subsidiary liability—the imputation of a parent's liability onto a subsidiary or of liability across subsidiaries within an undertaking that operates as a single economic unit. Until recently, it was widely assumed that the doctrine would only be invoked to shift liability upward, but not downward from a parent to a subsidiary, or laterally across subsidiaries.[12] On the one hand, subsidiary liability may seem to be the necessary logical conclusion of the doctrine. On the other hand, it would amount to a dramatic expansion of the doctrine, and the consequences would be wide-ranging. The Rubicon was crossed in the *Sumal* case.[13] In that case, the Court of Justice held that subsidiary liability could be available if "sufficient economic, organisational and legal links exist between the parent company and the subsidiary" and that "'a specific link' exists 'between the economic activity of that subsidiary and the subject matter of the infringement'."[14] The specific link requirement may be the last effective check on collective liability for members of a corporate group. Whether this will be the case depends on how this requirement is interpreted and applied by the courts.

This inexorable march of the doctrine has not gone unnoticed. Despite protestations by the Court to the contrary,[15] it is difficult to avoid the impression that the doctrine as it is currently

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[7] Case C-286/98 P *Stora Kopparbergs Bergslags v Commission* [2000] ECR I-9925; Case C-97/08 P *AKZO Nobel NV v Commission* [2009] ECR I-8237.

[8] Alexandr Svetlicinii, 'Who is to Blame? Liability of "Economic Units" for Infringements of EU Competition Law' (2011) ELR 52, 53.

[9] Case C-407/08 P *Knauf Gips KG v Commission* ECR I-4365.

[10] Benedikt Freund, 'Reshaping Liability—The Concept of Undertaking Applied to Private Enforcement of EU Competition Law' (2021) GRUR 731, 737; Bruce Wardhaugh, 'Punishing Parents for the Sins of their Child: Extending EU Competition Liability in Groups and to Subcontractors' (2017) JAE 22, 26.

[11] Case C-595/18 P *The Goldman Sachs Group Inc. v European Commission* [2021] ECLI:EU:C:2021:73.

[12] Peter Whelan, 'Private Enforcement and the Imputation of Antitrust Liability' in Barry Rodger, Francisco Marcos and Miguel Sousa Ferro (eds.), *Research Handbook on Competition Law Private Enforcement in the EU* (Edward Elgar 2023) 159, 167.

[13] Case C-882/19 *Sumal, S.L. v Mercedes Benz Trucks España, S.L.* [2021] ECLI:EU:C:2021:800.

[14] ibid para 51.

[15] Case C-97/08 *P Akzo Nobel and Others v Commission* [2009] ECLI:EU:C:2009:262, para 97.

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applied amounts to strict liability, or something close to it.[16] This has attracted criticism from some commentators, who maintain that the imposition of liability must be based on some notion of fault.[17] This inevitably leads to the question of what is the proper policy objective of the doctrine as far as attribution of liability is concerned. Related to the question of the need for fault is the application of the doctrine. Many have argued that the AKZO presumption, as interpreted and applied by the courts, has become practically insurmountable.[18] It is worth pondering whether liability should be shifted to the shareholder of a wholly owned subsidiary as a matter of course.

There is also the question of whether the doctrine should be applied in a differentiated manner. The argument is that the meaning of the single economic entity should vary depending on the purpose of the inquiry. For instance, a distinction may be drawn between when the doctrine is invoked to impute liability as opposed to increase the quantum of fines. The objective of the doctrine may differ as it is put to disparate uses, which may also have a bearing on whether liability should be fault-based. Fault-based liability can be introduced at least in some contexts. In order for this to be feasible, the doctrine would need to be untethered from the concept of an undertaking. So long as an undertaking is defined in accordance with the doctrine, there seems to be little room for differentiated application unless the Court is willing to countenance differentiated notions of an undertaking depending on the purpose of the inquiry. Finally, some have challenged the extension of the doctrine to subsidiary liability on the grounds that imputation of liability should be premised on some element of fault, the attribution of which requires control.[19] The lack of control of a subsidiary over a parent company or a sister company should negate the possibility of liability shifting.

This chapter seeks to shed light on the single economic "entity" doctrine by addressing a series of questions that are critical to our understanding and the continual application of the doctrine. These include: (1) whether parental liability under the doctrine should be fault-based; (2) whether a practically irrebuttable presumption of liability for the parent company is justified; (3) whether a distinction should be made between imputation of liability and calculation of fines; and finally, (4) whether the doctrine should be extended to impose subsidiary liability.

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[16] Pietro Merlino, '*Edison*: A Glimpse of Hope for Parent Companies Seeking to Rebut the Parental Liability Presumption?' (2014) JECLP 463, 466.

[17] Erik H. Pijnacker Hordijk and Simone J.H. Evans, 'The *Akzo* Case: Up a Corporate Tree for Competition Law Infringements' (2010) JECLP 126; André Fiebig, 'Goldman Sachs v Commission: The Liability of Financial Investors for the Sins of Their Portfolio Companies (C-595/18 P Goldman Sachs)' (2021) ECRLR 156, 161.

[18] Pijnacker Hordijk and Evans (n 17) 128; Clio Angeli and Rebecca Williams, 'Parental Liability, the Expansion of the Presumption of Decisive Influence to Full Ownership of Voting Rights: Case C-595/18 P *Goldman Sachs Group*' (2021) JECLP 691, 691; Stefan 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' (2012) JECLP 11, 18.

[19] Catarina Vieira Peres, 'Don't Blame the Children. Why Inverted and Horizontal Liability for Antitrust Infringements Should be Rejected' (2021) MCLR 15, 36–37.

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2. POLICY OBJECTIVES OF THE SINGLE ECONOMIC ENTITY DOCTRINE

Before one can ascribe a proper policy objective to the doctrine, one needs to ascertain whether the current liability regime is one of strict liability or one based on some notion of fault. A strict liability regime is one under which the parent is liable for all harm caused by a subsidiary regardless of fault.[20] There is no defense on the ground that the parent has done everything that can be reasonably expected of it to prevent harm arising from a subsidiary's conduct. In contrast, if one takes a fault-based approach to liability, one is expected to exercise due care to avoid harm up to the point where the costs of precaution equal the expected harm to be avoided.[21] The defendant will be exonerated if it can demonstrate that it has exercised due care or diligence. In the context of a parent-subsidiary relationship, a parent defendant would escape liability if it could show that it has exercised due care by carefully monitoring its subsidiary's conduct, implementing an effective compliance regime, or explicitly instructing its subsidiary not to engage in anticompetitive conduct. The liability regime will be based on fault.

Despite valiant attempts, especially by the Court of Justice, to argue otherwise,[22] the preponderance of arguments is that the single economic entity doctrine effectively amounts to strict liability. The Court of Justice has understood this issue from the perspective of the principle of personal responsibility. Under this principle, an entity should not be subject to liability if it bears no personal responsibility for the conduct.[23] There should be no automatic liability for another entity's conduct through no fault of one's own. The Court of Justice has insisted that the single economic entity doctrine is fully consistent with this principle. It argues that when a parent company is deemed liable for a subsidiary's conduct, it is in fact being held liable for its own conduct because the parent and the subsidiary are one and the same entity.[24] The person at issue for the purpose of personal responsibility is not the legal person of the parent and the subsidiary, but the economic entity consisting of all the entities deemed to be part of it. This argument is nothing more than a judicial sleight of hand. The principle can never be violated so long as the court is willing to dissociate the principle from legal personhood and expand its definition of the person. The true test for strict liability depends on whether the imposition of liability is premised on any notion of fault.

2.1 Fault-based Liability or Strict Liability?

A single economic entity is deemed to exist encompassing a parent and a subsidiary if the latter "although having a separate legal personality […] 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, organisational and

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[20] Wardhaugh (n 10) 35.

[21] ibid 37.

[22] See n 15.

[23] Andriani Kalintiri, 'Revisiting Parental Liability in EU Competition Law' (2018) ELR 145, 159.

[24] Stefan 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' (2012) JECLP 11, 15.

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legal links between those two legal entities."[25] A single economic entity can be established by demonstrating that "the parent company has the power to direct the conduct of the subsidiary to the point of depriving it of any independence in determining its commercial cause of action"[26] and that this power was in fact exercised. The former pertains to the potential to exert a decisive influence over a subsidiary's conduct and the latter, the actual exertion of this influence.[27]

Liability that is premised on the exercise of decisive influence over another entity's conduct may connote some notion of fault. Whether this is true would depend on what the decisive influence to be exercised is. If it is a decisive influence over conduct that constitutes the alleged competition law infringement, liability could be fault-based. This would be the case if the test hinges on whether the parent company has exercised its decisive influence in a sufficiently diligent manner to forestall the wrongful conduct. Unfortunately, as the doctrine is currently applied by the court, the focus of the decisive influence inquiry is not on the very conduct that constitutes an infringement, but on the subsidiary's general commercial policy.[28] As Peter Whelan points out, "[t]here is no need to prove that the parent company knew about, condoned, encouraged, supported, implemented, instigated or even benefited from the competition law infringement of the subsidiary: the mere exercise of decisive influence over the commercial policy (very broadly understood) of the subsidiary by its parent company is sufficient for liability to be imposed upon the latter entity for the infringement at issue."[29] This is echoed by Advocate General Nils Wahl.[30] This focus causes the doctrine to veer from a notion of fault-based liability.

What steers things even closer to strict liability is the rebuttable presumption of decisive influence on the part of a parent over a wholly owned subsidiary's general commercial policy. On the one hand, it is hard to quibble with such a presumption. If the parent company controls every share and hence every vote in the subsidiary, which would give the parent the right to nominate every director, it must have the ability to exercise complete control over the subsidiary's operation if it so chooses. On the other hand, by shifting the focus to the subsidiary's general commercial policy, and by presuming such a decisive influence in the case of wholly owned subsidiaries, the single economic entity doctrine as applied to the parent-subsidiary context has effectively imposed parental liability for the competition law infringement of every wholly owned subsidiary.

If the focus were on the specific infringing conduct, the parent could at least argue that it has made reasonable effort to instruct the subsidiary not to pursue such conduct. What constitutes reasonable effort is a question of fact that will need to be determined by the Commission and the Courts. If the subsidiary nonetheless persists with such conduct, the parent arguably lacks decisive influence over the subsidiary. If, however, the focus is on general commercial

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[25] Case C-440/11 P *European Commission v Stichting Administratiekantoor Portielje and Gosselin Group NV* ECLI:EU:C:2013:514, para 38.

[26] Thomas (n 24) 12–13.

[27] ibid 13.

[28] Paul Hughes, 'Competition Law Enforcement and Corporate Group Liability—Adjusting the Veil' (2014) ECLR 68, 78

[29] Whelan (n 12) 13.

[30] Nils Wahl, 'Parent Company Liability – A Question of Facts or Presumption?' 19th St. Gallen International Competition Law Forum ICF (St. Gallen, June 2012) 4.

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policy, it would be difficult for any parent to demonstrate a lack of decisive influence given its 100 percent share ownership, which by definition gives it complete control over the board. If liability is premised on 100 percent share ownership, it is based on status and not on action.[31] As Stephen Daly and Alison Jones observe, "it now appears that the rationale for liability is not the decisive influence exercised by the parent [over the infringing conduct] or its involvement in the breach, but the personal responsibility attached to the economic unit, liability is not based on fault".[32]

What arguably cements the status of the current regime as one of strict liability is the irrebuttable nature of the AKZO presumption. While the Court of Justice has acknowledged that the presumption is very difficult to rebut, it does not seem to think there is anything wrong with that.[33] Many commentators have gone one step further than the Court and argued that the presumption is practically irrebuttable. Erik Pijnacker Hordijk and Simone Evans assert that rebutting the AKZO presumption "appears near to impossible".[34] Bernardo Cortese points out "how difficult it still is to meet the burden of proof requested to rebut the presumption".[35] Clio Angeli and Rebecca Williams note that the presumption has been characterized "as being very hard, if not virtually impossible, to reverse."[36] Stefan Thomas calls it "effectively unrebuttable" outright.[37] The presumption puts parent companies in an impossible situation.[38]

A regime under which the parent of every wholly owned subsidiary automatically bears liability for the latter's wrongdoing with no realistic possibility of rebuttal is indisputably one of strict liability. Whether the parent has done anything wrong, for example, by directing the subsidiary to pursue the anticompetitive conduct, by failing to exercise adequate oversight over the subsidiary's operation, or by neglecting to put in place an effective compliance regime, seems to be entirely irrelevant to the issue of liability. Fault has no role to play in this liability regime. Whether such a regime for parental liability represents a sound policy decision would depend on what we hope to achieve by imposing parental liability for a subsidiary's competition law infringement.

2.2 Objectives of the Doctrine

Commentators have proposed different objectives for parental liability under the single economic entity doctrine. The first and most obvious objective is deterrence. Carsten Koenig and Bruce Wardhaugh have both argued that the only justifiable policy objective for the doctrine is deterrence of competition law infringements.[39] From an economic perspective, deterrence

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[31] Kalintiri (n 23) 158.

[32] Daly and Jones (n 5) 6.

[33] Case C-521/09 P *Elf Equitaine v Commission* [2011] ECLI:EU:C:2011:620, para 62.

[34] Pijnacker Hordijk and Evans (n 17) 128.

[35] Bernardo Cortese, 'Piercing the Corporate Veil in EU Competition Law: The Parent Subsidiary Relationship and Antitrust Liability' in Bernardo Cortese (ed.), *EU Competition Law—Between Public and Private Enforcement* (Wolters Kluwer 2014) 73, 88.

[36] Angeli and Williams (n 16) 691.

[37] Thomas (n 24) 18.

[38] ibid 19.

[39] Wardhaugh (n 10); Carsten Koenig, 'An Economic Analysis of the Single Economic Entity Doctrine in EU Competition Law' (2017) JCLE 281.

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is the most generally accepted justification for imposing punishment in general. In the ideal scenario, deterrence will be so effective that undesirable conduct that can be reasonably prevented is fully deterred. The doctrine may deter wrongful conduct by increasing the size of the fine or damages award.

The second, and a related, possibility is to ensure that fines are fully paid.[40] This would be a particularly worthwhile objective if there is widespread use of an underfunded subsidiary to limit the liability exposure of an entire corporate group, as in the famous *German sausage cartel* case, where the defendants had their assets removed and were closed down in order to avoid liability for the fine imposed by the German Federal Cartel Office.[41] The strategic use of underfunded subsidiaries or deliberate asset stripping by a parent leads to non-payment of fines, which results in under-deterrence, which in turn would be remedied by parental liability. If this were the main objective of the doctrine, however, there seems to be no good reason to make it a default rule in every case. Parental liability would only need to be imposed in actual instances of underfunding or asset stripping. It would also seem to make sense to limit the doctrine to imputation of liability and not apply it in the context of fine calculation. The doctrine only needs to make sure that the fine imposed is paid, either by the parent or the subsidiary. Including the parent's turnover in the calculation of fines does not further the objective of ensuring that fines are paid.

The final possibility is the disgorgement of ill-gotten gains from the parent company.[42] A parent company should not be allowed to keep the ill-gotten gains derived from its subsidiary's anticompetitive conduct. Disgorgement, however, falls short of achieving full deterrence. A potential wrongdoer will not be deterred by disgorgement, as the consequence of apprehension is only the profit from the wrongdoing. Given that the probability of detection and apprehension is almost never 100 percent, it would still pay for a potential wrongdoer to attempt anticompetitive conduct at the risk of getting caught. But the deterrent effect would still be greater than if the parent company bears no liability whatsoever.

2.2.1 Deterrence

From an economic perspective, the primary justification for imposing punishment is deterrence. Society suffers the least harm when wrongful conduct is deterred such that it never occurs. There are two ways in which a parent may play a role in a subsidiary's potential competition law infringement: direct involvement and failure to monitor and supervise. Direct involvement refers to when a parent plays an immediate role in instructing a subsidiary to engage in or pursue anticompetitive conduct. The wrongdoing is intentional, and the theory of liability is based on intentional wrongful conduct. The deterrent effect of fines must operate directly in the parent's calculus. The fine imposed must exceed the expected gains that the parent company may derive from the potential wrongdoing.

Failure to monitor or supervise encapsulates a fault-based or negligence-based theory of liability. A parent company is subject to fines for failure to prevent wrongful conduct on the part of the subsidiary through an effective compliance program or other kinds of direct or indirect supervision. The classic formulation of a negligence-based theory of liability is the

[40] Koenig (n 39) 283.

[41] ibid 314.

[42] Okeoghene Odudu and David Bailey, 'The Single Economic Entity Doctrine in EU Competition Law' (2014) CMLR 1721, 1755.

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B=PL formula propounded by Judge Learned Hand in the United States, where B stands for the burden to take care, P for probability of an accident (or of infringement in the present context), and L for liability.[43] The principle behind the formula is that a defendant in a negligence tort case should not be subject to liability if the cost of the care he has taken to minimize an accident equals or exceeds the expected liability from the accident, which is supposed to reflect the expected harm.[44] Once the cost of care exceeds expected harm, it would be more cost-effective for society to bear the potential loss than to incur further costs of precaution.[45] In the context of parental liability for a subsidiary's competition law infringement, a parent company should be excused from liability if the cost of the precaution it has undertaken equals or exceeds the expected harm from the anticompetitive conduct. Under either theory of liability, socially harmful conduct would be minimized. Intentional wrongdoing by the parent company would be deterred by direct fines while the parent company would continue to take care to prevent anticompetitive conduct so long as it is cost-effective to do so through parental liability. If deterrence works as expected, anticompetitive conduct by subsidiaries would be kept to a minimum.[46] A fault-based notion of liability should lead to optimal deterrence.

It is arguable whether the single economic entity doctrine pursues optimal deterrence. On the one hand, if the parent company is ultimately responsible for the anticompetitive conduct, it only makes sense to extend liability to it. For intentional wrongdoing, where the parent bears direct responsibility, parental liability appears superfluous. Under existing EU law, fines can be imposed directly for the parent's direct involvement.[47] There is no need to extend the subsidiary's liability to the parent. In contrast, a negligence-based theory of liability would be justified if the parent company is best positioned to stop the anticompetitive conduct. Liability would provide the parent company the incentive to take care.[48] Such a theory of liability would provide strong support for a presumption of decisive influence in the case of wholly owned subsidiaries. In comparison to other types of shareholders, a parent of a wholly owned subsidiary would be best suited to police the subsidiary's business practices.

Decisive influence would appear to be a particularly well-suited test for imposing parental liability if optimal deterrence is the chief justification for the single economic entity doctrine. If parental liability is justified on the ground that the parent company has failed to exercise due care in monitoring the subsidiary's business and in detecting and stopping wrongdoing, liability should only attach if the parent is in a position to monitor and alter its subsidiary's conduct. Imposing liability would achieve nothing if there was nothing that the parent could have done to stop the subsidiary's illicit conduct. Furthermore, the focus on the subsidiary's general commercial policy instead of the precise wrongdoing would also be well placed. The degree of influence over general commercial policy indicates the parent's ability to monitor a subsidiary's conduct and to alter a subsidiary's business decisions. A parent's degree of influence or extent of control over the specific wrongdoing should instead provide grounds for a defense. It should give the parent an opportunity to demonstrate its exercise of due care

[43] Wardhaugh (n 10) 37.
[44] ibid.
[45] ibid.
[46] Koenig (n 39) 294–95.
[47] Ulfbeck (n 6) 109–10.
[48] Koenig (n 39) 283.

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or diligence and to argue that it has done everything it could reasonably be expected to do to prevent the wrongdoing.

On the other hand, the single economic entity doctrine as it is currently formulated arguably exceeds optimal deterrence. If the doctrine is meant to discourage negligent monitoring or supervision of a subsidiary, a parent company must be exonerated if it can demonstrate that it has taken due care under the B=PL formula. If it is accepted that precaution becomes excessive and socially wasteful beyond a certain point, and that perfect monitoring of a subsidiary is impossible, the doctrine must provide a defense based on the exercise of due care.[49] Otherwise, the regime would become one of strict liability, which has a well-known tendency to lead to an excessive level of care, although some have argued that it redounds countervailing benefits.[50] Counterintuitively, the Court of Justice has repeatedly rejected defenses offered by parent companies on the grounds of due care and diligence.[51] In fact, the existence of a compliance program has not only failed to earn the defendant credit or clemency, it has backfired on the defendant.[52] As Andriani Kalintiri insightfully observes, "one is left wondering what precisely parental liability is intended to discourage. In a sense – and rather paradoxically, the answer is nothing. Indeed, parental liability, as applied by the EU Courts, appears to be nothing more than a vehicle for increasing the level of the fines, on the one hand, and ensuring their recovery, on the other."[53] Parental liability may even have the counterintuitive effect of encouraging a parent company to turn a blind eye to avoid uncovering wrongdoing by its subsidiary in the hope that the wrongdoing will never be discovered. If the single economic entity doctrine is to be reconciled with optimal deterrence, or avoiding excessive deterrence, some kind of defense based on due care or diligence is sorely missing.

Separately, if deterrence is the chief objective of the doctrine and if existing fines are insufficient to deter wrongful conduct for whatever reason, the doctrine provides a basis to remedy under-deterrence by incorporating a parent company's turnover in the calculation of fines. This is to be distinguished from the objective of ensuring the full payment of fines to preserve their deterrent effect, which will be discussed in the next section. Under the latter, it is assumed that fines at their current levels produce sufficient deterrence, which is compromised by the non-payment of fines due to strategic under-capitalization. The single economic entity doctrine is only needed to restore their full deterrent effect by ensuring that a parent is liable for fines that a subsidiary is unable to pay. There is no need for a further increase in the quantum of fines.

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[49] Wardhaugh (n 10) 35.

[50] ibid 36.

[51] Case T-138/07 *Schindler Holding Ltd and Others v European Commission* [2011] ECLI:EU:T:2011:362, para 88. Cases T-141/07, T-142/07, T-145/07 and T-146/07 *General Technic-Otis Sàrl* (T-141/07), *General Technic Sàrl* (T-142/07), *Otis SA and Others* (T-145/07) *and United Technologies Corporation* (T-146/07) *v European Commission* [2011] ECLI:EU:T:2011:363, para 85.

[52] Carsten Koenig, 'The Boundaries of the Firm and the Reach of Competition Law: Corporate Group Liability and Sanctioning in the EU and the US' in Marco Corradi and Julian Nowag (eds.), *Intersections between Corporate and Antitrust Law* (CUP 2023) 63, 69.

[53] Kalintiri (n 23) 159.

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2.2.2 Prevention of non-payment of fines

The single economic entity doctrine may foster deterrence by preventing the non-payment of fines through intentional under-capitalization of subsidiaries. Non-payment of fines clearly leads to under-deterrence. Carsten Koening argues that in the absence of wealth constraints, information costs, and high enforcement costs, there would be no need for parental liability in an ideal deterrence model.[54] The doctrine, however, "ensures effective deterrence where the primary target of liability—the corporation in the course of whose business the antitrust violation was committed—is under-deterred. The main reason for such under-deterrence is a lack of sufficient assets of the subsidiary to pay a fine or damages. Furthermore, the single economic entity doctrine prevents corporations from opportunistically exploiting the principle of limited liability."[55] The purpose of the doctrine is to ensure the full payment of fines, which preserves the deterrent effect of fines. And if the current level of fines produces optimal deterrence, ensuring their full payment would be of paramount importance.

This is also the rationale for the doctrine of piercing the corporate veil under U.S. corporate law[56] and for the legislative amendment to German competition law after the *sausage cartel* incident.[57] The incentive for a parent company to behave opportunistically by underfunding a subsidiary would disappear if the parent was directly liable for the fine. If, however, the objective is to prevent the non-payment of fines, an automatic imputation of liability on the parent company is arguably excessive and the classic piercing of the corporate veil doctrine may suffice. Parental liability would only be needed if there is evidence that the subsidiary is underfunded and unable to pay the fines. This is largely similar to how veil piercing operates under U.S. law. Koenig, however, has reservations about relying on veil piercing, arguing that most veil piercing doctrines "are ambiguous and leave a lot of room for interpretation."[58]

The difference between the two approaches, however, should not be overstated. Automatic imputation of liability on the parent amounts to joint and several liability of the parent and the subsidiary. If the subsidiary is able to pay the fine in full, the parent will have no financial exposure. It is only when the subsidiary is underfunded, perhaps deliberately so, that the parent will be on the hook for the fine, at which point veil piercing would produce the same outcome. Relying on the single economic entity doctrine instead has the added advantage of obviating the need for an additional judicial proceeding for veil piercing. Allocation of liability is settled at the same time as the fine is levied.

One may argue that parental liability should only be imposed upon evidence of intentional under-capitalization of the subsidiary. The single economic entity doctrine should only be invoked if the European Commission has established that the subsidiary may be unable to pay the fine in full. This, however, would leave open the risk of post-decision opportunistic behavior on the part of the parent. The veil-piercing jurisprudence is full of examples of shareholders depleting the company of funds after liability has arisen.[59] Imposing parental

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[54] Koenig (n 39) 299–311.

[55] Koenig (n 39) 283.

[56] Thomas K. Cheng, 'The Corporate Veil Doctrine Revisited: A Comparative Study of the English and the U.S. Corporate Veil Doctrines' (2011) BCICLR 329.

[57] Koenig (n 39) 316.

[58] Koenig (n 39) 314.

[59] Thomas K. Cheng, 'Form and Substance of the Doctrine of Piercing the Corporate Veil' (2010) MLJ 497.

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liability as part of the fining decision would remove the incentives for both *ex ante* intentional under-capitalization and *ex post* depletion of funds.

2.2.3 Disgorgement of ill-gotten gains

Apart from deterrence, the single economic entity doctrine can be justified as a tool to disgorge ill-gotten gains from a parent company that derived financial benefits from a subsidiary's anticompetitive conduct. Okeoghene Odudu and David Bailey assert that "[i]f liability were to be based solely on the benefit obtained without any form of participation (actual or presumed), then the purpose of any fine is to disgorge the non-participating legal entity of any benefit obtained."[60] Kalintiri calls this approach the enterprise liability theory, which propounds "the idea that, insofar as parent companies receive the benefits from the activities of their subsidiaries, they should also bear the respective risks".[61] The rationale is that if the parent derives the benefit from the subsidiary's anticompetitive conduct, it should also share the burden of the consequence. This would be especially true if the anticompetitive conduct generated ill-gotten gains for the parent company.[62]

Kalintiri advocates for this theory on the grounds that it promotes deterrence and that it can better account for the Court's post-AKZO jurisprudence.[63] Despite her protestation that parental liability based on enterprise liability theory "has a strong preventive potential".[64] it is clear that from an economic perspective, mere disgorgement of ill-gotten gains would not adequately deter a potential wrongdoer. If all you have to lose in the event of getting caught is your gains from the illicit conduct, what do you have to lose by trying? It, however, is true that the enterprise liability theory is most consistent with the post-AKZO jurisprudence. While 100 percent ownership may not necessarily connote full control—one can imagine exceptional circumstances where it may not—complete ownership unequivocally indicates undivided benefit from a subsidiary's conduct. After all, the profit of a wholly owned subsidiary can only go to its parent.

The enterprise liability theory has two important implications. The first one is that this theory only countenances liability shifting and not fine augmentation. Fines should not be increased by the inclusion of the parent, either through increasing the turnover base for fine calculation or imposing a penalty for recidivism.[65] The logic is clear. The parent did not derive independent financial benefits from the anticompetitive conduct. All the benefits arise from the subsidiary's anticompetitive conduct and are channeled to the parent from the subsidiary. The parent's liability is entirely derivative of the subsidiary's wrongdoing.

The second implication is whether it is justified to impose parental liability when ownership is only close to, but not reaching, 100 percent. The complete channeling of financial benefits can no longer be presumed once there exists another shareholder. To follow the logic of disgorgement to its logical conclusion, parental liability should not be confined to the majority shareholder, regardless of the size of the shareholding. It should be apportioned among

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60 Odudu and Bailey (n 42) 1755.
61 Kalintiri (n 23) 164.
62 ibid.
63 ibid 164–65.
64 ibid 164.
65 Odudu and Bailey (n 42) 1755.

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the shareholders according to their percentage of ownership. This can be compared with a parental liability regime that is premised on control or decisive influence, which in fact has more flexibility to accommodate less than complete ownership. So long as the right to nominate directors is proportionate to shareholding, complete ownership is not required to bestow control on a parent company. Assuming that directors take instruction from their nominating shareholder faithfully, a shareholder only needs a majority on the board of directors to impose its will on the subsidiary. Full control of the board is unnecessary. If parental liability is premised on control, the Court's willingness to accept close to complete ownership makes eminent sense. One may argue that the Court can go further and accept any major shareholding, or perhaps even a majority of voting rights as the basis of parental liability.

There is a potential overlap between disgorgement and the prevention of under-deterrence. Disgorgement would only serve as a valid basis for parental liability if fines are calculated based on illegal profit and this profit has been siphoned off to the parent, rendering the subsidiary unable to pay the fine. The size of the ill-gotten gains remains the same regardless of whether they are in the hands of the parent or the subsidiary or have otherwise dissipated. As mentioned earlier, this objective only justifies liability shifting and not the augmentation of fines. So long as the subsidiary is able to satisfy its financial obligation in full, there is no reason to extend the liability to the parent. The need for disgorgement only arises when the ill-gotten gains have been shifted to the parent, leaving behind an underfunded subsidiary. These two objectives for parental liability complement each other.

2.2.4 Summing up

Having surveyed possible objectives for the doctrine and their implications for its application, it is worth pondering which objective provides the best fit for the existing jurisprudence and which should be adopted as a matter of policy. Notable features of the existing jurisprudence include: (1) the AKZO presumption of decisive influence for a wholly-owned subsidiary; (2) the decisive influence test is adopted and applied with respect to the general commercial policy of the subsidiary as opposed to the specific wrongdoing; (3) the practical irrebuttability of the AKZO presumption and the consequent lack of defense based on due care; (4) relaxation of the complete ownership requirement to slightly less than 100 percent ownership; and (5) application of the doctrine to both the imputation of liability and the calculation of fines.

None of the proffered objectives fully describe the existing case law. A deterrence objective for the doctrine would certainly support the AKZO presumption. In fact, it would probably go further and justify a presumption as long as the parent owns sufficient shares to exercise effective control over the subsidiary. The ability to monitor a subsidiary's business conduct and stop its anticompetitive conduct does not require complete ownership. A deterrence objective would also bolster the case for a decisive influence test as applied to the subsidiary's general commercial policy. It would support the use of the doctrine for both the imputation of liability and the calculation of fines. What is sorely missing in the current formulation of the doctrine from the perspective of deterrence is a defense based on the exercise of due care and diligence. Deterrence, which presumes a negligence-based theory of liability, would reject an irrebuttable presumption. Therefore, a defense based on the exercise of due care would need to be introduced if the current single economic entity doctrine were to be fully consistent with optimal deterrence.

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Prevention of under-deterrence would put the focus of the doctrine on the state of capitalization of the subsidiary at issue and the risk of *ex post* opportunistic behavior. *Ex ante* undercapitalization, where the subsidiary was already underfunded before fines were imposed, is the relatively easy case. The Commission presumably would be able to scrutinize a subsidiary's financial situation at the time of the fining decision and impose parental liability accordingly. In contrast, *ex post* opportunistic behavior can be difficult to detect or predict and may call for a more interventionist approach, or perhaps even strict parental liability, which would remove all incentives for opportunistic behavior on the part of the parent.

From the perspective of ensuring the full payment of fines, the state of ownership almost seems to be a secondary concern. There is no direct correlation between the state of ownership on the one hand and the state of capitalization and the risk of *ex post* opportunistic behavior on the other hand. There is *a priori* no reason why the co-owners of a subsidiary cannot cooperate to move funds out of it to ensure the non-payment of fines. A quick look at the veil piercing cases in the U.S., however, suggests that such opportunistic behavior seems to be more common with wholly owned subsidiaries.[66] Therefore, an AKZO presumption for a wholly owned subsidiary could be justified from this perspective, although not to the extent that it becomes practically irrebuttable. A relaxation from the expectation of complete ownership would only be justified if there is other evidence indicating an elevated risk of *ex post* opportunistic behavior. Decisive influence, especially with respect to the subsidiary's general commercial policy, would be an irrelevant consideration. The only pertinent concern would be whether the parent can easily move funds out of the subsidiary. Lastly, there would be no reason to apply the doctrine to the calculation of fines if the policy objective is to prevent under-deterrence due to the non-payment of fines.

A disgorgement objective would fully support the AKZO presumption for parental liability of a wholly owned subsidiary. As indicated earlier, disgorgement in fact provides stronger support for this presumption than deterrence since the percentage of share ownership determines the share of profit that goes to a particular shareholder. Complete ownership implies identity in financial interests between the parent and the subsidiary. A practically irrebuttable presumption would probably be justified. Relaxation of the 100 percent ownership requirement could be problematic and parental liability may need to be apportioned among the shareholders of a partially owned subsidiary. Decisive influence again would be an irrelevant consideration if the concern is whether the parent benefited from the subsidiary's anticompetitive conduct. Nor is there a need for a defense based on the exercise of due care as disgorgement is not concerned with the prevention of wrongdoing. Lastly, the single economic entity doctrine should not be applied to increase the quantum of fines if the fine imposed on the subsidiary already captures the full size of the ill-gotten gains.

It is clear that none of the three proffered objectives for the single economic entity doctrine provides a perfect fit for the existing case law. Prevention of under-deterrence, which aims to restore the full deterrent effect of existing fines, which are in turn presumed to have optimal deterrent effect, generally does not account for the existing case law, which focuses on the state of ownership and decisive influence. As argued earlier, the state of ownership has little to do with the risk of *ex post* opportunistic behavior, and decisive influence over general commercial policy is of little significance so long as the shareholder can move funds out of the subsidiary. Deterrence provides a very good fit apart from the lack of a defense under

[66] Cheng (n 56) 365–71.

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the presumption. Disgorgement is also consistent with the existing case law apart from the relaxation of the 100 percent share ownership requirement and the application of the doctrine to increase the quantum of fines. Deterrence and disgorgement both provide reasonably good accounts for the existing jurisprudence, although instituting a defense based on the exercise of due care would represent a more dramatic change to the current approach than limiting the doctrine to wholly-owned subsidiaries.

From a policy perspective, the arguments for adopting deterrence as the policy objective for the doctrine are more persuasive. It is hard to ignore the principle that the chief purpose of imposing fines and punishment is to deter wrongful conduct. While it is difficult to dispute the logic that one who benefited from the wrongful conduct should shoulder the consequences, Kalintiri's strongest justifications for disgorgement are that it provides a deterrent effect and is the most consistent with existing case law. If it is deterrence that we are after, it seems odd to go for the second-best approximation. Fit for the existing case law should not be determinative if we are trying to determine the policy objective of the doctrine.

3. PRACTICAL IMPLICATIONS FOR THE SINGLE ECONOMIC ENTITY DOCTRINE

3.1 Should the AKZO Presumption be (Practically) Irrebuttable?

There has been considerable debate as to the rebuttability of the AKZO presumption for wholly owned subsidiaries. The enumerated exceptions to this presumption—"(i) the parent company is an investment company and behaves like a pure financial investor; (ii) the parent company holds 100 per cent of the shares in the subsidiary only temporarily and for a short period; (iii) the parent company is prevented for legal reasons from fully exercising its 100 per cent control over the subsidiary; or (iv) the subsidiary disregards the instructions given to it by its parent company"[67]—are widely understood to be of limited applicability.[68] They have been described as "limited in scope and do not provide any real room for manoeuvre."[69] The pure financial investor exception held some promise until the *Goldman Sachs* case.[70] In fact, the presumption is yet to be successfully rebutted.[71] The Court of Justice, however, has chosen to overlook this fact and insisted that "even though it is difficult to rebut, it 'remains within acceptable limits'."[72]

It is precisely in cases where the parent company has made no attempt to influence a subsidiary's business decisions that rebuttal would be impossible. Instead, a parent company would need to show that its subsidiary has openly defied its instruction. A parent company inclined to accumulate rebuttal evidence would thus need to issue an instruction to a subsidiary and hope that it would be contradicted. The attempt would backfire if the subsidiary chose to obey

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[67] Pijnacker Hordijk and Evans (n 17) 128.

[68] Merlino (n 16) 465.

[69] Pijnacker Hordijk and Evans (n 17) 129.

[70] Case C-595/18 P *The Goldman Sachs Group Inc. v European Commission* [2021] ECLI:EU:C:2021:73.

[71] Kalintiri (n 23) 154.

[72] Case C-521/09 P *Elf Equitaine v Commission* [2011] ECLI:EU:C:2011:620, para 62.

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the instruction. This reliance on evidence of subsidiary defiance can produce counterintuitive results. A parent could instruct a pliant subsidiary to feign defiance to fabricate rebuttal evidence. In such case, apparent defiance does not suggest independent decision-making on the part of the subsidiary. It indicates complete domination by the parent. Appreciating the limited utility of evidence of subsidiary defiance, the Court of Justice has suggested that a parent company can also "put forward 'any evidence relating to the organisational, economic and legal links' between its subsidiary and itself"[73] to rebut the presumption. What kind of evidence concerning these links is needed is "unhelpfully vague".[74]

In recent years, the Court has gone one step further and disavowed evidence of subsidiary defiance altogether. Even a subsidiary's manager's disregard of instructions by the parent company to refrain from anticompetitive conduct was deemed insufficient for rebutting the presumption.[75] Assuming that the refusal to obey was genuine, which admittedly can be difficult to verify, it is difficult to imagine more direct and persuasive evidence of lack of decisive influence. If such evidence does not suffice to rebut the presumption, then critics are probably right in observing that the presumption is practically irrebuttable.

Advocate General Kokott's contrary argument notwithstanding,[76] an irrebuttable presumption of decisive influence effectively imposes strict liability on a parent company for a wholly owned subsidiary's anticompetitive conduct.[77] An irrebuttable presumption of decisive influence with respect to wholly owned subsidiaries can lead to excessive deterrence. Optimal deterrence necessitates fault-based liability, which would require a defense for the parent company on the ground that it has exercised due care and diligence in monitoring the subsidiary's business conduct. The precise contours of this defense will need to be clarified by the courts. One of the first things that will need to be worked out is the interaction between such a defense and the decisive influence test that is currently in place. On the one hand, a standard for due care presumes that the parent is in a position to stop a subsidiary's anticompetitive conduct, which in turn presumes decisive influence. The requirement of due care or diligence, however, goes beyond that of decisive influence. The decisive influence test as applied by the courts mostly focuses on what kind of influence a parent company is capable of exerting. The actual influence limb of the test is mostly satisfied by the AKZO presumption. In contrast, a due care or diligence test directs attention to what the parent company has actually done to prevent wrongdoing. The fact that a parent company is in a position or has the capability to prevent a subsidiary from committing anticompetitive conduct need not mean it has done so. Under this due care and diligence defense, evidence of actual care or diligence would be required.

The test is satisfied if a parent company is deemed to have done enough to detect and put an end to a subsidiary's anticompetitive conduct. In the example of subsidiary defiance discussed earlier, open defiance of a parent's instruction would constitute evidence of a lack of decisive influence. Mere instruction to a subsidiary, however, may not meet the standard for due care

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[73] Case C-97/08 P *Akzo Nobel and Others v Commission* [2009] ECR I-8237, para 65.

[74] Thomas (n 17) 19.

[75] Vasiliki Fasoula, 'Extending the Presumption of Decisive Influence to Impute Parental Liability to Private Equity Firms for the Anticompetitive Conduct of Portfolio Companies' (2021) NJEL 101, 109.

[76] Case C-97/08 *P Akzo Nobel and Others v Commission* [2009] ECLI:EU:C:2009:262, AG Opinion para 97.

[77] Merlino (n 16) 466.

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or diligence. A parent may be expected to follow up on its instruction and make some effort to ensure that the subsidiary is complying with it. Meanwhile, some evidence that has been dismissed by the Court of Justice for rebuttal purposes, such as "[d]isregarded instructions of the parent company to the subsidiary's sole manager to not proceed with anticompetitive agreements, adoption of internal guidelines, code of conduct and audits performed by a compliance officer in order to avoid competition violations or even setting up formal written policies for compliance with competition law" should be accorded heavier weight.[78] While a holistic assessment is needed and none of these should be dispositive, all these measures are relevant evidence of a parent's effort to prevent a subsidiary's wrongdoing. If a parent adopts internal guidelines or a code of conduct and makes consistent efforts to enforce them, it is clearly making an effort at exercising due care to prevent wrongdoing. Given that this is part of a defense that must be raised by the parent company, the burden to show that it has exercised due care and diligence would lie with it.

An irrebuttable presumption of parental liability for a wholly-owned subsidiary's wrongful conduct would be favored under disgorgement. Disgorgement-based liability is premised on the notion that the parent has benefited from a subsidiary's wrongful conduct. The extent of a shareholder's benefit is directly proportionate to its shareholding. A shareholder with 100% shareholding derives undiluted benefit from the subsidiary's anticompetitive conduct either through distribution of dividends or increase in share prices. It is difficult to imagine a scenario under which such a shareholder would not have benefited from the subsidiary's anticompetitive conduct. Therefore, contrary to a deterrence-based view, the AKZO presumption, as it is currently enforced by the Court of Justice, is fully consistent with disgorgement.

3.2 Should the Single Economic Entity Doctrine be Allowed Differential Application?

The Court's insistence on defining an undertaking as a single economic entity leads to the inevitable consequence that the doctrine is applied uniformly in a variety of contexts. The most obvious ones are the imputation of parental liability and the calculation of fines, in particular, the inclusion of the parent company's turnover in the calculation of fines to increase the deterrent effect on potential wrongdoers. The idea is that the turnover of the entire economic entity should be used because it is the entire entity rather than the subsidiary that infringed the law. If liability is imposed on the parent because it is part of the undertaking under the single economic entity doctrine, the parent's turnover should also be included when calculating the fine.

It is difficult to dispute the logic of this argument once the concept of an undertaking is linked to the single economic entity doctrine. It is, however, not clear that such linkage is necessary. The discussion of whether an undertaking must be defined as a single economic entity will be deferred. The question for now is whether the single economic entity doctrine should be invoked in the context of fine calculation. While the doctrine is clearly pertinent to the imputation of liability, nothing inherent in the logic of the doctrine dictates equal applicability to fine calculation. In fact, there are good arguments against such application.

The doctrine should not be used for fine augmentation when viewed from the disgorgement perspective. The parent's liability is derivative of the subsidiary's liability. The parent

[78] Fasoula (n 75) 109.

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bears no independent responsibility for the subsidiary's wrongdoing apart from the financial benefit that the parent has derived from it. There is hence no basis to enlarge the parent's liability beyond that of the subsidiary. As for the deterrence perspective, it was suggested earlier that the doctrine may be invoked to increase the size of fines by taking into account a parent company's turnover. While there is nothing against the logic of deterrence to use the doctrine this way, such a use can smack of arbitrariness. If it is decided that excessively low fines lead to systemic under-deterrence, they should be augmented across the board for all offenders. Doing so through the single economic entity doctrine would only result in higher fines for corporate groups. Fines levied on stand-alone companies would remain unaffected. There is, however, no reason to believe that under-deterrence is confined to corporate groups. The inclusion of a parent's turnover is also a blunt way to increase fines. If a parent's turnover dwarfs that of a subsidiary, including the parent's turnover may overshoot the target and result in over-deterrence, and vice versa. All in all, there is no sound basis for using the single economic entity doctrine to increase the size of fines. The doctrine should be confined to imputing liability onto a parent for a subsidiary's wrongdoing.

Differentiated application of the doctrine may run into difficulty with the Court's current approach of conflating the concept of an undertaking with the single economic entity. The Court defines an undertaking as a single economic entity. Based on this definition, it would be difficult to argue against the inclusion of a parent's turnover in fine calculation for the wrongdoing of a wholly-owned subsidiary. This, however, need not be the case. As Alison Jones sagaciously observes, "[a]lthough it will be seen that a strong argument could be made that there should be a context-specific approach to the concept of an undertaking, the cases generally suggest that the principles apply to both situations without distinction."[79]

Recall the origin of the single economic entity doctrine as a defensive doctrine to shield intra-group transactions from the scrutiny of EU competition law. The purpose of the doctrine in the defensive context is to prevent the overreach of competition law into situations where the lack of independent decision-making means that the basic premise of Article 101 no longer applies. This cannot be more different from the deterrence or disgorgement objective served by the doctrine in the context of liability imputation. The former defensive function is concerned with determining the existence of an infringement. The latter imputation function is about the magnitude and incidence of fines. The disconnect between the doctrine and its underlying policy objectives has led Koenig to argue that "initially the instrumental approach was strongly emphasised, in recent years, the Courts have sometimes tried to find meaning in words instead of really getting to the bottom of the problem. … Moreover, the Courts have begun to treat the economic unit as akin to a legal entity, sometimes even seeming to endow it with legal personality."[80]

By defining an undertaking as a single economic entity, the Court of Justice has deprived itself of the ability to contextualize the doctrine and the flexibility to tailor the doctrine in accordance with its various policy objectives. This approach should be abandoned once its flaws are appreciated. The boundary the Court draws around an economic entity in one context should not tie its hands in another context.

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[79] Alison Jones, 'The Boundaries of an Undertaking in EU Competition Law' (2012) ECJ 301, 316.

[80] Koenig (n 39) 67.

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3.3 Should Liability be Imputed to Subsidiaries?

The answer to this question should be straightforward. It should be clear that under either the deterrence-based or the disgorgement-based conception of the single economic entity doctrine, liability should not be imputed downward from the parent to the subsidiary or laterally across subsidiaries. The reasons are obvious. A subsidiary has no control over the business conduct of the parent or a sister subsidiary. No amount of liability on the subsidiary will make a difference or achieve any deterrent effect. Likewise, a subsidiary does not receive any financial benefit from the parent's or a sister subsidiary's wrongdoing. The financial benefits only go to the parent company. Imposing liability on a subsidiary will not serve the purpose of disgorging ill-gotten gains, at least not directly. If the sister subsidiary is also wholly owned, imposing liability on it at least may be justified as an indirect way to target the parent company's assets, although one can argue that imposing direct liability on the parent would be more effective. If the subsidiary has multiple shareholders, imposing liability on it would amount to punishment for these shareholders who bear no responsibility for the parent's or the offending subsidiary's anticompetitive conduct. Therefore, subsidiary liability should be rejected.[81]

4. CONCLUSION

The single economic entity doctrine serves an important purpose in EU competition law. It, however, has been allowed to expand seemingly without limit, partly because the Court of Justice has neglected to ascribe to the doctrine an explicit policy objective. The nebulous nature of the concept of a single economic entity renders the doctrine susceptible to unchecked growth. Care must be taken to ground the doctrine on a principled basis to guard against limitless expansion. This chapter is an attempt at ascertaining the proper policy objective of the doctrine and to reconcile different features of the doctrine with these objectives. It is argued that deterrence is ultimately the most proper policy objective for imposing punishment from an economic perspective and deterrence probably best describes the existing jurisprudence apart from the practically irrebuttable nature of the AKZO presumption and the lack of defense against parental liability based on due care and diligence. If the Court of Justice decides to take up deterrence as the objective for the doctrine, it should introduce such a defense and retreat from its recent foray into subsidiary liability undertaken in the *Sumal* case.

[81] See Whelan (n 12).

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9. Undertakings and Legal Entities as Addressees of Articles 101 and 102 TFEU

Marcos Araujo Boyd

1. INTRODUCTION[1]

European competition rules are addressed to undertakings, which makes them their subjects.[2] That term designates an economic unit irrespective of legal form[3] and therefore does not normally coincide with a single legal entity. It is trite law that an undertaking may contain several persons, natural or legal,[4] and this is frequently the case above a certain size.

The Court of Justice of the EU ('CJEU' or 'Court') has been clear in that undertakings, and not legal entities, are the addressees of Articles 101 and 102 of the Treaty on the Functioning of the European Union ('TFEU'). By way of example, it proclaimed in *Schindler* that:

> (t)he authors of the Treaties chose to use the concept of an undertaking to designate the perpetrator of an infringement of competition law, who is liable to be punished pursuant to Articles 81 EC and 82 EC, now Articles 101 TFEU and 102 TFEU, and not the concept of a company or firm or of a legal person, used in Article 48 EC, currently Article 54 TFEU.[5]

The consequence of that identification was summarised shortly after in *Siemens Österreich* as follows:

> (…) the rules governing EU competition law, including those relating to the Commission's power to impose penalties, the EU law principle of personal liability for an infringement and the principle that the penalty must be specific to the offender and the offence, which must be complied with when the power to impose penalties is being exercised, relate only to the undertaking per se, not the natural or legal persons forming part of the undertaking.[6]

[1] This contribution is based on my PhD thesis delivered in Glasgow in 2023 which is available at https://theses.gla.ac.uk/83415/. I wish to thank Professors Alison Jones and Theodora Groza for their useful comments on earlier drafts and especially Florence Thépot and Anna Tzanaki for their many important suggestions.

[2] The term 'subjects' applied to undertakings was first used by the Commission in Joined Cases 29 and 30/83, *CRAM and Rheinzink v Commission* EU:C:1984:130, [1984] ECR 1679 para 8, and later recovered by Wouter P.J. Wils, 'The undertaking as subject of E.C. competition law and the imputation of infringements to natural or legal persons' (2000) 25 European Law Review 99.

[3] Case C-41/90 *Höfner and Elser v Macrotron* EU:C:1991:161, [1991] ECR I-1979, para 21.

[4] Case C-217/05 *CEES v CEPSA* EU:C:2006:784, [2006] ECR I-11987, para 40.

[5] Case C.501/11 P *Schindler and Others v Commission* EU:C:2013:522, para 102.

[6] Joined Cases C-231/11 P to C-233/11 *Commission v Siemens AG Österreich and Others* EU:C:2014:256, para 56.

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Despite the above proclamations, Articles 101 and 102 TFEU do not entirely disregard traditional subjects of the law, that is, natural or legal persons.[7] Procedural acts, and especially the statement of objections ('SO') and indeed the decision adopted at the end of the procedure, can only be communicated to entities with legal personality.[8] Private enforcement before national courts will generally also require the identification of a person. In short, Articles 101 and 102 TFEU are simultaneously applied to undertakings and legal entities under a dual enforcement model.

That said, it is often difficult to grasp which entity, whether the undertaking or the legal person, is targeted by each component of an enforcement action. We may look at the undertaking when examining the conduct and turn to legal entities to establish the turnover for the purposes of calculating a fine. We might consider the participation of several legal entities within an undertaking separately when assessing time limits and prescription but look at the undertaking as a whole to increase fines for recidivism. We may proclaim parental liability as a consequence of the notion of undertaking but refuse to accept subsidiary liability unless some specific links are present. Parting with the traditional person-centric enforcement model in favour of an identification of liable entities based on economic reality was never meant to be easy.

This contribution discusses the respective roles of the undertaking and legal entities as addressees of Articles 101 and 102 TFEU. The analysis is divided into three sections: *public enforcement*, where this matter has most often been examined by the Court; *private enforcement*, an area where some developments have recently taken place; and *public procurement*, where the distinction between economic and legal entities is affected by the interplay between EU competition law and the specific legislation in that area.

2. UNDERTAKINGS AND LEGAL ENTITIES IN THE PUBLIC ENFORCEMENT OF ARTICLES 101 AND 102 TFEU

Despite the grandiose proclamations that Articles 101 and 102 TFEU concern undertakings, and not legal entities, there is no question that their enforcement by the European Commission ('the Commission') requires identifying one or more natural or legal persons that may be heard and to whom, ultimately, decisions may be addressed.

That requirement is sometimes downplayed as a formality resulting from the fact that the Commission enforces these provisions through decisions within the meaning of Article 288 TFEU,[9] which must be addressed to a 'person' where they impose pecuniary obligations.[10] This dismissive attitude towards identifying legal entities has been echoed by the Court

[7] In this chapter, 'legal persons' are understood to be structures which enjoy legal personality under the law of their constitution, and 'natural persons' identifies individuals.

[8] Case C-97/08 P *Akzo Nobel and Others v Commission* EU:C:2009:536, [2009] ECR I-08237, para 57. Cf Joined Cases C-395/96 P and C-396/96 P *CMB and Dafra-Lines v Commission*, EU:C:1998:518, [2000] ECR I-01365, Opinion of AG Fennelly, para 179.

[9] 'A decision shall be binding in its entirety. A decision which specifies those to whom it is addressed shall be binding only on them.'

[10] Article 299 TFEU: 'Acts of the Council, the Commission or the European Central Bank which impose a pecuniary obligation on persons other than States, shall be enforceable.'

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itself.[11] At the same time, however, case law has recognised and protected the rights of legal entities in procedural matters in a way that challenges the identification of undertakings as sole addressees of EU competition rules, as the following paragraphs discuss.

2.1 The Role of the Legal Entity in Public Enforcement Procedures

The public enforcement of Articles 101 and 102 TFEU requires the identification of one or more specific legal entities which may be formally heard, appoint a representative, and provide an address for service. In that respect, procedural acts are understandably tilted towards a 'legal entity' rather than an 'undertaking' perspective.

Somewhat surprisingly, legal structures were handled more flexibly in the early years of competition law enforcement. By way of example, the Commission notified its decision in *Dyestuffs*[12] to the German subsidiary of Imperial Chemical Industries plc, probably to avoid notifications outside the territory of the Communities at the time. On appeal, the Court seemed to concede that this was a procedural irregularity, but dismissed the challenge noting that the parent company to which the decision was addressed had ultimately been able to access the text of the decision.[13] A similar stance was followed some months later in *Continental Can*.[14] A few years later, in *Orkem*, the Court validated that a request for information may be sent to the affiliates of the intended addressee.[15] The underlying logic of these early decisions was that procedural acts could be communicated to a different legal entity, provided that it was determined that its content had in the end arrived at the intended addressee.

The Court however changed tack on this matter when confronted with the communication of the statement of objections ('SO') in *Compagnie Maritime Belge* (*CMB*). The case concerned an uncommon accusation of joint abuse of a dominant position committed within a maritime conference, the Associated Central West Africa Lines, or Cewal. Given the nature of the accusation, the SO named the maritime conference itself as the entity that had committed the breach, overlooking that it had no legal personality. However, the decision adopted on the matter specified the legal entities that should bear the fine, ignoring the fact that the SO had been served on the conference, not on them.[16]

In the appeal against the decision, the General Court ('GC') accepted this handling of the matter, noting that, as it had occurred in the above cases with a decision or a request

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[11] *Siemens Österreich* (n 6) para 55, where the Court refers to this designation as having 'a purely practical nature'.

[12] *Dyestuffs* (Case IV/26.267) Commission Decision 69/243/CEE [1969] OJ L195/11.

[13] Case 48/69 *Imperial Chemical Industries Ltd. v Commission* EU:C:1972:70, [1972] ECR 619, paras 34–44.

[14] Case 6/72 *Europemballage Corporation and Continental Can Company Inc. v Commission* EU:C:1973:22, [1973] ECR 215, para 3.

[15] Case 374/87 *Orkem v Commission* EU:C:1989:387, [1989] ECR 3283 at para 6. On 8 December 2022, the UK Competition and Markets Authority announced having fined BMW AG for failure to deliver information requested through its UK affiliate. That decision was initially corrected by a combined judgment of the High Court and the Competition Appeals Tribunal, but on 17 January 2024, the Court of Appeal confirmed the powers of the competition agency to request information in that way ([2023] EWCA Civ 1506).

[16] *Cewal, Cowac and Ukwal* (IV/32.448 and IV/32.450) and *Cewal* (IV/32.448 and IV/32.450), Commission Decision 93/82/EEC, [1993] OJ L34/20.

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for information, the claimant had been in the end apprised of the statement of objections.[17] However, the Court of Justice ('CJ')[18] was far more formal and annulled the decision for breach of essential procedural rights, noting that 'the Commission is required to specify *unequivocally*, in the statement of objections, the *persons* on whom fines may be imposed'.[19] Since the SO had only identified as the perpetrator of the infringement the collective entity constituted by Cewal, and since the participating companies had not been made sufficiently aware of the fact that fines could be imposed on them, the Commission's decision was quashed.[20]

CMB concerned multiple competitors participating in a maritime conference, but shortly after, the Court extended that requirement of individual communication to separate legal entities of the same undertaking in *ARBED*, one of various appeals against the Commission decision in *Steel Beams*.[21] In that case, the offending market-sharing initiatives had been carried out by an affiliate, TradeARBED, to which the SO was notified. However, the decision adopted at the end of the procedure had been addressed to ARBED, the parent company.[22] Again, the GC saw nothing wrong with that, since both legal entities were one and the same undertaking for the purposes of the competition rules.[23] And again, the CJ disagreed with this reasoning and reiterated the formulation in *CMB* that 'the statement of objections must specify unequivocally the legal person on whom fines may be imposed and be addressed to that person.'[24] As the SO had not stated that fines may be imposed on the parent entity, no sanctions could be imposed on it at the end of the procedure. It was irrelevant that ARBED may have been aware of the SO, or that it may have participated in the procedure and caused

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[17] Joined Cases T-24/93, T-25/93, T-26/93 and T-28/93 *CMB and others v Commission* ECLI:EU:T:1996:139, [1996] ECR II-1201, paras 35–36.

[18] The denomination 'CJ' is here reserved for the upper court of the CJEU, hearing appeals against decisions of the GC.

[19] Joined Cases C-395/96 P and C-396/96 P *CMB Transports SA and others v Commission* EU:C:2000:132, [2000] ECR I-01365 at 143 (emphasis added). Note that the judgment did not specify a 'legal person', but merely a 'person', which in that context meant each member of the shipping conference, not necessarily specific legal entities.

[20] Interestingly, the CJ judgment examined (and dismissed) all the other arguments of the appellant, leaving the question of the failure of the SO to state on whom fines could be imposed to the very end of the judgment, instead of the usual approach of dealing with procedural issues first (especially where they are successful). This suggests that the Court wanted to address the merits of the case given the absence of case law at that time on maritime conferences, which probably facilitated the re-adoption by the Commission of the infringement decision against Compagnie Maritime Belge with a lower fine (*Compagnie Maritime Belge* (COMP/D/32.448 and 32.450), Decision 2005/480/EC, [2005] OJ L171/28), which was also appealed, this time unsuccessfully (Case T-276/04 *Compagnie Maritime Belge v Commission* ECLI:EU:T:2008:237, [2008] ECR II-1277).

[21] *Steel Beams* Decision 94/215/ECSC, [1994] OJ L116/1. While the case was based on the European Coal and Steel Community, the discussion is valid also for the TFEU.

[22] The Decision (para 322) explains that this was done to ensure equality of treatment with other participants, suggesting that otherwise it would have calculated the fine having regard to the turnover of TradeARBED, resulting in lower fines.

[23] Case T-137/94 *ARBED SA v Commission* EU:T:1999:46, para 90. Note that this judgment predated the CJ's judgment in *CMB*.

[24] Case C-176/99 P *ARBED SA v Commission* EU:C:2003:524, [2003] ECR I-10687, para 21.

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ambiguity itself; such an ambiguity could only have been corrected by the Commission properly issuing a fresh statement of objections.[25]

This strict approach on the need for the SO to identify the legal entity of the undertaking to which the breach was being imputed was strengthened some years later in *Bolloré*, where the CJ again corrected the more lenient views of the GC and annulled a decision because the SO, despite having identified the imputed legal entity (in that case, the parent company), had not sufficiently specified the *capacity* in which the parent company was being accused.[26] Shortly thereafter, these ideas would be revisited in *Akzo*, which added something that was obvious from the beginning: that not only the SO, but also the enforcement decision at the end of the procedure should be addressed to a specific legal entity, which had to be the same one to which the SO had been notified.[27]

The position adopted by the Court, requiring that a specific legal entity be identified in both the SO and the final decision, and not the undertaking or economic unit, should be understood in the context of greater attention to procedural rights at a time when the Commission was substantially increasing the level of fines. At the same time, however, it is remarkable that this development took place precisely at the time when the CJEU was defining the notion of undertaking, with the promise of disregarding legal form.[28] In any event, these judgments consolidated a legal entity approach, as opposed to an economic entity perspective, with respect to procedural rights.

In the Court's most recent judgments, this formal legal entity perspective appears to have softened. An example is *Siemens Österreich*, where the GC had followed a strict legal entity viewpoint in demanding that each legal entity or company should be able to discern, from a decision imposing a fine on it to be paid jointly and severally with one or more other companies, the amount which it must pay in relation to the other joint and several debtors.[29] That

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[25] It is interesting to note that the Opinion of AG Stix-Hackl, while coinciding in correcting the judgment of the General Court, relied on a material violation of the rights of the defence, as ARBED may not have been aware of the need to put forward specific arguments in respect of the attribution of liability for the acts of its affiliate. Case C-176/99 P *ARBED SA v Commission* ECLI:EU:C:2002:532, [2002] ECR I-10687, Opinion of AG Stix-Hackl, para 75. In contrast, the Court took a strictly formal approach, regardless of the access that the parent entity may have had to the documents communicated to the affiliate.

[26] More specifically, whether it was charged because of its direct actions or as a parent of an affiliate. 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 and T-136/02 *Bolloré SA and Others v Commission* EU:T:2007:115, [2007] ECR II-00947, paras 66–81. On appeal, Joined Cases C-322/07 P, C-327/07 P and C-338/07 P *Papierfabrik August Koehler AG, Bolloré SA and Distribuidora Vizcaína de Papeles SL v Commission* EU:C:2009:500, [2009] ECR I-07191, paras 23–48.

[27] Case C-97/08 P *Akzo Nobel and Others v Commission* EU:C:2009:536, [2009] ECR I-8237, para 57.

[28] While the single entity doctrine had been used by the CJEU since its early jurisprudence, the term 'undertaking' to identify economic units eventually composed of multiple legal entities is a much later occurrence that was not consolidated until the CJ's judgment in *Confederación Española de Estaciones de Servicio* (Case C-217/05 *CEES v CEPSA* EU:C:2006:784, [2006] ECR I-11987, para 40).

[29] Joined Cases T-122/07 to T-124/07 *Siemens AG Österreich and Others v Commission* EU:T:2011:70, [2011] ECR II-793, para 153.

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perspective was corrected by the CJ,[30] who dismissively referred to the identification of legal entities as one 'of a purely practical nature'.[31] Another decision seemingly weakening the legal entity perspective is *Versalis*,[32] where again the GC had followed a legal entity perspective in determining that a parent company that had not participated in the procedure where a sanction had been imposed on an affiliate should not bear an increased penalty for recidivism,[33] a doctrine that the CJ also corrected, weakening the logic of separate procedural rights for each legal entity. And among the judgments potentially weakening the legal entity perspective in procedural matters *Sumal*[34] may be included too; as discussed in more detail later in this chapter, in that case the Court accepted (within limits) claims for damages against legal entities forming part of the same undertaking other than those to which the Commission decision was addressed, correcting the doctrine set by the GC in an earlier case whereby a decision may only be enforced against the specific legal entity or entities identified therein.[35]

The foregoing suggests that legal entities are the 'legal letterbox' of the undertaking. While it is easy to downplay their importance as of a purely practical nature, their identification may mean something more – an implied recognition that these legal entities, rather than the 'undertaking', possess procedural rights and standing, a point which may be relevant in cases where fundamental rights are at stake. At the same time, however, the current trend in case law is decidedly moving away from recognising the relevance of the legal entity and moving to a paradigm where the undertaking itself would be the 'person'.[36]

The foregoing raises the question of whether the identification of legal entities within an undertaking is relevant beyond their "letterbox" function. The following section explores that.

2.2 Material Relevance of the Legal Entity

Leaving aside the procedural relevance of legal entities, their identification in a case has material effects on the decision.

Exploring this area may be confusing given the terminological inconsistencies that plague the notion of undertaking. That term was used to designate legal entities rather than economic

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[30] Joined Cases C-231/11 P to C-233/11 P *Commission v Siemens AG Österreich and Others* EU:C:2014:256, para 66.

[31] Ibid at para 55.

[32] Case T-103/08 Versalis and Eni v Commission EU:T:2012:686, paras 273–274. On appeal, joined Cases C-93/13 P and C-123/13, Commission v Versalis, EU:C:2015:150.

[33] See Joined Cases T-144/07, T-147/07, T-148/07, T-149/07, T-150/07 and T-154/07 *ThyssenKrupp Liften Ascenseurs NV and others v Commission* EU:T:2011:364, [2011] ECR II-05129 at paras 319-322.

[34] Case C-882/19 *Sumal v Mercedes Benz Trucks España* EU:C:2021:800.

[35] Case T-67/11 *Martinair v Commission* EU:T:2015:984, para 35.

[36] At the time of correcting the proofs for this publication, two cases have shed additional light on the relevance of the legal entity as an addressee of procedural actions. In MOL (Case C-425/22, EU:C:2024:578), the Court dismissed that a parent company may use the economic unit doctrine to file a claim for damages resulting from a competition breach on behalf of its subsidiaries. In *Transsaqui* (Case C-632/22, EU:C:2024:601), the Court rejected that an applicant for damages may notify the parent company domiciled abroad at the address of its local subsidiary. Both decisions seemingly follow a legal entity perspective in procedural matters, where EU law instruments other than competion rules are also at play.

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units in jurisprudence before the 1990s[37] and clarifications on its meaning are still being made by the Court. Besides this evolutionary element, the term is used in EU law for multiple purposes beyond those in competition law,[38] and even in that field some rules mean different things.[39] On top of this come the occasional translation errors.[40] The result is that it is not always easy to understand when the law is identifying an economic entity or a specific legal entity, a part of a group of companies or the entire group.[41]

The following subsections discuss three areas where the choice of legal entities may affect the contents of a decision: derivation of liability, time limits and calculation of fines.

2.2.1 Derivation of liability

Derivation of liability refers to situations where a legal entity other than the one initially committing the infringement is made liable under the logic that both are the same undertaking. That is the case of parental, affiliate and sibling liability.

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[37] See, e.g., the operative part of the judgments in Case 15/74 *Centrafarm BV et Adriaan de Peijper v Sterling Drug Inc.* EU:C:1974:114, [1974] ECR 1147 and Case 16/74 *Centrafarm BV et Adriaan de Peijper v Winthrop BV* EU:C:1974:115, [1974] ECR 1183. *Hydrotherm* (Case 170/83, *Hydrotherm* EU:C:1984:271, [1984] ECR 2999) is often presented as a case where the Court changed the meaning of the term, but cf its paras 11 and 12. That terminological dispute is also apparent in *Viho*, where the GC relied on *Hydrotherm* and identified the undertaking with a single economic unit (Case T-102/92 *Viho v Commission* [1995] ECR II-00017 at 50), a move criticised by AG Lenz in his Opinion before the Court (see esp. para 59). The assimilation of undertakings and single economic units would only be accepted by the CJ in *Confederación Española de Estaciones de Servicio* (Case C-217/05 *CEES v CEPSA* C:2006:784, [2006] ECR I-11987, para 40).

[38] See concerning the Directive on the Transfers of Undertakings (Directive 2001/23/EC [2001] OJ L82/16) the judgment in Case C-234/98 *Allen* EU:C:1999:594, [1999] ECR I-08643, para 19. Art 3 of the Directive on European Works Council (Directive 2009/38/EC, [2009] OJ L122/28) adds to the confusion by defining 'groups of undertakings' with a terminology that is very close to, but not quite the same as, that used in competition law. The Accounts Directive (Directive 2013/34/EU [2013] OJ L18/19) also employs the term 'undertaking', again with a different meaning. See also Art 2 (13) of Regulation 2015/848 on Insolvency Proceedings, [2015] OJ L141/19.

[39] See Art 5 of the Merger Regulation which, when importing the terminology of the Accounts Directive, uses the term 'undertaking' as referring to legal entities and consequently makes reference to 'undertakings that control other undertakings'. See also Art 2(2) of the Vertical Block Exemption Regulation (Regulation 2022/720, [2022] OJ L134/4). In both cases, the terminology seems borrowed from the accounting Directives.

[40] A notable example is the definition of 'undertaking' in Art 1 of Protocol 22 to the Agreement on the European Economic Area of 2 May 1992 ([1994] OJ L1/3), in which the German version used the term 'Rechtssubjekt', suggesting it had to be a legal entity, unlike other language versions. This was at the heart of the discussion in Case C-189/02 *Dansk Rørindustri v Commission* EU:C:2005:408, [2005] ECR I-05425, paras 107–114. An earlier example is *Intermills*, whose English version uses at some points 'undertakings' while the French employs 'sociétés' (Case 323/82 *Intermills* EU:C:1984:345, [1984] ECR 3809 at para 2).

[41] For a recent example of these difficulties, see in AG Emiliou's Opinion in *MOL* (Case C-425/22, EU:C:2024:131).

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Parental liability in EU competition law is a relatively consolidated doctrine on which very substantial research has been made,[42] which excuses a thorough discussion here. The sole purpose of this chapter is to explain that, through it, public enforcement decisions make another legal entity liable even if the latter's direct involvement in the infringement has not been established.[43]

Parental liability in EU competition law might be viewed from two perspectives corresponding to the dual attribution model mentioned earlier. Under an 'undertaking' or economic entity perspective, which in its extreme form places the undertaking as a centre of attribution, there would be no such thing as a transmission of liability. From a traditional legal entity viewpoint, however, parental liability is the clearest example of transmission of liability between separate centres of attribution. These two perspectives are reflected in the two arguments used by the Court to explain it: as a consequence of the identification of the undertaking as the 'person' whom decisions are addressed to[44] and, at the same time, as a result of the decisive influence that a legal entity possesses over the other.[45]

Whichever perspective is adopted, parental liability produces effects in the real world – else few would dispute it. Making parents liable ensures that decisions are targeted at the head of corporate groups, increasing deterrence and encouraging better oversight of the affiliates' conduct. Whether it is expressed as the result of a discretionary choice among the entities

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[42] The bibliography on parental liability in EU competition law is vast. Among the most interesting papers see Aitor Montesa and Ángel Givaja, 'When Parents Pay for their Children's Wrongs: Attribution of Liability for EC Antitrust Infringements in Parent-Subsidiary Scenarios' (2006) 29(4) World Competition 555; Erik H Pijnacker Hordijk and Simone J. H. Evans, 'The AKZO Case: Up a Corporate Tree for Parental Liability for Competition Law Infringements' (2010) 1(2) Journal of European Competition Law & Practice 126; Ana Perestrelo de Oliveira and Miguel Sousa Ferro, 'The Sins of the Son: Parent Company Liability for Competition Law Infringements' (2010) 1(3) Revista de Concorrência e Regulação 53; Laura La Rocca, 'The Controversial Issue of the Parent-Company Liability for the Violation of EC Competition Rules by the Subsidiary' (2011) 32 European Competition Law Review 68; Stefan Thomas, 'Guilty of a Fault that It Has Not Committed: The Limits of the Group-Based Sanction Policy Carried out by the Commission and the European Courts in EU Antitrust Law' (2012) 3(1) Journal of European Competition & Law Practice 11; Yves Botteman, '"You Can't Beat the Percentage" – The Parental Liability Presumption in EU Cartel Enforcement' (2012) European Antitrust Review 3; John Temple Lang, 'How Can the Problem of the Liability of a Parent Company for Price Fixing by a Wholly-owned Subsidiary Be Resolved?' (2014) 37 (5) Fordham International Law Journal 1481; Bruce Wardaugh, 'Punishing Parents for the Sins of Their Child: Extending EU Competition Liability in Groups and to Subcontractors' (2017) 5 Journal of Antitrust Enforcement 22; Andriani Kalintiri, 'Revisiting Parental Liability in Competition Law' (2018) 43 European Law Review 145; Carsten Koenig, 'Comparing Parent Company Liability in EU and US Competition Law' (2018) 41(1) World Competition 69. A full review is available in Peter Whelan, *Parental Liability in EU Competition Law: A Legitimacy-Focused Approach* (OUP 2023).

[43] Case C-97/08 P *Akzo Nobel and Others v Commission* EU:C:2009:536, [2009] ECR I-08237, para 59.

[44] This was first declared in *ETI* (Case C-280/06 *ETI and Others v Autorità Garante della Concorrenza e del Mercato* EU:C:2007:775, [2007] ECR I-10893, paras 38–39). See also *Siemens Österreich* (fn 6).

[45] As in, for example, Case C-97/08 P *Akzo Nobel and Others v Commission* EU:C:2009:536, [2009] ECR I-08237, para 77.

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forming part of the undertaking or an imputation of a different legal entity does not change that.

In recent times, parental liability has been complemented with subsidiary liability in *Sumal*,[46] a judgment that is relevant to the discussion of the interplay between the undertaking and legal entities. *Sumal* relies on the broad shoulders of the doctrine on the undertaking and therefore shares its logic: liability rests with the undertaking and not any specific legal entities that belong to it, and any of those entities is equally liable.[47] However, under the legal entity logic applied in parallel, the Court was uncomfortable holding affiliates entirely unconnected to the infringement liable for its consequences.[48] This forced the Court to define a convoluted set of 'links' that should be present for affiliate transmission of liability,[49] taking the Court to the unprecedented step of quartering conglomerate groups into several economic units,[50] a determination that does not appear to apply to subsidiary liability only and raises multiple difficult questions, for instance, if agreements between affiliates in very different business areas may fall under Article 101 TFEU or if fines can be calculated using the consolidated sales of conglomerate groups. Anyway, *Sumal* showcases the contradictions that affect the dual attribution model of undertakings and legal entities, with the Court unable to either stand firmly on either the 'undertaking' as the sole centre of attribution or bow to the traditional legal entity perspective.[51]

Another recent decision that is relevant to the transmission of liability is *Unilever*,[52] where the Court accepted that an undertaking may be liable for acts committed by entities not controlled by ownership but under its direction (in this case, distributors). Remarkably, *Unilever* clarified that the liability of the supplier did not require proving that Unilever and its distributors were a 'single entity' or undertaking.[53] This pronouncement opens the door for asserting liability in a much wider range of situations without the need to twist the doctrine of the undertaking further. It is too soon to tell if this recent development will lead to reconsidering parental and subsidiary liability, which may be based on circumstances other than the existence of a single entity going forward.

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[46] Case C-882/19 *Sumal v Mercedes Benz Trucks España* EU:C:2021:800.

[47] Ibid, paras 44 and 63.

[48] Ibid, para 46.

[49] Cf paras 45, 46, 51 and 52.

[50] See paras 45 and 47.

[51] As graphically put by Carsten Koenig, '(t)he case law fluctuates between the Courts' efforts to maintain their strong focus on the economic unit as the actual perpetrator, while at the same time doing justice to the individual addressees of the decision imposing the fines'. See Carsten Koenig, 'The Boundaries of the Firm and the Reach of Competition Law: Corporate Group Liability and Sanctioning in the EU and the US' in Marco Corradi and Julian Nowag (eds), *The Intersections between Corporate Law and Antitrust* (Cambridge University Press 2023) 15.

[52] Case C-680/20 *Unilever Italia* EU:C:2023:33.

[53] Ibid, para 32: 'the imputability to the undertaking in a dominant position of the conduct implemented by the distributors forming part of the distribution network for its goods or services is not conditional (…) on the demonstration that the relevant distributors are also part of that undertaking'.

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2.2.2 Calculation of fines

A second area where the identification of legal entities influences the content of a decision is the calculation of fines.

Article 23 of Regulation 1/2003[54] and the Fining Guidelines[55] mention the turnover of the undertaking as a yardstick. It might be wondered if the turnover in these rules is that of the 'undertaking' as an economic unit or if it means separate legal entities, which is the notion of the Account Directives.[56] That question has been responded to by the Court in the sense that the notion of undertaking for the purposes of fines under Article 23 of Regulation 1/2003 is the same as that used for other purposes in competition law – that is, an economic entity.[57] Despite that conclusion, the Court has also validated that the Commission uses the consolidated accounts of groups of companies, downplaying the difference between these two.[58]

The size of the undertaking (understood, as just noted, as the economic entity), in the Fining Guidelines, affects the calculation of the fine in four of its components: *recidivism*,[59] where earlier breaches of competition law committed by other legal entities of the same undertaking aggravate the sanction; *deterrence*, which increases the fine for groups in view of their entire economic capacity; *the 10% limit*, which sets a cap on the amount of the fine based on the turnover of the undertaking; and finally, *inability to pay* as a justification for reducing a sanction, which is also applied under an economic entity viewpoint.

A detailed examination of the application of these tools reveals various inconsistencies. Recidivism, for instance, aggravates the fine on the parent legal entity, but not on subsidiaries, which implies identifying separate centres of attribution within an undertaking.[60] Similarly, where only the subsidiary is a repeat offender, the uptake is limited to that separate legal

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[54] [2003] OJ L1/1.

[55] Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003 (Fining Guidelines), [2006] OJ C210/2.

[56] Directive 2013/34/EU on Annual Accounts, [2013] OJ L182/19.

[57] See, among others, Joined Cases C-247/11 P and C-253/11 P *Areva and Others v Commission* EU:C:2014:25, para 124; Case C-408/12 P *YKK Corporation and others v Commission* EU:C:2014:2153, para 59; Case C-724/17 *Vantaan kaupunki v Skanska* EU:C:2019:204, para 47; Case C-882/19 *Sumal v Mercedes Benz Trucks España* EU:C:2021:800, paras 38–39.

[58] Case C-58/12 P *Groupe Gascogne SA v Commission* EU:C:2013:770, para 54. Cf the Opinion of AG Sharpston in that case, paras 55–58.

[59] On recidivism in competition law, see Ludovic Bernardeau, *La Recidive en Droit de la Concurrence* (Bruylant 2017), esp 43 ff; Juan Jorge Piernas López, 'The Aggravating Circumstance of Recidivism and the Principle of Legality in the EC Fining Policy: Nulla Poena Sine Lege?' (2006) 29 World Competition 441; Marc Barennes and Gunnar Wolf, 'Cartel Recidivism in the Mirror of EU Case Law' (2011) 2(5) Journal of European Competition Law & Practice 423.

[60] Case T-391/09 *Evonik Degussa and AlzChem v Commission* EU:T:2014:22, para 271. This point was not discussed in the subsequent appeal (Case C-155/14 P, *Evonik Degussa and AlzChem v Commission* EU:C:2016:446). See also Case T-827/14 *Deutsche Telekom AG v Commission*, EU:T:2018:930, paras 505–506 and 509–513.

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entity.[61] While the GC challenged this logic in *Versalis*,[62] the CJ confirmed in the ensuing appeal that a parent entity would only bear the additional fine if, at the time of the initial infringement, the two entities were part of the same economic unit.[63] At the same time, however, the CJ corrected the doctrine of the GC in the sense that parent companies should not bear an increase in the fine resulting from an earlier enforcement procedure in which they had not been heard.

These decisions show how, despite the insistence on the 'undertaking' being the only relevant centre of attribution, separate legal personality matters in the calculation of the fine.

Another element where a group perspective affects the level of the fine is the deterrence factor. In contrast to recidivism, it is applied equally to the subsidiary and the parent company, having regard to the consolidated accounts of the group of entities. However, in *Slovak Telekom*[64] the Commission imposed a deterrence multiplier only on the parent company, Deutsche Telekom. In the subsequent appeal, the GC disagreed and declared that imposing a higher fine on the parent company would only be possible if there were elements in the infringement that were specific to the former, which was not the case.[65] Again, this implies recognising that the conduct of legal entities within an undertaking may, at least in certain situations, be separately assessed, which goes against the core of the doctrine on the undertaking as an economic unit.

The 10% cap on fines is also applied under an economic entity perspective. Given that its purpose is not one of retribution, but to ensure that the fine does not put the existence of the undertaking at risk,[66] the cap is calculated with respect to the infringer's situation at the time of the decision imposing the fine, not the date of infringement. Where an economic entity has been broken up in the period between the infringement and the decision, the 10% rule is applied separately to each separate undertaking.[67] Surprisingly however, that logic seems not to apply to the reverse situation, where an entity has been absorbed by an economic group after the infringement but prior to the decision. In that situation, the calculation must consider two separate periods before and after the taking up of control.[68]

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[61] By way of example, in several decisions affecting Arkema, the Commission increased the fine because of prior infringements of that entity but not its parent company, which had taken control of Arkema after those breaches. See *MCAA* (Case COMP/37.773) Commission Decision 2006/897/EC [2006] OJ L353/12, paras 310–311, 314 and fn 222; *Hydrogen Peroxide* (Case COMP/38.620), Commission Decision 2006/903/EC [2006] OJ L353/54 para 469, fn 409; *Methacrylates* (Case COMP/38.645) Commission Decision 2006/793/EC [2006] OJ L322/20 paras 358, 369.

[62] Case T-103/08 *Versalis and Eni v Commission* EU:T:2012:686, para 276.

[63] Joined Cases C-93/13 P and C-123/13 P, *Commission v Versalis and Eni and Versalis and Eni v Commission* EU:C:2015:150, paras 91, 93, 97 and 102.

[64] *Slovak Telekom* (Case AT.39523) Commission Decision C(2014) 7465 final [2015] OJ L314/7 at 1531.

[65] Case T-827/14 *Deutsche Telekom v Commission* EU:T:2018:930, paras 520–524. Note that this was not discussed in the ensuing appeal, Case C-152/19 P *Deutsche Telekom AG v Commission* EU:C:2021:238.

[66] Joined Cases 100 and 103/80 *SA Musique Diffusion française and others v Commission* EU:C:1983:158, [1983] ECR 1825, para 119. For a recent restatement, see Case C-619/13 P *Mamoli Robinetteria v Commission* EU:C:2017:50 at para 83.

[67] Case C-50/12 P *Kendrion v Commission* EU:C:2013:771, para 57.

[68] Case C-408/12 P *YKK Corporation and others v Commission* EU:C:2014:2153, para 64.

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2.2.3 Limitation periods

Another area revealing the tension between the economic and legal entity perspectives concerns limitation periods. These are provided for in Articles 25 and 26 of Regulation 1/2003 and defined by AG Bot in his Opinion in *ThyssenKrupp Nirosta* as 'a universal and fundamental principle of our law [whereby] a prosecution lapses because a certain period of time has elapsed since the date on which the offence was committed.'[69]

Limitation periods raise two interrelated questions. On the one hand, whether this defence may be raised by each legal entity of an undertaking separately in light of their specific involvement. The second question is whether, assuming a separate calculation for each legal entity, the expiry of a deadline against a subsidiary would bar any claim against the parent entity for that conduct, given that such a claim would derive from a time-barred claim.

The first of these questions was addressed by the Court in favour of a legal entity perspective in *Steel Beams*. Following the annulment of the initial decision against ARBED discussed above,[70] the Commission adopted a new decision imposing a fine on both the parent company and the affiliates.[71] In the subsequent appeal, the subsidiaries argued that the new decision was time-barred against them, since the first appeal had not suspended the limitation periods in their respect.[72] Both the GC[73] and later the CJ sitting as Grand Chamber[74] accepted that claim, confirming that time limits should apply in a separate way to each legal person (in the Court's jargon, it had *inter partes* and not *erga omnes* effect) and therefore may benefit the subsidiaries but not their parent entity. At the same time, the Court confirmed that the time limits had been suspended for the parent company during the first appeal, and therefore the claim against it had not expired.

The remarkable consequence in that specific case was that the actual infringing entity (the subsidiaries) could escape liability, but not their parent company, who had not as such participated in the conduct. That raised the second question noted above, namely if parental liability could exist despite the expiry of the liability of the initial infringer, from which it could be assumed to be derived.

On that question, the case law seemed to follow two conflicting directions. In *Tomkins*, which concerned the Commission's decision in the *Copper Fittings* cartel,[75] the GC had shortened the duration of the infringement for a subsidiary and later reduced the parent's liability as a result.[76] When the Commission appealed, the Grand Chamber confirmed that the liability of the parent company was exclusively *derived* from that of its subsidiary and may not be greater

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[69] Case C-352/09 P *ThyssenKrupp Nirosta v Commission* EU:C:2011:191, [2010] ECR I-2359, Opinion of AG Bot at 187–188.

[70] See discussion in section 1.1.

[71] *Steel Beams* (Case COMP/F/38.907) Commission Decision C(2006) 5342 final, [2008] OJ C 235/4.

[72] Note that the subsidiaries had not appealed the previous decision, which had been issued against their parent company.

[73] Case T-405/06 *ArcelorMittal Luxembourg SA, ArcelorMittal Belval & Differdange SA and ArcelorMittal International SA v Commission* EU:T:2009:90, [2009] ECR II-00789, para 124.

[74] Case C-201/09 P and C-216/09 P *ArcelorMittal v Commission* EU:C:2011:190, [2011] ECR I-2239. See esp. 149–150.

[75] *Fittings* (COMP/F-1/38.121) Commission Decision 2007/691/EC [2007] OJ L 283/63.

[76] Case T-382/06 *Tomkins plc v Commission* EU:T:2011:112, [2011] ECR II-1157, para 38.

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than that of the latter.[77] That doctrine was restated in the subsequent judgments of *Siemens Österreich*[78] and *Areva*.[79]

In parallel, however, the GC seemed to question the 'derived liability' paradigm in *Bolloré II,*[80] where a parent company was held liable for an infringement committed by an affiliate that could not be sanctioned because the limitation period had expired with respect to it. In the words of the General Court,

> … the fact that the subsidiary may no longer be capable of being penalised for the infringement found, whether because the subsidiary has ceased to exist or — as the applicant claims in the present case — because the limitation period has expired in favour of that subsidiary, has no effect on the question whether the parent company, which is itself deemed to have committed the infringement owing to the economic unity with its subsidiary, may be penalised. Admittedly, there would be no liability of the parent company if it were shown that there had been no infringement, but that liability cannot cease to exist because the penalty against the subsidiary is time-barred.[81]

The two conflicting lines of case law were ultimately placed before the Court in the appeal against the *Heat Stabilisers* decision,[82] where Akzo Nobel was being held liable for two cartels stretching back to 1987 and 1991 in which its subsidiaries had taken part. As in the case of *Bolloré II*, the older part of the infringement was time-barred against some legal entities, but other entities also controlled by Akzo had replaced them in the offending agreements. In its decision, the Commission ignored that change and declared the subsidiaries' liability alongside that of their parent for the entire period, stressing the latter's control over them.[83] The appeal against that decision was resolved by the judgments of the GC and CJ in *Akzo II*.[84]

In the first instance judgment, the GC corrected the decision of the Commission and declared that the affiliates in question could not be held liable since the time limits had expired with respect to them. However, quoting its own decision in *Bolloré II* as sole authority,[85] it held that the fact that the claim against the affiliates was time-barred would not affect the liability of their parent.[86] Akzo appealed, claiming that the GC had infringed the rules concerning the

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[77] Case C-286/11 P *Commission v Tomkins* EU:C:2013:29, para 49.

[78] Joined Cases C-231/11 P to C-233/11 P *Commission v Siemens AG Österreich and Others* EU:C:2014:256, para 47.

[79] Joined Cases C-247/11 P and C-253/11 P *Areva and Others v Commission* EU:C:2014:257, para 137.

[80] Case T-372/10 *Bolloré v Commission* EU:T:2012:325 paras 186-195. Note that this decision followed the annulment of an earlier decision in Joined Cases C-322/07 P, C-327/07 P and C-338/07 P *Papierfabrik August Koehler AG, Bolloré SA and Distribuidora Vizcaína de Papeles SL v Commission* EU:C:2009:500, [2009] ECR I-7191.

[81] Ibid at 194.

[82] *Heat Stabilisers* (COMP/38.589) Commission Decision C(2009) 8682 [2010] OJ L307/9.

[83] Ibid, paras 512–514 and 671.

[84] *Akzo II* denotes here Case T-47/10 *Akzo Nobel NV and Others v Commission* EU:T:2015:506 and C-516/15 P *Akzo Nobel NV and Others v Commission* EU:C:2017:314.

[85] Case T-47/10 *Akzo Nobel NV and Others v Commission* EU:T:2015:506, paras 117–129.

[86] It is noteworthy that during the written phase of the Akzo case before the GC, the CJ issued its judgments in *Siemens Österreich* and *Areva,* both seemingly endorsing *Tomkins* and arguably its 'derived liability' paradigm. Despite inviting the parties to submit their views on the relevance

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liability of parent companies for the unlawful conduct of their subsidiaries,[87] relying on the derived nature of parental liability.

In its judgment on the case, and despite the contrary views of AG Wahl,[88] the CJ confirmed the position of the GC and proclaimed that the parent company 'is held individually liable for an infringement of the EU competition rules *which it is itself deemed to have infringed*, because of the decisive influence which it exercised over the subsidiary'.[89] The Court thus concluded that the GC was fully entitled to find that the fact that the Commission's power to impose penalties on the affiliates had expired did not preclude Akzo Nobel from being held liable as their parent in respect of that infringement period.[90]

Akzo II may be hailed as strengthening the doctrine on the undertaking by recognising the irrelevance of limitation periods for the liability of parent entities. In its decision, the Court has ensured that parent companies are unable to claim an expiry unless every entity under their control and themselves have ceased the conduct, avoiding a carrousel of subsidiaries replacing each other in a cartel that impacts the liability of the group.

At the same time, it is noteworthy that the solution adopted by the Court, while formally recognising the presence of separate legal entities with formally independent legal rights originating from their separate participation in an infringement, seeks to limit the material impact of their structure, so that the fine is, to the extent possible, unaffected by the legal structure of the undertaking. While it is tempting to challenge this under the traditional imputation model centred on legal entities, this perspective makes good sense from the viewpoint of the undertaking as the material addressee of competition laws.

2.3 The Discretion in the Identification of the Legal Entity

The fact that, as discussed in the previous sections, the identification of specific legal entities within an undertaking impacts its reach by making parent entities or subsidiaries liable, permitting a larger base for calculating sanctions, and limiting claims that may be open or time-barred against different legal entities, raises the question of how enforcers determine which legal entity or entities within an undertaking should be formally addressed in an infringement decision.

In his seminal paper on the undertaking as subject of EU competition law, Wouter Wils argued that the Commission should be granted discretion in that respect for, among other reasons, the difficulty in determining whether an entity controls another.[91] He relied on para-

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of those judgments in their procedures, the GC dismissed the relevance of those decisions. Ibid, at 83 and 90.

[87] Case C-516/15 P *Akzo Nobel NV and Others v European Commission* EU:C:2017:314, para 28.

[88] Case C-516/15 P *Akzo Nobel NV and Others v European Commission* EU:C:2016:1004, Opinion of AG Wahl, paras 81–91.

[89] CJ judgment in *Akzo II* at 56 (emphasis added).

[90] For a comment on this decision by Judge Da Cruz Vilaça, rapporteur in that case, see José Luís da Cruz Vilaça, Mariana Martins Pereira, 'Parental Liability Under the ECN+ Directive and its Extension to Accessory Sanctions' (2020) XI (42–43) Revista de Concorrência e Regulação 75, at 78.

[91] Wouter Wils, 'The undertaking as subject of E.C. competition law and the imputation of infringements to natural or legal persons' (2000) 25(2) European Law Review 99, 112–113.

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graph 154 of *British Gypsum*, where the GC had noted that the Commission could have chosen between the parent company and the subsidiary, implicitly accepting a discretionary power.[92]

The Courts looked at this issue more closely in the *Spanish Raw Tobacco* saga.[93] The case concerned six entities which had agreed the maximum average price for raw tobacco between 1996 and 2001. In its decision, the Commission identified the liable entities as follows:

- World Wide Tobacco España SA was controlled by the US multinational Standard Commercial Corporation through Standard Commercial Tobacco Co., Inc. and Trans-Continental Leaf Tobacco Corporation. The Commission held all four entities jointly liable.
- Deltafina and Taes were owned by Universal Corporation, the latter through the intermediate company Universal Leaf Tobacco Company Inc. However, the Commission considered that it had insufficient evidence of either parent having exercised decisive influence over Deltafina or Taes, and therefore did not impute either the ultimate parent entity or any intermediate company.[94]
- In respect of Agroexpansión, which was a wholly-owned subsidiary of Intabex, in turn a wholly-owned subsidiary of Dimon Inc., the Commission imputed liability to the ultimate parent company (Dimon), but not the intermediate (Intabex).
- Finally, as regards Cetarsa, the Commission just imputed liability to that company, but not to its parent company, the public holding entity SEPI, or its ultimate owner, the Spanish State.

Since all the parties had cooperated under the then-applicable leniency rules,[95] the appeals focused on how the fines had been calculated and especially when and why the Commission had imposed fines on parent companies.[96]

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[92] Case T-65/89 *BPB Industries Plc and British Gypsum Ltd v Commission* EU:T:1993:31, [1993] ECR II-389. Unfortunately, that point of the GC judgment was not discussed in the subsequent appeal either by AG Léger (Opinion, paras. 20–31) or in the judgment itself, despite BPB having raised it in its appeal (Case C-310/93 P *BPB Industries plc and British Gypsum Ltd v Commission* EU:C:1995:101, [1995] ECR I-865, para 11).

[93] Decision 2007/236/EC of 20 October 2004 (Case COMP/C.38.238/B.2) — *Raw tobacco — Spain* [2007] OJ L102/14.

[94] It may be noted that the decision identified Taes and Deltafina as separate undertakings and even granted Taes a reduction of the fine as it had assisted in providing incriminating evidence in respect of Deltafina, which shows the terminological and conceptual confusion over the notion of undertaking at that time.

[95] The 1998 Fining Guidelines (Guidelines on the method of setting fines imposed pursuant to Article 15(2) of Regulation No 17 and Article 65(5) of the ECSC Treaty, [1998] OJ C9/3) in force at the time did not ban joint requests for leniency.

[96] Of the six cartel participants, five lodged appeals (all but Taes). Alliance One International, formerly Standard Commercial Corporation ('SCC'), appears as an appellant in several of these due to a string of acquisitions, both during the proceedings and following the decision. For clarity, the references below identify the initial appellant in each case: World Wide Tobacco España SA: Case T-24/05 *Alliance One International and others v Commission* EU:T:2010:453, [2010] ECR II-5329. On appeal: Joined Cases C-628/10 P and C-14/11 P *Alliance One International and others v Commission* EU:C:2012:479. Dimon: Case T-41/05 *Alliance One International v Commission*

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In its judgment at first instance in the WWTE appeal,[97] the General Court noted that the Commission had not relied on the presumption of decisive influence to make parent entities liable, a doctrine which was at that time unclear,[98] but claimed that the parent entity effectively controlled the subsidiary. Given that situation, the GC examined the evidence of actual exercise of decisive influence relied upon by the Commission.[99] Since the evidence on the file did not support the conclusion that one of the intermediate companies (TCLT) had exercised decisive influence, the GC annulled the decision of the Commission in respect of that specific intermediate company, while confirming the liability of the other parent companies upward in the corporate tree whose exercise of influence had been established.

In its appeal, the Commission argued that the intermediate company was liable by law and not because of a discretionary decision. In answering that argument, AG Kokott drew a distinction between the question of whether the parent and subsidiary companies belong to a single undertaking and their consequential liability for a cartel offence (a question to be answered with legal criteria alone, as the Commission argued) and the fines that may be imposed for that cartel offence and to whom, on which she noted:

> In the context of its discretion under Article 23(2)(a) of Regulation No 1/2003 the Commission can decide in each individual case whether it will impose a fine at all for the cartel offence of an undertaking, but also on which legal person (or persons) standing behind the undertaking concerned it will impose such a fine.[100]

With these words, AG Kokott took the position that the choice of the legal person or persons to be fined was a matter for the Commission to decide at its discretion, as that ultimately would impact on the calculation of the fine.[101] That approach was accepted by the Court, on

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EU:T:2011:586, [2011] ECR II-7101. On appeal: Case C-679/11 P *Alliance One International v Commission* EU:C:2013:606. Agroexpansión: Case T-38/05 *Agroexpansión v Commission* EU:T:2011:585, [2011] ECR II-7005. On appeal: Case C-668/11 P *Alliance One International v Commission* [2013] ECR. Cetarsa: Case T-33/05 *Cetarsa v Commission* EU:T:2011:24, [2011] ECR II-12. On appeal: Case C-181/11 P *Cetarsa v Commission* EU:C:2012:455. Deltafina: Case T-29/05 *Deltafina SpA v Commission* EU:T:2010:355, [2010] ECR II-4077. Appeal withdrawn, see Case C-537/10 P (Order) EU:C:2011:475.

[97] Case T-24/05 *Alliance One International and others v Commission* EU:T:2010:453, [2010] ECR II-5329.

[98] Note that the Commission's decision predated the *Akzo* judgments, the only authority at the time being Case C-286/98 P *Stora Kopparbergs Bergslags AB v Commission* EU:C:2000:630, [2000] ECR I-9925.

[99] Case T-24/05 *Alliance One International and others v Commission* EU:T:2010:453, [2010] ECR II-5329, paras 133–147.

[100] Joined Cases C-628/10 P and C-14/11 P *Alliance One International and others v Commission* EU:C:2012:11, Opinion of AG Kokott at paras 46–47. Cf para 55, where it is said that the Commission 'need not necessarily impose fines on all the parent companies of participants in a cartel'.

[101] In support of discretion, AG Kokott quoted para 82 of the judgment in Joined Cases C-125/07 P, C-133/07 P, C-135/07 P and C-137/07 P *Erste Group Bank AG and others v Commission* EU:C:2009:576, [2009] ECR I-8681 and para 121 of the judgment in Case C-521/09 P *Elf Aquitaine SA v European Commission* EU:C:2011:620, [2011] ECR I-8947.

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the understanding that this matter was linked to the Commission's powers to quantify fines.[102] Since then, the Courts have maintained the approach suggested by AG Kokott: on the one hand, which legal entities may be imputed is a legal matter, there being no discretion in that respect;[103] on the other hand, however, the Commission has discretion to hold liable a specific legal person which is part of an undertaking.[104]

The most recent relevant decision on the choice of legal entities when enforcing a decision is, of course, *Sumal*.[105] While this is a judgment adopted in the context of private enforcement, some of its findings are relevant to public enforcement.[106]

Sumal relies on earlier case law on the joint and several liability of all the legal entities within an undertaking[107] and therefore leaves the door open to a free choice as regards the selection of any of them both for public and private enforcement purposes,[108] adding two qualifications: first, that the notion of undertaking should not be read as encompassing the entire group of companies, in particular where they are 'conglomerates', but rather it should be divided according to 'economic activities', and therefore the joint and several liability would apply within that part of the group; and second, that in the specific case of a claim against the subsidiary of an entity against which an infringement has been established, a 'specific link' may be applied; namely, 'that the anticompetitive agreement concluded by the parent company, for which it has been punished, concerns the same products as those marketed by the subsidiary'.[109]

At the time of writing, the Court has not yet provided additional clarifications on the above two limitations. Leaving aside the difficult slicing of conglomerate groups of companies, which goes beyond the question of the choice of a legal entity within an undertaking, a word needs to be said about the indication contained in the second limitation, that is, that the entity to be picked as liable markets certain specific products.

In that respect, *Sumal* seems to have changed the logic underpinning the discretion discussed above. The freedom to select a given entity to hold liable, as declared by the CJEU, assumed that any of the legal entities within an undertaking could be used, an approach that paragraphs 48 and 50 of *Sumal* echo. However, by imposing a link with the cartel products,

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[102] Joined Cases C-628/10 P and C-14/11 P *Alliance One International and others v Commission* EU:C:2012:479, paras 44 and 59.

[103] This results in the joint liability of affiliates, which operates by law, as confirmed in Joined Cases C-231/11 P to C-233/11 *Commission v Siemens AG Österreich and Others* EU:C:2014:256, para 57; Joined Cases C-247/11 P and C-253/11 P *Areva and Others v Commission* EU:C:2014:25, para 122; Case C-625/13 P *Villeroy & Boch* v *Commission* ECLI:EU:C:2017:52, para 150; Case C-625/13 P *Commission v GEA Group*, C-823/18 P, EU:C:2020:955, para 61.

[104] Joined Cases C-125/07 P, C-133/07 P, C-135/07 P and C-137/07 P *Erste Group Bank AG and others v Commission* EU:C:2009:576, [2009] ECR I-8681, para 82; Case C-444/11 P *Team Relocations and Others* v *Commission* EU:C:2013:464, para 159, *Akzo II* at para 51. Cf judgment in Case C-882/19 *Sumal v Mercedes Benz Trucks España* EU:C:2021:800, para 63.

[105] Case C-882/19 *Sumal v Mercedes Benz Trucks España* EU:C:2021:800.

[106] Ibid at para 38. Note also that the reasoning of the judgment in this respect relies heavily on earlier decisions adopted in a public enforcement context.

[107] Ibid at para 44. The judgment also recalls the discretion of public enforcement agencies at para 63.

[108] Ibid at paras 48 and 50.

[109] Ibid at para 52.

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the Court narrows that choice. This raises the question of whether this limitation in the choice of the entity is a specific feature of downward liability claims to avoid claims against unrelated subsidiaries[110] or if it would also apply for other purposes of the notion of undertaking – for instance, if agreements between affiliates of a group of companies in disparate sectors may fall within Article 101 TFEU.

On the other hand, *Sumal* provides an excellent starting point for examining the process of identifying liable entities in relation to private enforcement of Articles 101 and 102 TFEU, that the following section discusses.

3. UNDERTAKINGS AND LEGAL ENTITIES IN THE PRIVATE ENFORCEMENT OF ARTICLES 101 AND 102 TFEU

The roles of the undertaking and legal entity as centres of attribution in the application of Articles 101 and 102 TFEU may, in addition to public enforcement, be seen from the perspective of private enforcement, a sleeping giant seemingly awakening that is transforming competition law in various ways, not least on the notion of undertaking.

An initial point that needs to be made is that 'attribution,' the process of identifying specific legal entities for the purposes of enforcement, has a different meaning and purpose in private claims. Instead of seeking the punishment of a business, civil actions are aimed at private law obligations such as the payment of damages, the modification or termination of contracts, or similar remedies—claims which may be only available against a specific legal entity, such as the party to a contract. These limitations are not necessarily present in public enforcement.

The possibility to enforce Articles 101 and 102 TFEU in civil claims before ordinary courts, first declared in *BRT/SABAM*[111] has ensured a constant flow of references that have examined the notion of undertaking. Mention could be made of *Hydrotherm*,[112] *Höfner*,[113] *Poucet and Pistre*,[114] *Diego Cali*[115] or *Pavlov*,[116] all of which originated in private claims. A common element in all these judgments should be noted: they all implicitly assumed that the notion of 'undertaking' in a public and private enforcement setting was identical, quoting indistinctly public and private enforcement decisions.

In 2001, *Crehan* opened a new era in the private enforcement of Articles 101 and 102 TFEU, one founded on the 'full effectiveness' of these provisions. Under this new perspective, Articles 101 and 102 should be read in a way going beyond their literal confines to ensure that their implied aims are attained. In other words, their enforcement required not only that

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[110] Ibid at para 46.

[111] Case 127/73 *BRT v SABAM* EU:C:1974:6, [1974] ECR 51, paras 15–16. By contrast, the (now expired) parallel provisions of the ECSC Treaty did not have direct effect, as confirmed by Case C-128/92 *H. J. Banks & Co. Ltd v British Coal Corporation* ECLI:EU:C:1994:130, [1994] ECR I-1209.

[112] Case 170/83 *Hydrotherm* EU:C:1984:271, [1984] ECR 2999.

[113] Case C-41/90 *Höfner and Elser v Macrotron* EU:C:1991:161, [1991] ECR I-1979.

[114] Joined Cases C-159/91 and C-160/91 *Poucet and Pistre* EU:C:1993:63, [1993] ECR I-637.

[115] Case C-343/95 *Diego Calì & Figli* EU:C:1997:160, [1997] ECR I-1547.

[116] Joined Cases C-180/98, C-181/98, C-182/98, C-183/98 and C-184/98 *Pavlov* EU:C:2000:428, [2000] ECR I-6451.

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certain practices should be prohibited, but also that other remedies be available, among them, a right to compensation for the harm caused, since the full effectiveness of these provisions 'would be put at risk if it were not open to any individual to claim damages for loss caused to him by a contract or by conduct liable to restrict or distort competition'.[117] In that respect, the importance of *Crehan* does not lie in its confirmation of the possibility of claiming damages, something already available and quite common in many EU countries at that time, but the determination that this right, and eventually others, would stem directly from EU law under the 'full effectiveness' paradigm.

That vein would be carefully mined by the Court in subsequent decisions. *Manfredi* confirmed that damages may be sought by any individual, even if not a party to an agreement, provided that there was a causal relationship for that harm.[118] *Kone*[119] relied on that logic to strengthen the rights of claimants by enabling them to pursue umbrella damages. *Pfleiderer*[120] and *Donau Chemie*[121] examined if measures by enforcement authorities to protect leniency applicants from disclosure might conflict with the principle of effectiveness. That same paradigm was at stake in *Skanska*,[122] where the question of whether the identification of the entity that should answer for an infringement should be defined by EU law and be identical in public and private enforcement came before the Court.

In that case, put simply, the Court had two options: either to accept that the identification of the legal entity within an undertaking was a matter for national law, eventually corrected by the principles of equivalence and effectiveness, or to declare that this choice was a matter of EU law, and consequently that the doctrine on succession – which had been created with public enforcement purposes in mind – should also be followed in private enforcement situations. As proposed by AG Wahl, the Court opted for the latter.[123] In so doing, it enshrined the notion of 'undertaking' as an 'autonomous concept of EU law', the scope of which was the same, regardless of whether the Commission applied it when imposing fines or national courts in private actions for damages resulting from an infringement of competition rules.[124] That

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[117] Case C-453/99 *Courage v Crehan* EU:C:2001:465, [2001] ECR I-6297, para 26.

[118] Joined Cases C-295 to C-298/04 *Vincenzo Manfredi et al v Lloyd Adriatico et al* EU:C:2006:461, [2006] ECR I-6619, para 62.

[119] Case C-557/12 *Kone et al v ÖBB Infrastruktur* EU:C:2014:1317, paras 24–26.

[120] Case C-360/09 *Pfleiderer* EU:C:2011:389, [2011] ECR I-5161, para 24.

[121] Case C-536/11 *Donau Chemie* EU:C:2013:366, para 27.

[122] Case C-724/17 *Skanska* EU:C:2019:204. See generally on this decision Christian Kersting, 'Kartellrechtliche Haftung des Unternehmens nach Art. 101 AEUV – Folgerungen aus EuGH, Urt. v. 14.03.2019, C-724/17 – Skanska (2019) Wirtschaft und Wettbewerb 290. Revised and updated translation 'Private law liability of the undertaking pursuant to Art 101 TFEU' available at SSRN: https://ssrn.com/abstract=3439973; Tatiana Siakka, 'Case C-724/17 Vantaan kaupunki v Skanska Industrial Solutions: Transposition of the Concept of an 'Undertaking' into Civil Damages Actions' (2019) Journal of European Competition Law & Practice 1; Czsongor István Nagy, 'Has the Time Come to Federalize Private Competition Law? The Autonomous Concept of Undertaking in the CJEU's Ruling in Case C-724/17 Vantaa v. Skanska' (2019) 26(5) Maastricht Journal of European and Comparative Law 720; Hans-Markus Wagener, 'Follow-up to Skanska – The 'Implementation' by National Courts So Far' (2019) 10 Neue Zeitschrift für Kartellrecht. Available at SSRN: https://ssrn.com/abstract=3455993 .

[123] *Skanska*, 28.

[124] *Skanska*, 47.

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linked the notion of undertaking in private enforcement cases to the criteria and standards developed over the years in the field of public enforcement, on the understanding that both serve essentially the same purpose: to strengthen the EU competition rules by discouraging their infringement.[125]

The above principles would be later developed in *Sumal*.[126] This judgment has been discussed earlier and is only looked at here as regards its contribution to private enforcement.

In that respect, *Sumal* is largely an offspring of *Skanska*. In the past, affiliate liability had been assumed to be a matter for national law, as *Provimi* and other cases decided by national courts show.[127] But following the declaration in *Skanska* that the determination of the legal entity that should make good cartel damages was governed by EU law, that avenue had been closed.[128] Consequently, the Grand Chamber confirmed the solution in *Skanska* declaring that the choice of the legal entity should be determined by EU law only[129] and follow the same logic as in public enforcement, including proclaiming the liability of the undertaking but not that of any legal entities which it may contain,[130] the 'automatic' nature of the joint and several liability of any entities that comprise the economic unit[131] and the communication of liability between the various entities in an economic unit.[132] At the same time, it restated the legal entity-centric approach to procedural rights, acknowledging the rights of subsidiaries (this is, legal entities, not undertakings) to challenge rulings based on their forming part of an economic unit.

While the logic that the notion of undertaking should be identical in public and private enforcement, as proclaimed in *Skanska* and *Sumal*[133] usefully serves to avoid divergences between these two sides of the same coin, there is arguably an area where it may require caution, and that is with respect to the discretion that (public) enforcement authorities possess and that allows them to choose one or more liable legal entity or entities. If, as explained in section 1.3 above, that discretion in the public enforcement of Articles 101 and 102 TFEU is founded on the powers of the Commission under Article 23 of Regulation 1/2003,[134] private claim-

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[125] *Skanska*, 44.

[126] Case C-882/19 *Sumal v Mercedes Benz Trucks España* EU:C:2021:800.

[127] See also the cases cited by Carsten Koenig, 'Comparing Parent Company Liability in EU and US Competition Law' (2018) 41(1) World Competition 69 at fn. 26. See also Aqueel Kadri and Scott Campbell, 'Subsidiary Liability—the Provimi Point Answered?' (2021) 12 European Competition Law Review 686.

[128] AG Pitruzzella's Opinion for the case wondered if the question before the Court was not so much 'why downward liability exists in law' but rather 'whether there are logical reasons to discard it'. That suggests that he was assuming that downward liability may not result from EU law, but a solution required by national law, the question being if EU law should tolerate it. Case C-882/19 *Sumal v Mercedes Benz Trucks España*, EU:C:2021:293, Opinion of AG Pitruzzella at 52.

[129] *Sumal* at 34, 38 and especially 75, where the Court confirms that a different solution would contradict EU law.

[130] Ibid at 42.

[131] Ibid at 44.

[132] Ibid at 48.

[133] *Skanska*, at 47; *Sumal* at 38.

[134] As *Sumal* para 63 notes, 'the Commission may freely choose to hold liable for an infringement, and to punish by the imposing [sic] a fine, any legal entity belonging to an undertaking that

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ants do not possess such powers, and must file their claim initially only against specific legal persons. It might be said that the Court gave injured parties a somewhat discretionary right to choose the liable legal entity in *Sumal*. However, that power came with substantial limitations such as the requirement that the subsidiary that may face a claim following a public enforcement decision against its parent entity would have sold the same products as its parent, as earlier discussed. It is submitted that these limitations reflect the different logics of public and private enforcement on an eventual discretionary power or individual right to choose the liable legal entity within an undertaking.

4. THE UNDERTAKING AND THE LEGAL ENTITY IN BIDDER EXCLUSION

In recent times, a 'new kid on the block' has emerged in the catalogue of remedies for competition law breaches aimed at boosting deterrence: the exclusion from public tenders, a potential sanction which would be added to 'classic' public enforcement and private claims.[135] While a detailed examination of this recent development is beyond the scope of this chapter, the roles of the undertaking and legal entity deserve a mention here, complementing the outlook provided in earlier sections.

Briefly, the Public Procurement Directive[136] provides two competition law-related mechanisms which may result in a bidder being excluded from a procurement process: On the one hand, its Article 57.4(c) empowers the contracting authority, either of its own volition or when so required by the Member State in question, to exclude bidders 'where the contracting authority can demonstrate by appropriate means that the economic operator is guilty of grave professional misconduct, which renders its integrity questionable', a mechanism that, as Recital 101 of the Directive acknowledges and the Court has confirmed,[137] applies to findings of breach of the competition rules. On the other, paragraph (d) of that same provision empowers the authority to exclude a bidder 'where the contracting authority has sufficiently plausible indications to conclude that the economic operator has entered into agreements with other economic operators aimed at distorting competition,' which seemingly targets activity that may be uncovered within a procurement process. These mechanisms are explained in a Commission Notice 'on tools to fight collusion in public procurement and on guidance on how

participated in an infringement of Article 101 TFEU.'

[135] See on this policy OECD (2022), Director Disqualification and Bidder Exclusion in Competition Enforcement, *OECD Competition Policy Roundtable Background Note*, available at http://www.oecd.org/daf/competition/director-disqualification-and-bidder-exclusion-in-competition-enforcement-2022.pdf.

[136] Directive 2014/24/EU of 26 February 2014 on public procurement, [2014] OJ L94/65.

[137] Case C-470/13 *Generali-Providencia Biztosító* EU:C:2014:2469 and Case C-425/18 (Order) *CNS v Gruppo Torinese Trasporti* EU:C:2019:476.

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to apply the related exclusion ground' adopted on 18 March 2021[138] ('Procurement Notice'), besides two recent preliminary rulings.[139]

The power to exclude bidders under these provisions (which, as the Court has explained, is exclusively the contracting authority's, which is not bound by the position taken by other authorities[140]) is governed by the EU procurement rules. Importantly, these identify the entities to which these rules apply under the term 'economic operator', which is defined in Article 2.1(10) of the Procurement Directive as follows:

> "economic operator" means any *natural or legal person* or public entity or *group of such persons and/or entities*, including any temporary association of undertakings, which offers the execution of works and/or a work, the supply of products or the provision of services on the market. (emphasis added).

As it will immediately be noticed, the provisions in question follow a legal entity perspective, even though these remedies relate to an infringement of competition rules. Thus, the eventual exclusion applies to a legal entity, often an affiliate of a group of companies. As a result, in the event the undertaking controls several affiliates with the requisite qualifications, the exclusion could be useless from a deterrence perspective and betray the logic that infringements of competition law are predicated on the 'undertaking' regardless of its legal structure.

To make matters worse, the Procurement Notice treats the notions of 'economic operator' and 'undertaking' as having the same meaning, confusingly proclaiming that Article 101 prohibits anticompetitive agreements between 'economic operators', while at the same time suggesting that collusion between affiliated entities would be prohibited, something which is true under procurement rules but initially not under Article 101 following *Ecoservice*,[141] as section 5.5 of the Procurement Notice itself recalls, but certainly not under competition law.

Leaving aside the careless drafting of the Notice, the regulation of exclusion sits uncomfortably between the competition and procurement rules, making it difficult to determine the principles that should be applied to resolve a given situation. That is particularly the case with respect to the entity that may bear the exclusion. While the breach of the competition rules will be attributable to an undertaking, the exclusion may only apply to the 'economic operator' concerned (that is, the legal entity submitting a bid), as candidly acknowledged in the last paragraph of the Notice.[142]

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[138] [2021] OJ C91/1. For a criticism of the Notice, see Albert Sánchez-Graells, 'First Thoughts on the Commission's Bid Rigging Exclusion Guidance – What Difference Will It Make?' (*How To Crack a Nut*, 22 March 2021) https://www.howtocrackanut.com/blog/bid-rigging-exclusion-guidance.

[139] Case C-416/21 *Omnibusunternehmen* EU:C:2022:689, confirming that the exclusion may cover practices other than Article 101 TFEU and Case C-66/22 *Futrifer* EU:C:2023:1016, where the Court has confirmed that the exclusion of tenderers may not be reserved to competition authorities.

[140] Case C-41/18 *Meca Srl v Comune di Napoli* EU:C:2019:507, para 28 (with respect to national courts) and Case C-267/18 *Delta* U:C:2019:826, para 27 (concerning other contracting authorities).

[141] Case C-531/16 *Specializuotas transportas Ecoservice* [2018] ECR. See on this judgment Marcos Araujo Boyd, 'Rethinking the Intragroup Exemption after Ecoservice' (2021) V(2) Market and Competition Law Review 50.

[142] 'Lastly, exclusion decisions on grounds of collusion refer only to the economic operator found to have colluded and not to other economic operators in some way affiliated to that operator

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While this result is understandable from a public procurement standpoint, where legal form carries more weight than in EU competition law, the solution advocated in the Notice is contrary to the purpose and goals of the competition rules. By way of example, it would be difficult to justify the exclusion of an entire undertaking that would have colluded with a rival when the latter happens to own a subsidiary that can file a separate or subsequent bid. That situation could be argued to run counter to the principle of effectiveness of Articles 101 and 102 TFEU defined by the Court and summarised earlier in this chapter, which ultimately is aimed at preventing measures that shield infringers from liability.

5. FINAL COMMENTS

Despite the huge advances made in making the undertaking the only subject of the competition rules, the legal structure used by economic entities is legally relevant in several ways, with the Court seemingly unable to find a safe passage between the Scylla of the 'economic unit' (the six-headed sea monster Odysseus was advised to pass by) and the Charybdis of the 'legal entity' paradigm (a mythical whirlpool allowing no escape in the quest to put substance over form). Several points may be made in this respect.

First, at the risk of stating the obvious, legal entities are relevant for public enforcement purposes. In the end, a 'person' must be addressed the decision and pay the fine.

Second, the identification of a legal entity is not only a requirement for the valid adoption of a decision, but also for certain procedural acts and especially the notification of the SO. In that respect, it carries out a 'letterbox' function. This suggests that legal entities, and not economic players, that possess procedural rights. This contrasts with the proclamation that the principle of personality in the infringement applies to undertakings and not legal entities, as followed by the CJEU since *ETI*. Looking ahead, and despite these statements, it is hard to imagine that legal entities will ever be fully disconnected from public enforcement procedures.

A third point is that, beyond that letterbox function, the legal structure of the undertaking impacts elements such as the level of the fines, the transmission of liability between legal entities, and limitation periods. These are areas where a legal entity perspective seems to hold sway, betraying the proclaimed irrelevance of the legal structure of undertakings in *Höfner* and its progeny. The fact that consequences stem from how undertakings are legally structured also raises difficult questions about the level of discretion held by public enforcement agencies in selecting the legal entity against whom enforcement may be made.

Fourth, the clarification in *Skanska* and *Sumal* that the notion of undertaking is defined by EU law only and, especially, that its meaning in private and public enforcement coincides is to be welcomed, as it avoids divergence. A distinction appears, however, necessary between these two areas of enforcement with respect to the power to determine the legal entities, which makes sense in public enforcement but arguably not in private enforcement. *Sumal* has addressed this in an odd way, mandating a series of 'links' that ultimately limit that choice in a private enforcement context. It is too soon to tell if these limits will stay in the realm of private enforcement or expand, alongside the identification of multiple undertakings in conglomerate groups, to public enforcement.

(such as mother companies, other companies belonging to the same group or subsidiaries of the excluded companies) and which were not involved in the given award procedures.'

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10. Enforcement of EU Competition Law Against Groups of Companies: The Calculation of Fines

Carsten Koenig

1. INTRODUCTION[1]

The European Court of Justice (ECJ) has consistently held that Articles 101 and 102 TFEU – the central prohibition rules of EU competition law – address economic units, not legal entities.[2] This approach is based on a functional interpretation of the term "undertaking", which is used in both provisions.[3] The consequences of the "economic unit" doctrine are much discussed, and the concept is often criticised on both theoretical and policy grounds.[4] Liability issues tend to be at the centre of the debate. The ECJ famously assumes that legal entities can be liable for infringements of competition law solely because they belong to the economic unit that constitutes the undertaking within the meaning of Article 101 or 102 TFEU. Recent judgments such as *Sumal*[5] and *SEN*[6] make it clear that, in the Court's view, it is the economic

[1] I am grateful to the editors, Anna Tzanaki and Florence Thépot, as well as Mariana Pargendler and the other attendees of the workshop on 27–28 March 2023 at Mannheim Centre for Competition and Innovation (MaCCI) for their helpful feedback.

[2] The most important recent judgment is arguably C-882/19 *Sumal* ECLI:EU:C:2021:800, paras 31ff. Until then, the leading case was C-97/08 *Akzo Nobel and Others v Commission* ECLI:EU:C:2009:536, paras 58–60.

[3] For more information on the concept of undertaking and its uses in EU competition law, see Carsten Koenig, 'Undertaking (notion)', *Global Dictionary of Competition Law* https://www.concurrences.com/en/dictionary/undertaking-notion accessed 5 November 2023; Marcos Araujo Boyd, 'The Notion of Undertaking in EU Competition Law' (PhD thesis, University of Glasgow) Ch. 2 https://theses.gla.ac.uk/83415/ accessed 5 November 2023.

[4] See e.g. Stephen Daly and Alison Jones, 'The Undertaking and Single Entity Doctrine in EU and UK Competition Law: Proposals for a Refined Approach' in this volume; Peter Whelan, 'Private Enforcement and the Imputation of Antitrust Liability' in Barry J Rodger, Miguel Sousa Ferro and Francisco Marcos (eds), *Research Handbook on Private Enforcement of Competition Law in the EU* (Edward Elgar 2023) 159; Benedikt Freund, 'Heralds of Change: In the Aftermath of *Skanska* (C-724/17) and *Sumal* (C-882/19)' (2022) 53 Intl Rev Intell Prop & Comp L 246; Mark Leddy and Athina van Melkebeke, 'Parental liability in EU competition law' (2019) 40 Eur Comp L Rev 407; Andriani Kalintiri, 'Revisiting Parental Liability in EU Competition Law' (2018) 43 Eur L Rev 145; Bruce Wardhaugh, 'Punishing Parents for the Sins of Their Child: Extending EU Competition Liability in Groups and to Subcontractors' (2017) 5(1) J Antitrust Enforcement 22; Bettina Leupold, 'Effective Enforcement of EU Competition Law Gone Too Far? Recent Case Law on the Presumption of Parental Liability' (2013) 34 Eur Comp L Rev 570.

[5] *Sumal* (n 2), paras 31ff.

[6] Case C-377/20 *Servizio Elettrico Nazionale and Others* ECLI:EU:C:2022:379, paras 104ff.

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unit that commits the infringement and that therefore all members of the unit may be liable. This obviously deviates from the usual approach in liability and sanctions law and is often regarded as a violation of fundamental legal principles.[7] In the case law of the ECJ, however, the liability-expanding function of the "economic unit" doctrine is firmly established, despite the criticism.

In this chapter, however, the focus will not be on establishing liability, but on a related yet different issue. The aim is to explore the role that the "economic unit" doctrine plays in the calculation of fines. This function of the doctrine has received little attention in the literature so far.[8] However, it is of great practical importance. Fines cannot be imposed on "undertakings" as economic units, but only on legal entities, i.e., natural and legal persons.[9] As it has become routine to extend liability to several members of the economic unit, the task of calculating the appropriate fine for each member becomes a central part of public enforcement proceedings. This raises difficult questions that are not always answered satisfactorily in practice. Against this background, this chapter aims to present the relevant issues and discuss them together with the decisions that have been adopted by the European Commission and the Courts in this context.

To start with, Section 2 briefly recalls basic aspects of the calculation of fines in EU competition law. This is to illustrate at which steps of the fine calculation the question may arise as to whether the economic unit or an individual legal entity is to be taken into account. Section 3 then explains that a group perspective is typically required when considering turnover or sales figures, e.g., when determining the basic amount or the 10% turnover cap. It is recommended that, as a rule, the consolidated accounts under the EU Accounting Directive[10] be used for this purpose. Section 4 then takes a closer look at how the "economic unit" doctrine affects, and should affect, individual elements of the calculation of fines, such as the multipliers for recidivism and deterrence, the 10% turnover cap, and inability-to-pay rules. It will be seen that the case law on these important determinants is complex and quite nuanced, but not always convincing, especially from a policy point of view. Often, simpler solutions would better serve the objectives of the law on fines. In particular, it will be found that the best results can often be achieved by simply setting the fine on the basis of the corporate group as it exists at the time of the prohibition decision. This is the best way to take into account the true economic strength of the respective addressee of the fine and to ensure that the fine has a deterrent effect, as required by law.

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[7] Leddy and van Melkebeke (n 4) 414; Kalintiri (n 4) 158–159; Leupold (n 4) 579; Stefan 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 EU Courts in EU-Antitrust Law' (2012) 3(1) J Eur Comp L & Prac 11, 15–16; Antoine Winckler, 'Parent's Liability: New Case Extending the Presumption of Liability of a Parent Company for the Conduct of its Wholly Owned Subsidiary' (2011) 2(3) J Eur Comp L & Prac 231, 233.

[8] But see Luca Crocco and Andreas Scordamaglia-Tousis, 'YKK v Commission: how the 10 per cent fining cap works in cases of corporate restructuring' (2015) 6(3) J Eur Comp L & Prac 177; Araujo Boyd (n 3) 102–114.

[9] See, e.g., Case C-231/11 P *Commission v Siemens Österreich and Others* ECLI:EU:C:2014:256, para 55; Araujo Boyd (n 3) 162–167.

[10] Directive 2013/34/EU of the European Parliament and the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings [2013] OJ L182/19.

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2. METHOD OF SETTING THE FINE

The imposition of fines for infringements of Articles 101 and 102 TFEU is regulated in Article 23(2) of Regulation 1/2003.[11] However, the provision does not contain a concrete method for the calculation of fines. Instead, only an upper limit and general principles are formulated. More concrete specifications for the calculation methodology can be found in the EU Commission's Fining Guidelines, which were last updated in 2006.[12] They are not formal legal rules but limit the Commission's discretion under Article 23(2) Regulation 1/2003 by way of self-commitment.[13] Furthermore, the determination of fines is shaped by the overarching objectives of competition policy and general principles of EU law. In particular, the Courts have repeatedly emphasised that the calculation of fines must serve the purpose of deterrence (i.e., the specific deterrence of the undertaking to be fined),[14] while at the same time respecting the principle of proportionality.[15] In the context of corporate groups and the "economic unit" doctrine, it is also relevant that fines can only be imposed on legal entities. Otherwise, decisions imposing fines would be unenforceable, as enforcement is governed by the law of the Member States pursuant to Article 299(2) TFEU.[16] If a competition law infringement is committed by an economic unit consisting of several legal entities, the Commission is free, according to the case law of the Courts, to choose against which of these legal entities it will impose fines.[17] The Commission must then calculate the fine for each addressee and may well arrive at different amounts.

2.1 Regulation 1/2003

Article 23(2) Regulation 1/2003 authorises the Commission to impose fines on "undertakings" and "associations of undertakings" if they intentionally or negligently infringe Article 101 or Article 102 TFEU. The fact that the term "undertaking" is used here just as in the Treaty provisions suggests that it is intended to have the same meaning. As is well known, the ECJ assumes that the concept of "undertaking" covers "any entity engaged in an economic activity, irrespective of the legal status of that entity and the way in which it is financed" and thus defines "an economic unit even if in law that economic unit consists of several persons,

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[11] Council Regulation (EC) 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.

[12] Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003 [2006] OJ C210/2 (2006 Fining Guidelines or simply Fining Guidelines).

[13] Case C-95/15 *H & R ChemPharm v Commission* ECLI:EU:C:2017:125, para 57; Case C-189/02 P *Dansk Rørindustri and Others v Commission* ECLI:EU:C:2005:408, para 211.

[14] Case C-100/80 *Musique Diffusion française v Commission* ECLI:EU:C:1983:158, para 106; Case T-42/07 *Dow Chemicals and Others v Commission* ECLI:EU:T:2011:357, para 148; Case T-31/99 *ABB Asea Brown Boveri v Commission* ECLI:EU:T:2002:77, para 166. Cf also Point 4 of the 2006 Fining Guidelines (n 12).

[15] *H & R ChemPharm* (n 13), para 95.

[16] Cf for a more detailed elaboration of this point, Marcos Araujo Boyd, 'Undertakings and Legal Entities as Addressees of Articles 101 and 102 TFEU' in this volume.

[17] *Sumal* (n 2), para 62–63; Case C-516/15 P *Akzo Nobel and Others v Commission* ECLI:EU:C:2017:314, para 51; Case C-444/11 P *Team Relocations and Others v Commission* ECLI:EU:C:2013:464, para 159–160. Cf. also Araujo (n 16).

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natural or legal".[18] This meaning shall also be decisive for the application of Article 23(2) Regulation 1/2003.[19] At the same time, it is recognised that fines can only be imposed on legal entities, not on economic units.[20] The question therefore arises as to how exactly the "economic unit" doctrine is to be applied to the calculation of fines in relevant cases. This will be examined in detail in the following sections.

Regarding the calculation of fines, Article 23(2) Regulation 1/2003 is not very informative. It merely states that for each undertaking or association of undertakings participating in the infringement, the fine shall not exceed 10% of its total turnover in the preceding business year. In practice, however, the fines are usually much lower. It is important to note that Article 23(2) Regulation 1/2003 also determines the relevant point in time for the calculation of the fine, namely the date of the prohibition decision. The statement on the "preceding business year" also refers to this. Both stipulations are significant, as will be explained later. In addition to Article 23(2), Article 23(3) Regulation 1/2003 provides that the Commission shall take into account both the gravity and the duration of the infringement when setting the amount of the fine. These are important, but of course very general principles, which in themselves would not be sufficient to ensure a predictable practice of fines. However, development has not stopped here.

2.2 Fining Guidelines

Today, the practical implementation of the fine calculation is mainly described in the Fining Guidelines of the EU Commission. As already mentioned,[21] the Fining Guidelines are not formal legal rules, so they only bind the Commission, not the Courts. However, the Courts accept that the Commission uses the Guidelines as a basis for calculating fines. According to the 2006 Fining Guidelines, the fine calculation consists of two main steps: the determination of the basic amount and its possible adjustment to special circumstances of the respective case.

The basic amount is determined by multiplying the so-called 'value of sales' by multipliers for the type and duration of the antitrust violation. According to Point 13 of the Guidelines, the value of sales refers to the value of the undertaking's sales of goods or services to which the infringement directly or indirectly relates in the relevant geographic area within the EEA. The relevant period is normally the last full business year of the undertaking's participation in the infringement. A certain percentage of the value of sales is then taken to determine the basic amount. It depends on the gravity of the infringement and ranges from 0 to 30%.[22] The share thus defined is a proxy for the damage caused by the antitrust violation.[23] Horizontal price-fixing, market-sharing and output-limitation agreements are considered to be the most harmful restrictions, for which the percentage should be set at the higher end of the scale.[24] In the

[18] See, e.g., *Sumal* (n 2), para 41; *Akzo Nobel and Others v Commission* (n 17), 47–48.

[19] *Sumal* (n 2), para 39; Case C-247/11 P *Areva and Others v Commission* ECLI:EU:C:2014:257, paras 123–124; Case C-823/18 P *Commission v GEA Group* ECLI:EU:C:2020:955, paras 62–63.

[20] See n 9.

[21] See n 13.

[22] Point 21 of the Fining Guidelines (n 12).

[23] European Commission, Fines for breaking EU Competition Law, Factsheet, November 2011, p. 1.

[24] Point 23 of the Fining Guidelines (n 12).

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Trucks cartel case, for example, the Commission set the percentage at 17%.[25] For particularly serious infringements, a so-called 'entry fee' of up to 25% can be added to increase specific deterrence.[26] Finally, the relevant share of the value of sales is multiplied by the number of years the competition law infringement lasted. In the Trucks case, this was 10–14 years.[27] The result of this calculation is the basic amount of the fine.

The second step is that the basic amount is further adjusted according to the particular circumstances of the respective case. The basic amount may be increased if the Commission finds aggravating circumstances (e.g., recidivism, refusal to cooperate, or particular responsibility for the infringement) or reduced if it finds mitigating circumstances (e.g., immediate termination of the infringement, limited involvement, effective cooperation). In the case of undertakings whose turnover is much higher than the sales to which the infringement relates, the Commission may increase the fine further to ensure that it has a sufficiently deterrent effect.[28] On the other hand, the Commission must ensure that the final amount of the fine does not exceed 10% of the undertaking's total turnover in the preceding business year, which is the legal maximum under Article 23(2) Regulation 1/2003 and Point 32 of the Fining Guidelines. The rules of the Leniency Notice[29] and/or the Settlement Notice[30] may also be applied in favour of the undertaking. Finally, the Commission may exceptionally, and only at the request of the undertaking, grant a reduction (up to a complete exemption) where the imposition of the normal fine would irretrievably jeopardise the economic viability of the undertaking ("inability to pay").[31]

3. CONSOLIDATED ACCOUNTS

What special features arise when calculating fines in relation to corporate groups or "economic units"? An important overarching point is that, to the extent that sales figures and turnover are to be taken into account, the Commission can typically look at the entire group of companies. Such figures are relevant for the determination of the basic amount as well as for some of the adjustments described above. In this context, a specific antitrust approach based on the economic unit competes with a simpler calculation method based on company law. According to this second approach, the Commission simply uses the consolidated accounts, which the companies have to prepare anyway in accordance with the EU Accounting Directive.[32] This approach, which has already been recognised by the EU Courts, is usually preferable. The simpler application is just one of several reasons for this, as will be explained in the following.

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[25] *Trucks* (Case AT.39824) Commission Decision C(2017) 6467 [2020] OJ C 216/9, para 117.

[26] Point 25 of the Fining Guidelines (n 12).

[27] *Trucks* (n 25), para 120.

[28] Points 30–31 of the Fining Guidelines (n 12).

[29] Commission Notice on Immunity from fines and reduction of fines in cartel cases [2006] OJ C298/17.

[30] 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 (EC) No 1/2003 in cartel cases [2008] OJ C167/1.

[31] Point 35 of the Fining Guidelines (n 12).

[32] See n 10.

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3.1 Value of Sales

As explained above,[33] one of the factors used to determine the basic amount is the value of the undertaking's sales of goods or services to which the infringement directly or indirectly relates. The ECJ has clarified in *H & R ChemPharm* that, in principle, the sales figures of the entire economic unit can be used to determine the value of sales.[34] In doing so, the Court followed up on its judgment in the *Groupe Gascogne* case,[35] where a similar finding was made in relation to the calculation of total turnover. This will be explained in more detail in the following section, which discusses the group-related calculation of turnover figures. A very similar approach is taken when the relevant factor is not turnover in general, but the value of the sales to which the infringement relates. In order to determine the relevant value of sales, the Commission must use the best available data, which typically comes from the undertaking concerned. As with turnover in general, it will normally be appropriate to use the consolidated financial statements as prepared in accordance with the Accounting Directive 2013/34 to identify the relevant value of sales.[36] The relevant period is the last full business year of the undertaking's participation in the infringement.[37] According to the ECJ's judgments in *H & R ChemPharm* and *Groupe Gascogne*, if the undertaking wants individual sales figures to be disregarded, it must prove that they are not relevant for the calculation of the fine.[38] The burden therefore lies with the undertaking.

3.2 Turnover

Other factors that are relevant for the calculation of the fine relate to turnover, e.g., the 10% turnover cap under Article 23(2) of Regulation 1/2003.[39] In this context too, the Courts have clarified that, in principle, the turnover of the entire economic unit can be taken into account. One important reason is to ensure that the fine has a sufficiently deterrent effect. According to the case law of the Courts, the deterrent effect on the infringing undertaking must be assessed in relation to the size and economic power of the undertaking, taking into account its global resources.[40] As pointed out by AG Kokott, it is important for specific deterrence to correctly assess the "true economic strength of the whole undertaking," i.e., the corporate group.[41]

The leading judgment by the ECJ on the relevance of group turnover is *Groupe Gascogne*.[42] In this decision, the ECJ stated that, in so far as turnover is relevant for the calculation of the fine, it is the consolidated turnover of the group as a whole that must be taken into account.

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[33] See text accompanying nn 21–24.

[34] *H & R ChemPharm* (n 13), paras 54ff.

[35] C-58/12 P *Groupe Gascogne v Commission* ECLI:EU:C:2013:770, paras 47ff.

[36] See n 10.

[37] Point 13 of the 2006 Fining Guidelines (n 12).

[38] *H & R ChemPharm* (n 13), para 61; *Groupe Gascogne* (n 35), para 61.

[39] For details on the cap and its rationale, see Section 4.3 below.

[40] Case C-286/13 *Dole Food and Dole Fresh Fruit Europe v Commission* ECLI:EU:C:2015:184, para 142; *Groupe Gascogne v Commission* (n 35), para 49–50; Case C-413/08 *Lafarge v Commission* ECLI:EU:C:2010:346, paras 102, 104.

[41] Case C-97/08 P *Akzo Nobel and Others v Commission*, Opinion of AG Kokott, ECLI:EU:C:2009:262, para 43.

[42] *Groupe Gascogne* (n 35), paras 47ff.

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Furthermore, the ECJ explicitly referred to Article 1(1) of Directive 83/349[43] for the purpose of determining the 10% turnover cap. Today, the relevant provision is to be found in Article 22(1) of the Accounting Directive 2013/34,[44] which, like its predecessor, obliges parent companies and subsidiaries to prepare consolidated financial statements. The purpose of this requirement is to provide "a true and fair view of assets and liabilities, the financial position and the profit and loss" of the whole group of companies.[45] It should be noted, however, that the conditions for determining "parent undertakings" and "subsidiary undertakings" within the meaning of Article 22(1) of the Accounting Directive are set out exclusively in that provision. The criteria listed there are similar to those used in EU competition law to determine economic units – but they are not identical. Therefore, when reference is made to the Accounting Directive, it is not necessarily the competition law concept of an undertaking that determines the attribution of turnover.[46]

The importance of the consolidated group turnover for the calculation of the fine (and in particular for the decision whether to reduce the fine under the 10% turnover cap) already results from the fact that fines can only be deterrent if the true economic strength of the companies concerned is taken into account. As I have explained in more detail elsewhere,[47] where turnover is relevant to the calculation of the fine, the Commission should therefore always be able to take into account the consolidated turnover of the corporate group, irrespective of which members of the economic unit are held liable for the competition law infringement. Moreover, the Courts should acknowledge that the relevant point in time for the calculation of the fine is usually the date of the prohibition decision, as deterrence is forward-looking. This is an important finding because the undertaking at the time of the decision may be quite different from the one at the time of the infringement.[48] The objective of setting the fine in such a way as to deter future infringements may even justify taking into account the economic strength of entities which were not part of the undertaking at the time of the infringement. In contrast to the liability function, it is irrelevant for the calculation of the fine whether other members of the group could have prevented the competition law infringement. Rather, it is simply a matter of correctly taking into account the actual economic strength of the group when calculating the fine.

One objection to the relevance of the date of the Commission's decision and the last business year preceding the decision could be that this approach creates incentives for evasive behaviour. This is because companies usually know well in advance that a decision will be issued. They may therefore try to influence their company data in their favour in order to obtain a lower fine. It is difficult to refute this argument completely. However, while it is very easy to shift turnover within a corporate group, it is much more difficult to make turnover disappear

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[43] Seventh Council Directive 83/349/EEC of 13 June 1983 based on Article 54(3)(g) of the Treaty on consolidated accounts [1983] OJ L193/1 (Seventh Company Law Directive).

[44] See n 10.

[45] Article 4(3) and recital 9 of the Accounting Directive; Recital 5 of the Seventh Company Law Directive.

[46] Cf Araujo Boyd (n 3) 75.

[47] Carsten Koenig 'The Boundaries of the Firm and the Reach of Competition Law: Corporate Group Liability and Sanctioning in the EU and the US' in Marco Corradi and Julian Nowag (eds), *Intersections Between Corporate and Antitrust Law* (Cambridge University Press 2023), Ch. 4.

[48] See nn 124–131 below.

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completely without affecting the undertaking's core business. The fact that group turnover is to be used for the calculation of fines therefore already significantly reduces the risk of circumvention. Furthermore, it should not be overlooked that, according to the Commission's Fining Guidelines, the main purpose of using turnover figures is to avoid excessive fines (cf. e.g. the 10% turnover cap) and too low fines (cf. e.g. the deterrence multiplier[49]). In contrast, the basic amount of the fine, i.e., the starting point for any fine calculation under the Fining Guidelines, is based on the value of the sales to which the infringement relates, usually calculated by multiplying the relevant sales in the last full business year of the infringement by the number of years of the infringement.[50] It is therefore not the case that the calculation of the fine is based solely on the situation at the time of the prohibition decision. Rather, the calculation of the basic amount relates primarily to the period of infringement and the harm caused during this period. However, to the extent that turnover is relevant for the adjustment of the basic amount, it would be problematic from a policy point of view to refer to a time other than the date of the prohibition decision, such as the last full business year in which the undertaking participated in the infringement. Such an approach would run the risk of misjudging the real economic strength of the undertaking at the time the fine is imposed. However, taking into account the real economic strength of the undertaking is crucial to ensure that the fine has a sufficient deterrent effect. From the point of view of deterrence, therefore, there is no alternative but to take as reference points the date of the Commission's decision and the last business year preceding the decision. Beyond this policy consideration, it must also be recognised that these reference points are also set out in Article 23 of Regulation 1/2003, so that the Commission could not simply depart from them anyway.

4. SPECIFIC CIRCUMSTANCES

Now that some of the basics of calculating fines for members of corporate groups have been discussed, this section will look at some of the factors that the Commission uses to adjust the basic amount to take account of special circumstances. It is often these adjustment factors that explain why even sole owners frequently oppose findings of parental liability in competition law cases, even though it is clear that, in economic terms, they bear the consequences of their subsidiaries' misconduct anyway. For example, in *Choline chloride*, the decision that led to the famous *Akzo* judgment establishing the 100%-shareholding presumption,[51] the Commission not only held the parent company liable for an infringement by a subsidiary, but it also applied a deterrence multiplier of 1.5 because of the particularly large turnover of the whole Akzo

[49] See Section 4.2 below.

[50] Points 13 and 19 of the Fining Guidelines (n 12); see also text accompanying nn 21–22, 37 above.

[51] See *Akzo Nobel and Others v Commission* (n 2), para 27: "In the specific case of a parent company holding 100% of the capital of a subsidiary which has committed an infringement, there is a simple presumption that the parent company exercises decisive influence over the conduct of its subsidiary […]", quoting Case T-112/05 *Akzo Nobel and Others v Commission* ECLI:EU:T:2007:381, para 60.

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group and refused to cap the fine at 10% of the turnover attributable to the subsidiary.[52] As a result, the fine was set at 20.99 million euros instead of the 12.45 million euros that Akzo itself considered appropriate (a plus of 8.54 million euros or 68.6%). The calculation of fines for groups of companies and their members has been a recurrent concern of the EU Courts in recent years. As we will see, difficulties arise in particular when the composition of the group changes, for example, because a company involved in the infringement is acquired or sold.

The case law fluctuates between the Courts' efforts to maintain their strong focus on the economic unit as the actual perpetrator, while at the same time doing justice to the individual addressees of the decision imposing the fines. As a general rule, the ECJ considers that the principle of personal responsibility and the principle that the penalty must be specific to the offender and the offence relate to the undertaking itself, not to the natural or legal persons forming part of it (i.e., to the corporate group, not to its members).[53] In normal circumstances, the liability of the parent company is therefore derivative and necessarily depends on the facts constituting the infringement committed by a subsidiary under the parent's control.[54] Because the parent company and the subsidiary together form part of an economic unit, their liability is said to be "inextricably linked".[55] To this effect, the ECJ has concluded that the liability of the parent company may normally not exceed that of its subsidiary.[56] However, it considers that exceptions can be made where circumstances characterise the conduct of the parent company individually. The GC has followed these instructions and held that, while the unity of an undertaking's market conduct justifies holding the various companies belonging to the undertaking in principle all liable for payment of the same amount, an exception to that rule must be made for individual circumstances which justify adjustment of the amount of the fine only for individual addressees.[57]

From a practical point of view, it is therefore of particular interest which factors can lead to a higher fine and which part of the fine may be imposed on which addressee. In the following sections, four factors will be analysed for which it is recognised that they may lead to an increase in the fine for groups of companies: (1) the aggravating circumstance of recidivism,

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[52] *Choline chloride* (Case COMP/37.533) Commission Decision C(2004) 4717 [2005] OJ L190/22, paras 203, 238; Case T-112/05 *Akzo Nobel and Others v Commission* (n 51), para 86.

[53] *Commission v Siemens Österreich and Others* (n 9), para 56. See also Case T-827/14 *Deutsche Telekom v Commission,* ECLI:EU:T:2018:930, para 503; Case T-470/13 *Merck v Commission* ECLI:EU:T:2016:452, para 530.

[54] Case C-351/15 P *Commission v Total and Elf Aquitaine* ECLI:EU:C:2017:27, para 44; *Akzo Nobel and Others v Commission* (n 17), para 61; Case C-597/13 P *Total v Commission* ECLI:EU:C:2015:613, para 38; *Areva v Commission* (n 19), para 137; Case C-286/11 P *Commission v Tomkins* ECLI:EU:C:2013:29, para 39.

[55] *Akzo Nobel and Others v Commission* (n 17), para 61. See also *Deutsche Telekom v Commission* (n 53), para 498; Case T-444/14 *Furukawa Electric v Commission* ECLI:EU:T:2018:454, para 288; Case T-419/14 *The Goldman Sachs Group v Commission* ECLI:EU:T:2018:445, para 266; Case T-382/06 *Tomkins v Commission* ECLI:EU:T:2011:112, para 46.

[56] *Commission v Total and Elf Aquitaine* (n 54), para 44; *Akzo Nobel and Others v Commission* (n 17), para 62; *Total v Commission* (n 54), para 38. See also *Deutsche Telekom v Commission* (n 53), para 499; Case T-264/12 *UTi Worldwide and Others v Commission* ECLI:EU:T:2016:112, para 330.

[57] *Deutsche Telekom v Commission* (n 53), para 505; Case T-391/09 *Evonik Degussa and AlzChem v Commission* ECLI:EU:T:2014:22, para 271.

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(2) the specific increase for deterrence, (3) the 10% turnover cap, and (4) the rules on inability to pay. For every factor, it will be examined how it is affected by the uniform view on corporate groups under the "economic unit" doctrine and whether the Courts' approach in this regard is convincing. Particular attention will be paid to the relationship between the liability of parent companies and subsidiaries and to the consequences of restructuring and other changes in control.

4.1 Recidivism

Point 28 of the 2006 Fining Guidelines[58] lists recidivism as one of the aggravating circumstances that can lead to a higher fine.[59] According to this provision, recidivism means that an undertaking continues or repeats the same or a similar infringement after the Commission or a national competition authority has found that the undertaking infringed Article 101 or 102 TFEU. The Courts have confirmed that recidivism is an important factor which the Commission must appraise, with the purpose being to provide an additional deterrent incentive to firms that have already demonstrated a tendency towards infringing the competition rules.[60] Under the Fining Guidelines, the Commission can increase the basic amount of the fine by up to 100% for every prior infringement. In practice, the Commission typically starts with an increase of 50% (i.e., a multiplier of 1.5).[61] In any case, the consequences can be very severe. In *Elevators and Escalators*, for example, the Commission increased the basic amount of the fine for *ThyssenKrupp* and its subsidiaries by 50%. As a result, the total amount of fines to be paid by the *ThyssenKrupp* group increased to a little under 480 million euros instead of 'only' about 320 million euros.[62]

4.1.1 Group perspective

A finding of recidivism becomes more likely where the reference is to the economic unit, i.e., the whole corporate group and not its individual members. In particular, the Courts have made it clear that a parent company can be liable as a repeat offender even if it only committed the infringements indirectly through one or more subsidiaries. A simple example is

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[58] See n 12 above.

[59] A similar rule was already part of the previous version of the Fining Guidelines; see Guidelines on the method of setting fines imposed pursuant to Article 15(2) of Regulation No 17 and Article 65(5) of the ECSC Treaty [1998] OJ C9/3 (1998 Fining Guidelines), Section 2.

[60] Case C-3/06 P *Groupe Danone v Commission* ECLI:EU:C:2007:88, paras 38–39; Case T-56/09 *Saint-Gobain Glass France and Others v Commission* ECLI:EU:T:2014:160, para 327; Case T-53/03 *BPB v Commission* ECLI:EU:T:2008:254, para 383; Case T-161/05 *Hoechst v Commission* ECLI:EU:T:2009:366, para 141. For more extensive information on the objectives of the recidivism uplift, see nn 90–94 below.

[61] See e.g. *Slovak Telekom* (Case AT.39523) Commission Decision C(2014) 7465 [2015] OJ C314/7, para 1531; *Calcium Carbide and magnesium based reagents for the steel and gas industries* (Case COMP/39.396) Commission Decision C(2009) 5791 [2009] OJ C301/18, para 310; *Bitumen (Netherlands)* (COMP/38.456) Commission Decision C(2006) 4090 [2007] OJ L196/40, para 336.

[62] *Elevators and Escalators* (Case COMP/38.823) Commission Decision C(2007) 512 [2008] OJ C75/19. The GC later annulled the finding of recidivism and reduced the fines, see Case T-144/07 *ThyssenKrupp Liften Ascenseurs v Commission* ECLI:EU:T:2011:364, paras 303–323, 461–462.

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the *Plasterboard* decision, where the Commission applied recidivism multipliers to *BPB* and *Lafarge*. *BPB* had committed the first infringement indirectly through its subsidiary *BPB De Eendracht*, but had directly committed the second. *Lafarge*, in contrast, had directly committed the first infringement, but had committed the second infringement indirectly through its subsidiary *Lafarge Plâtres International*.[63] The GC upheld the findings of parental liability and expressed no concerns about the classification as recidivism.[64] The ECJ later dismissed *Lafarge's* appeal, rejecting a number of fundamental criticisms against the Commission's recidivism policy.[65]

Later in *Versalis*, the ECJ made clear that, in order to establish a parent company's recidivism, it is not even necessary that the parent was itself an addressee of the first prohibition decision.[66] Instead, it is sufficient if the first decision was addressed to a subsidiary, as long as the Commission establishes, in the second decision, that the parent and the subsidiary constituted an economic unit at the time of the first infringement. Thus, for holding the parent company liable as a repeat offender, the Commission must only show that it *could have held* the parent company liable already in the first decision. The ECJ thereby overruled the GC, which had previously found that it would violate the company's rights of the defence if the Commission could base a finding of recidivism on a first decision that was not formally addressed to the parent company.[67] The GC had argued that an effective defence required that the company had had the chance to fight the findings of the first decision already when that decision was adopted, which was only possible if the company had been a subject of the first investigation. On appeal, the ECJ countered that it must be sufficient if the parent company can defend itself against the first decision at the time when the Commission adopts the second decision, confronting the company with the accusation of repeated infringement.[68] Otherwise, the parent could easily avoid the application of the recidivism multiplier by altering its legal

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[63] *Plasterboard* (Case COMP/37.152) Commission Decision 2005/471/EC [2005] OJ L166/8, paras 13–14, 493–494, 501–509, 559–561, 564. Note that Lafarge was formally addressed in *Plasterboard* and the previous decision (albeit under two different names), but BPB was only addressed in *Plasterboard*. The first decision concerning the BPB group was exclusively addressed to a subsidiary.

[64] *BPB v Commission* (n 60), paras 378–413; Case T-54/03 *Lafarge v Commission* ECLI:EU:T:2008:255, paras 558, 731–732.

[65] *Lafarge v Commission* (n 40), paras 61–76, 81–96.

[66] Case C-93/13 P *Commission and Others v Versalis and Others* ECLI:EU:C:2015:150, para 91. The Commission had considered Eni SpA and its subsidiary Polimeri Europa SpA as repeat offenders because Anic SpA and Enichem SpA, two other subsidiaries of Eni, had been subjects of earlier decisions. See *Chloroprene rubber* (Case COMP/38.629) Commission Decision 2008/C 251/07 [2008] OJ C251/11, para 540, fn 517.

[67] Case T-103/08 *Versalis and Eni v Commission* ECLI:EU:T:2012:686, paras 273–274. The same was held in *ThyssenKrupp Liften Ascenseurs v Commission* (n 62), paras 319–320, 322, and Case T-558/08 *Eni v Commission* ECLI:EU:T:2014:1080, paras 296–298. Earlier judgments had been less restrictive, see e.g. Case T-343/06 *Shell Petroleum and Others v Commission* ECLI:EU:T:2012:478, paras 244–276; *Hoechst v Commission* (n 60), para 147; Case T-203/01 *Michelin v Commission* ECLI:EU:T:2003:250, para 290. The GC later explained this in *Eni v Commission*, paras 303–306, by pointing out that the parties in the old cases had not argued that the Commission had violated their rights of the defence.

[68] *Commission and Others v Versalis and Others* (n 66), para 93.

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structure, which would jeopardise effective deterrence.[69] However, in order to respect the parent company's rights of the defence, the Commission must reveal its intention to rely on the earlier infringement already in the statement of objections.[70] Moreover, the Commission must explain in the statement of objections and the prohibition decision that the parent company formed, at the time of the first infringement, a single economic unit with a subsidiary that was formally addressed by the first prohibition decision.[71] This seems to be a fair compromise, even if one takes into account that the first infringement may have occurred many years ago. In *Chloroprene rubber*, for example, the decision leading to the *Versalis* appeal, the Commission based its finding of recidivism on two decisions from 1994 and 1986, which concerned cartels in the late 1970s and early 1980s.[72] However, this part of the *Versalis* judgment may lose significance over time, as it has become common practice, at least since the *Akzo* judgment,[73] to formally include parent companies in the investigations.

4.1.2 Exceptions

It has thus been shown that the Courts consider that recidivism multipliers may concern several members of the economic unit. Nevertheless, the GC considers recidivism to be one of the factors which may characterise the conduct of the parent company individually and can – and must – therefore lead to a higher fine being imposed on the parent company than on the subsidiary. This was first decided in *Evonik Degussa*, where the GC explained that "an entity in respect of which the aggravating circumstance of recidivism has not been established *cannot* be held jointly and severally liable with another entity, in respect of which this circumstance has been established, for the part of the fine that is imposed for recidivism".[74] In the underlying decision, the Commission had applied the recidivism multiplier to both the parent company and the subsidiary, even though the prior decision only concerned the parent company.[75] The GC eliminated the recidivism uplift for the subsidiary but maintained it for the parent company.[76] The Court later repeated its view in *Deutsche Telekom*, where it had been the Commission which had decided to apply the recidivism multiplier only in relation

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[69] Ibid, para 92.

[70] Ibid, para 96.

[71] Ibid, para 96. The Commission decision (*Chloroprene rubber*, n 66) did not meet this standard, so the ECJ agreed with the GC's finding that Eni could not be considered a repeat offender (albeit for a different reason); see *Commission and Others v Versalis and Others* (n 66), paras 99–101.

[72] *Chloroprene rubber* (n 66), para 540, fn 517.

[73] *Akzo Nobel and Others v Commission* (n 2).

[74] *Evonik Degussa and AlzChem v Commission* (n 57), para 271 (my translation, emphasis added).

[75] *Calcium Carbide and magnesium based reagents for the steel and gas industries* (n 61), paras 309–312.

[76] *Evonik Degussa and AlzChem v Commission* (n 57), para 271. It should be noted that the judgment was partly based on the GC's prior evaluation that a finding of recidivism was only possible if the repeat offender had formally been addressed by a prior prohibition decision. As explained in the text accompanying nn 66–67, that evaluation was later contradicted by the ECJ in *Commission and Others v Versalis and Others* (n 66).

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to the parent company.[77] In its judgment, the GC confirmed the Commission's approach and repeated its finding from *Evonik Degussa* that recidivism may constitute a factor which individually characterises the parent company's own conduct and, therefore, justifies the imposition of a higher fine.[78] The Court further explained that this finding was not altered by the fact that the subsidiary had been part of a single economic unit with the parent company already at the time of the first decision.[79] It justified this on the ground that the subsidiary had not participated in the earlier infringement and that the illegal act by the parent company could not be attributed to the subsidiary.[80]

It is striking that the Courts have so far resolved the opposite situation differently. If only the subsidiary was to be considered a repeat offender (e.g., because it had committed the first offence before it was acquired or controlled by the parent company), the Commission has for a long time followed the practice of applying the recidivism multiplier only to the subsidiary, resulting in a higher fine for the subsidiary than for the parent company. For example, in *MCAA*, *Hydrogen peroxide* and *Methacrylates*, the Commission imposed higher fines on Arkema than on its parent, Elf Aquitaine, because Arkema had committed prior infringements at times when, according to the Commission's findings, it was not yet controlled by Elf Aquitaine.[81] This would be in line with the GC's finding in *Evonik Degussa* and *Deutsche Telekom* that recidivism is a factor that may be specific to one member of the group and therefore justifies a differentiation in the fine. However, in its *Versalis* judgment mentioned above, the GC held that a finding of recidivism in respect of the subsidiary is sufficient to justify the application of the recidivism multiplier also towards the parent company.[82] In support of this holding, the Court reasoned that the joint and several liability of a parent company which controls a subsidiary always attaches to the final amount of the fine imposed on that subsidiary.[83] The ECJ later confirmed the GC's finding of recidivism on appeal. In response to the appel-

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[77] *Deutsche Telekom v Commission* (n 53), paras 505–506. See also *UTi Worldwide and Others v Commission* (n 56), para 332. For more discussion of *Deutsche Telekom v Commission* (n 53) see Section 4.2. below at nn 107–114.

[78] *Deutsche Telekom v Commission* (n 53), paras 505–506.

[79] Ibid, paras 509–513.

[80] According to the view expressed in this chapter, attribution for the purpose of establishing liability and for the purpose of setting the fine should be clearly distinguished. That also applies to recidivism, which is part of the latter, not the former. This is confused by the GC in the *Deutsche Telekom* judgment (n 53) at para 512, where the attribution of a prior infringement to the subsidiary was rejected, inter alia, by reference to the ECJ's judgment in Case C-196/99 P *Aristrain v Commission* ECLI:EU:C:2003:529, which, however, concerned the attribution of liability, not the calculation of fines.

[81] *MCAA (Monochloroacetic acid)* (Case COMP/37.773) Commission Decision 2006/897/EC [2006] OJ L353/12, paras 310–311, 314, fn 222; *Hydrogen peroxide (and perborate)* (Case COMP/38.620) Commission Decision 2006/903/EC [2006] OJ L353/54, para 469, fn 409; *Methacrylates* (Case COMP/38.645) Commission Decision 2006/793/EC [2006] L322/20, paras 358, 369, fn 86.

[82] *Versalis and Eni v Commission* (n 67), para 276. Along this route, the GC justified the application of the recidivism multiplier to both the parent and the subsidiary, even though it had previously found that the parent could not be considered a repeat offender because it had not been formally addressed by the first prohibition decision.

[83] Ibid, para 276.

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lant's complaint that the ECJ had previously approved the Commission's earlier approach to apply the multiplier exclusively to the subsidiary,[84] the Court pointed out that it had so far "simply reviewed the calculation of the fine on the basis of the Commission's choices" (with wide discretion), but that it had not yet ruled on the conditions for repeated infringement in such a situation.[85]

4.1.3 Critical analysis

It is respectfully submitted that the GC's approach of holding parent companies responsible for repeat offences committed by their subsidiaries while refusing to allow the opposite is mistaken. To begin with, it is not quite clear what the Court is trying to achieve with this differentiation. Where the parent company holds 100% of the shares in the subsidiary, it ultimately makes no difference economically whether 'only' the parent company is liable for the recidivism or also the subsidiary. The economic consequences will be borne by the ultimate shareholders of the corporate group either way. It is therefore not surprising that, in the *Evonik Degussa* case, the parent company and its wholly owned subsidiary had not even asked the GC not to apply the recidivism multiplier to the subsidiary.[86] That was different in *Deutsche Telekom*, where the parent company had expressly denied that it could be solely liable for the recidivism uplift.[87] However, in this case, the parent company only held a 51% stake in the subsidiary, and it appears that the Commission's main purpose in imposing different fines on the parent company and the subsidiary was to protect the minority shareholders of the subsidiary. This raises the suspicion that the Commission was trying to influence the internal allocation of the fine (i.e., its distribution within the corporate group), which the ECJ has clearly rejected in *Siemens Österreich*.[88]

In any case, it would be naive to believe that the ultimate allocation of liability costs could be determined in the fining decision. Given the rights and obligations under company law and the control relationship between the parent company and the subsidiary, it is much more likely that the corporate group redistributes the costs internally in the way that is most efficient for the group's members. Even if the companies cannot reach an amicable solution (e.g., because it is prevented by a minority shareholder with veto rights), the final distribution is decided only at the level of recourse. The Commission can claim the full amount of the fine from any member of the undertaking as all members are jointly and severally liable. If some members pay but others do not, the question arises whether the paying member can claim a contribution from the others. If no agreement is reached, the paying member may even have to take legal

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[84] For the Commission's practice, see n 81 above. The Courts let that approach pass on multiple occasions; see, e.g., Case C-520/09 P *Arkema v Commission* ECLI:EU:C:2011:619, paras 68–86; Case T-168/05 *Arkema v Commission* ECLI:EU:T:2009:367, paras 198–205; Case T-217/06 *Arkema France and Others v Commission* ECLI:EU:T:2011:251, para 277; Case T-190/06 *Total and Elf Aquitaine v Commission* ECLI:EU:T:2011:378, paras 165–170.

[85] *Commission and Others v Versalis and Others* (n 66), para 109.

[86] *Evonik Degussa and AlzChem v Commission* (n 57), paras 139–140.

[87] *Deutsche Telekom v Commission* (n 53), paras 483–486.

[88] *Commission v Siemens Österreich and Others* (n 9), paras 58–77. See also Case C-625/13 *Villeroy & Boch v Commission* ECLI:EU:C:2017:52, para 151; Case T-677/14 *Biogaran v Commission* ECLI:EU:T:2018:910, para 275; *The Goldman Sachs Group v Commission* (n 55), para 200; *Merck v Commission* (n 53), para 530; Case 823/18 P *Commission v GEA Group*, Opinion of AG Pitruzzella, ECLI:EU:C:2020:426, para 40.

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action against other members of the undertaking. However, the internal allocation of payment obligations among the members of the undertaking will entirely depend on the circumstances of each case (e.g., in terms of contractual distribution of risk, extent of participation in the infringement, etc.). It may even be the case that a subsidiary has to indemnify the parent company for the payment of the recidivism uplift, for example because the subsidiary bears sole responsibility for the competition law infringement and has thus breached an internal duty of care. In view of these difficulties and contingencies, there is a solid case for focusing on the group as a whole and refraining from differentiating between its members when applying the recidivism multiplier.

What is even more important, however, is that the GC seems to have lost sight of the purposes that should drive the calculation of fines and especially the application of the recidivism multiplier. As already mentioned, the most important criterion for the assessment of fines, also from the perspective of the Courts, is the objective of effective deterrence. Concerning specifically the issue of imposing higher penalties for repeat offenders, several justifications have been identified in the literature:[89] First, recidivism may indicate that the offender values the infringement more highly than others, so that a fine of the normal amount will not deter them.[90] In the case of a competition law offender, a possible reason would be that the infringement is particularly profitable for them. Second, repeat offenders may also become more proficient at avoiding detection and sanctioning, as they benefit from a "learning by doing" effect.[91] Thus, a higher fine may be necessary to compensate for the fact that it is less likely that a fine will actually be imposed. Third, some firms may have a higher-than-average propensity to commit infringements, e.g. because they suffer from a corporate culture that favours such infringements.[92] Establishing this on the occasion of a first infringement can be burdensome and expensive, but a second infringement can be interpreted as a reasonably certain indication. Fourth, higher fines for repeat offenders may also be necessary to express an increased moral condemnation and reaffirm the robustness of the legal system.[93] Finally, the first decision may have helped the firm to calculate the costs of the infringement more precisely and discover that it is actually profitable. A higher fine may be necessary to reinforce deterrence for such firms.[94]

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[89] The list is not exhaustive. Cf for more details Mitchell Polinsky and Steven Shavell, 'On Offense History and the Theory of Deterrence' (1998) 18 Intl Rev L & Econ 305; Mitchell Polinsky and Daniel L Rubinfeld, 'A model for optimal fines for repeat offenders' (1991) 46 J Pub Econ 291; Steven Shavell, *Foundations of Economic Analysis of Law* (Belknap 2004) 528–530.

[90] Richard Posner, *Economic Analysis of Law* (8th edn, Aspen Publishers 2011) 289; Richard Posner, 'An Economic Theory of the Criminal Law' (1985) 85 Colum L Rev 1193, 1216.

[91] Thomas J. Miceli, *The Economic Approach to Law* (3rd edn, Stanford University Press 2017) 257; Posner, *Economic Analysis* (n 90) 289; Wouter Wils, 'Recidivism in EU Antitrust Enforcement: A Legal and Economic Analysis' (2012) 35 World Comp 5, 14.

[92] Wils (n 91), 13–14; T. Eftychidou and F. Maiorano, 'Once Burned Twice Shy: What Does Economics Say About Repeated Cartel Offences?' (2016) 7 J Eur Comp L & Prac 622. This aspect has also been stressed by the Courts, see *Groupe Danone v Commission* (n 60), para 39; *Saint-Gobain Glass France and Others v Commission* (n 60), paras 327–328; Case T-38/02 *Groupe Danone v Commission* ECLI:EU:T:2005:367, para 349.

[93] Wils (n 91), 14; David A. Dana, 'Rethinking the Puzzle of Escalating Penalties for Repeat Offenders' (2001) 110 Yale LJ 733, 776–783.

[94] Wils (n 91), 15.

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At least as a general rule, it cannot be concluded from these reasons that the recidivism uplift should be imposed only on the parent company and/or those parts of the undertaking which were directly involved in previous infringements.[95] It seems more convincing to set a single fine for all liable members of the group and not to differentiate according to their respective responsibilities. A possible higher profitability of the infringement typically results from the markets concerned, the specific business model, and the cost structure of the company, i.e., factors that are not necessarily limited to only one part of the undertaking. Learning effects and corporate culture may also concern the whole group, as a parent company that is able to exercise a decisive influence on other entities will have no difficulty in establishing a group-wide knowledge management or setting unified rules of conduct. Looking back at the *Deutsche Telekom* case, for example, there is little evidence that the subsidiary would not have been plagued by the same compliance problems as the parent company, so that the application of the multiplier was probably necessary not only for the parent company but also for the subsidiary.

4.2 Deterrence Multiplier

According to Point 30 of the 2006 Fining Guidelines,[96] the Commission may, in order to ensure a sufficiently deterrent effect, increase the fine for undertakings "which have a particularly large turnover beyond the sales of goods or services to which the infringement relates".[97] The exact policy behind this deterrence multiplier is difficult to grasp. On the one hand, fines which are high enough to make competition law infringements unprofitable should be able to deter large and small companies alike. It goes without saying that even large companies do not want to give money away. If fines are optimally calculated, they should therefore be just as deterrent for large companies as for small ones. The multiplier could therefore be the expression of a "large firm bias", as companies sometimes claim. On the other hand, it cannot be denied that even competition law fines do not look very impressive when compared to the enormous economic power of some companies. Of course, these companies do not want to waste money either, but it is obvious that they are more easily able to cope with losses if a project develops differently than planned (e.g., because an infringement is discovered which they thought would remain secret). In any event, the Courts have welcomed the use of deterrence multipliers.[98]

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[95] Wils (n 91) 17–18 suggests that the analysis of recidivism could focus on specific groups of employees. But even such an approach (not shared by the Courts, which focus solely on the undertaking and are not interested in which employees were actually responsible) should not depend on arbitrarily drawn legal boundaries.

[96] See n 12 above.

[97] The 1998 Fining Guidelines (n 59) contained a similar rule, under which the Commission had to take account of the "effective economic capacity" of the offender, and had to set the fine at a level which ensures a "sufficiently deterrent effect".

[98] *Lafarge v Commission* (n 40), para 102; Case C-289/04 P *Showa Denko v Commission* ECLI:EU:C:2006:431, para 16; *Musique Diffusion française v Commission* (n 14), paras 119–121; *Deutsche Telekom v Commission* (n 53), para 515; Case T-82/08, *Guardian Industries and Guardian Europe v Commission* ECLI:EU:T:2012:494, para 117; Case T-214/06 *Imperial Chemical Industries v Commission* ECLI:EU:T:2012:275, para 142; Case T-190/06 *Total and Elf Aquitaine v Commission* ECLI:EU:T:2011:378, paras 228–231.

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In cases involving corporate groups as economic units, the Commission typically refers to the consolidated turnover of the corporate group in order to establish whether applying a deterrence multiplier is appropriate. If it concludes that it is, the Commission has for a long time applied the multiplier without distinction to the parent company and its subsidiaries involved in the unlawful behaviour.[99] For example, in *Hydrogen peroxide*, the Commission multiplied the fines for *Total*, *Elf Aquitaine* and *Arkema* by a factor of 3 because of the very high turnovers of *Total* and *Elf Aquitaine*.[100] The firms had previously argued that it was not appropriate to also increase the fine for *Arkema*, a subsidiary controlled directly by *Elf Aquitaine* and indirectly by *Total*. The Commission countered that the uniform application of the multiplier was necessary to prevent large firms from escaping high fines by creating small subsidiaries with little turnover.[101] It could be added that this practice is also in line with the Courts' approach of considering the economic unit to be the real perpetrator.[102] Moreover, group turnover is also decisive in other relevant contexts, in particular for the calculation of the 10% turnover cap according to Article 23(2) of Regulation 1/2003 and Point 32 of the Fining Guidelines. An important difference between the two instruments is that the 10% turnover cap limits the fine, while the deterrence multiplier increases it. In both cases, however, the aim is to adjust the fine to the true economic strength of the undertaking, so that it is neither under-deterred nor over-deterred by the fine imposed.

The Courts have confirmed the appropriateness of the Commission's approach at least implicitly on several occasions,[103] but they have also introduced an important modification. In *Pegler*, the GC has held that the relevant point in time for assessing whether to apply a deterrence multiplier, is the date of the Commission's prohibition decision.[104] The reason for this is, simply put, the deterrence multiplier is forward-looking, as its main objective is specific deterrence, i.e., to induce the particular wrongdoer to comply with the competition rules in the future. As a consequence, the GC has held that a deterrence multiplier reflecting a particularly large turnover of a parent company must not be applied to a subsidiary if that subsidiary is no longer controlled by the parent at the time when the prohibition decision is

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[99] See e.g. *Gas insulated switchgear* (Case COMP/38.399) Commission Decision C(2006) 6762 [2008] OJ C5/7, para 491; *Copper fittings* (Case COMP/38.121) Commission Decision 2007/691/EC [2007] OJ L283/63, paras 766–773 (multiplier applied to Tomkins and Pegler); *MCAA (Monochloroacetic acid)* (n 81), paras 298–300; *Hydrogen peroxide (and perborate)* (n 81), paras 463–466; *Methacrylates* (n 81), paras 337–350. The approach is still used in more recent cases, see e.g. *Rechargeable batteries* (Case AT.39904) Commission Decision C(2016) 8456 [2017] OJ C117/9, paras 97–98.

[100] *Hydrogen peroxide (and perborate)* (n 81), para 463.

[101] Ibid, para 465.

[102] See text accompanying n 53 above.

[103] Case T-566/08 *Total Raffinage Marketing v Commission* ECLI:EU:T:2013:423, paras 437–464; Case T-112/07 *Hitachi and Others v Commission* ECLI:EU:T:2011:342, paras 349–355; Case T-189/06 *Arkema France v Commission* ECLI:EU:T:2011:377, paras 110–121; *Akzo Nobel and Others v Commission* (n 52), paras 17, 57–66, 90–91.

[104] Case T-386/06 *Pegler v Commission* ECLI:EU:T:2011:115, para 133. Note that under the 1998 Fining Guidelines (n 59) there were two different criteria for determining economic strength. The Commission could base the deterrence multiplier either on the undertaking's "legal and economic knowledge and infrastructures" (during the infringement) or its "effective economic capacity" (at the time of the prohibition decision).

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adopted.[105] This finding was soon after confirmed in *Arkema France*.[106] In both cases, the subsidiary was sold – and the single economic unit broken – after the infringement ended, but before the Commission adopted the prohibition decision. The GC found that, in such cases, the Commission must fix a separate multiplier (or none at all) exclusively for the former subsidiary.

In *Slovak Telekom*, the decision leading to the *Deutsche Telekom* judgment already mentioned,[107] the Commission deviated from its usual approach to apply the deterrence multiplier uniformly to the parent company and the subsidiary. Given the *Deutsche Telekom* group's worldwide turnover of more than 60 billion euros, the Commission considered a deterrence multiplier of 1.2 to be appropriate, but made it clear that it should only apply to the parent company.[108] The Commission thus followed the same approach as with the recidivism multiplier, which it had also applied only to the parent company.[109] The GC, however, saw things differently. While it classified recidivism as a factor that may characterise the conduct of the parent company individually and can therefore require a higher fine to be imposed on the parent company than on the subsidiary,[110] the Court rejected the same approach with regard to the deterrence multiplier.[111] On the substance, this was the right decision, but, with all respect, the reasoning was not convincing. First, the GC made the rather circular argument that the higher turnover of the parent company could not individually characterise the parent's conduct for the purpose of calculating the fine, because its liability was "purely derivative from the liability of its subsidiary".[112] Whether this was the case, however, was precisely the question that the GC had to answer. The Court then added that the mere establishment of turnover was an "element of fact" which could not individually characterise the conduct of the parent company.[113] Unfortunately, this is also a rather strange explanation. Apparently, the GC wanted to focus on the behaviour of the parent company, as opposed to dry data such as turnover figures. However, the recidivism multiplier is not intended to punish again past behaviour (just think of the *ne bis in idem* principle[114]), but rather – just like the deterrence multiplier – to create an additional deterrent effect for the future.

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[105] In *Tomkins v Commission* (n 55), a parallel decision to *Pegler v Commission* (n 104), the GC indicated at paras 56–59 that the deterrence multiplier should not be applied even to the parent company (still having the high turnover justifying the increase for deterrence) if it is no longer possible to apply that multiplier to the subsidiary.

[106] *Arkema France and Others v Commission* (n 84), paras 272, 277–280. See also Case T-40/10 *Elf Aquitaine v Commission* ECLI:EU:T:2014:61, paras 350–357.

[107] See text accompanying nn 77–80 above.

[108] *Slovak Telekom* (n 61), paras 1534–1535. Before the GC, the Commission argued that it could have applied the multiplier also to the subsidiary, but it decided against it in the exercise of its wide discretion. See *Deutsche Telekom v Commission* (n 53), para 490.

[109] *Slovak Telekom* (n 61), paras 1531. See also text accompanying n 77 above.

[110] See text accompanying n 78 above.

[111] *Deutsche Telekom v Commission* (n 53), paras 501–514, 515–522. See also Case C-179/12 *The Dow Chemical Company v Commission* ECLI:EU:C:2013:605, paras 79–83.

[112] *Deutsche Telekom v Commission* (n 53), para 520.

[113] Ibid, para 520.

[114] The GC has so far rejected all claims that taking into account recidivism is in conflict with the principle of *ne bis in idem*, see *Arkema France and Others v Commission* (n 84), paras 285–302; *Groupe Danone v Commission* (n 92), paras 356–369. However, this finding only holds where

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In conclusion, however, it is correct that the GC seeks to have the deterrence multiplier applied to all members of the economic entity. As shown above,[115] the problem is that it does not hold the same view for the recidivism multiplier. The correct approach would be to focus the application of both multipliers on the corporate group as a whole and not on its individual members. As indicated above in Section 3, this is generally the right method to ensure that the calculation of fines correctly reflects the true economic strength of the economic unit and provides the necessary incentives for future compliance. It is also to be welcomed that the GC, because of the forward-looking perspective on the calculation of fines, assumes that the relevant point in time for determining the deterrence multiplier is the time of the prohibition decision. Therefore, if the group's consolidated turnover at that date exceeds the thresholds defined by the case law, the Commission should impose an increased fine on all liable entities.

If a restructuring takes place between the end of the infringement period and the Commission's decision, the Commission may well take this into account, as the GC requested in the *Pegler* case.[116] For this purpose, the Commission should examine what corporate links exist at the time of the decision and then determine, on the basis of the respective group turnover, whether or not the application of the deterrence multiplier is justified in each case. However, the Commission should not focus only on the economic units that it has defined for the purpose of establishing liability. Rather, it is important that the need for deterrence is measured for each legal entity on the basis of the relevant group turnover, as outlined above.[117] For example, if the infringing subsidiary leaves the economic unit after the infringement but before the prohibition decision, different fines may be imposed on that subsidiary and on the other members of the former economic unit. For the purpose of the deterrence multiplier, it is necessary to determine whether the subsidiary, on the one hand, and the other members of the former economic unit, on the other hand, form a group with other companies at the time of the prohibition decision. If so, the consolidated accounts of the group should be used for the deterrence multiplier. This has nothing to do with the former economic unit, which is relevant for the determination of liability.

4.3 10% Turnover Cap

According to Article 23(2) of Regulation 1/2003 and Point 32 of the Fining Guidelines, the final amount of the fine imposed for an infringement of Article 101 or 102 TFEU shall not exceed 10% of the undertaking's total turnover in the business year preceding the prohibition decision. The objective of this upper limit is to ensure the proportionality of the fine and that it does not exceed the financial capacity of the undertaking addressed.[118] The relevant

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"the Commission did no more than take into account a number of factual considerations which were considered to be relevant for the purposes of setting the fine at a level which would ensure that it would have a sufficiently deterrent effect and by no means found against the applicants twice for the same infringement", as the GC phrased it in *Arkema France and Others v Commission* (n 84), para 298.

[115] See text accompanying n 95 above.

[116] See text accompanying n 104 above.

[117] See Section 3.2.

[118] Case C-619/13 P *Mamoli Robinetteria v Commission* ECLI:EU:C:2017:50, para 83; *Groupe Gascogne v Commission* (n 35), para 48; Case C-189/02 *Dansk Rørindustri and Others v*

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point in time for the application of the 10% turnover cap is therefore the date of the prohibition decision. The Courts have also clarified that in the case of groups of companies, it is in principle the turnover of the whole group that must be taken into account.[119] In particular, as already mentioned,[120] the ECJ has held in *Groupe Gascogne* that, where the Commission has established to a sufficient degree that an infringement can be attributed to a company which heads a corporate group, it may refer, for the assessment of the 10% cap, to the group's consolidated turnover as determined according to Article 1(1) of Directive 83/349,[121] which has since been replaced by Article 22(1) of the Accounting Directive 2013/34.[122] As explained above,[123] focusing on group turnover is the right approach, but the calculation of turnover should not depend on which legal entities are held liable for the infringement. The calculation should be based on the groups of companies as they exist at the time of the decision, not on the economic unit at the time of the infringement.

The basic rule regarding the application of the 10% limit to corporate groups is therefore as simple as it is convincing, but the Courts have introduced important qualifications, some of which entail considerable difficulties. First, the ECJ, confirming earlier judgments by the GC,[124] has held in *Kendrion* that, where two separate legal persons, such as a parent company and its subsidiary, no longer constitute a single economic unit on the date of the prohibition decision, each of them is entitled to have the 10% ceiling applied individually to itself.[125] The most common case is where the subsidiary is sold after the infringement but before the decision. In *Industrial bags*, for example, the decision leading to the *Kendrion* judgment, the Commission set the fine for Kendrion at 34 million euros but capped the fine for Kendrion's former subsidiary Fardem Packaging at 2.2 million euros because Fardem had left the Kendrion group two years before the prohibition decision.[126] Without the limit, Fardem should have been fined 60 million euros (it had participated in the infringement longer than Kendrion), but Fardem's turnover in the year preceding the decision was only a little more than 22 million euros.[127] In principle, this approach is correct, because if the subsidiary actually no longer has access to the resources of the group when the fine is imposed (and eventually enforced), there would be no point in including these resources in the calculation of the fine. However, it appears that the Commission and the Courts do not examine whether the subsidiary, following the change of control, belongs to a different economic unit at the date of the prohibition decision. That would be wrong. As explained above,[128] the turnover cap for

Commission ECLI:EU:C:2005:408, paras 280–281.

[119] Case T-191/06 *FMC Foret v Commission* ECLI:EU:T:2011:277, para 324; *Akzo Nobel and Others v Commission* (n 52), para 90; Case T-9/99 *HFB and Others v Commission* ECLI:EU:T:2002:70, paras 528–529.

[120] See text accompanying n 42 above.

[121] See n 43.

[122] See n 44.

[123] See text accompanying nn 47–48 above.

[124] Case T-54/06 *Kendrion v Commission* ECLI:EU:T:2011:667, paras 90–93; Case T-71/03 *Tokai Carbon v Commission* ECLI:EU:T:2005:220, paras 387–393.

[125] Case C-50/12 P *Kendrion v Commission* ECLI:EU:C:2013:771, para 57.

[126] *Industrial bags* (Case COMP/38.354) Commission Decision C(2005) 4634 [2007] OJ L282/41, paras 814, 820, 879.

[127] Ibid, paras 784, 820; *Kendrion v Commission* (n 125), para 57.

[128] See text accompanying nn 47–48 above.

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each addressee should be calculated on the basis of the consolidated turnover of the group to which it belongs at the time of the prohibition decision.

Much greater difficulties are, however, raised by the 2014 *YKK* ruling of the ECJ.[129] In this case, the subsidiary had been acquired by the parent company only during the infringement, i.e., the parent company effectively bought itself into a cartel. There were therefore two periods to be distinguished. In the first period, the later subsidiary (which was initially not yet part of the YKK group and thus not yet a subsidiary) was the sole perpetrator; in the second, the subsidiary committed the infringement as part of an economic unit with its new parent company. In such cases, the different participation is typically reflected by applying a separate duration multiplier for each company. In *YKK*, the question arose as to whether a distinction should also be made between the two periods with regard to the 10% turnover limit. Quite surprisingly, the ECJ answered in the affirmative.[130] It held that, with respect to the first period in which only the later subsidiary committed an infringement, the Commission must apply the 10% limit solely based on the turnover of the subsidiary. Thus, the Court reduced the fine imposed exclusively on the subsidiary for the period before its acquisition from 19.25 million to just under 2.8 million euros.[131] This was without prejudice to the joint and several liability of the parent company and the subsidiary in respect of the second period, during which both committed the infringement as part of a single economic entity and for which the fine was set at 49 million euros.

It is respectfully submitted that this approach of determining a separate 10% cap for the subsidiary is wrong, whether or not the subsidiary has committed part of the infringement alone. It is already not very logical that the ECJ argued, in *YKK*, that the 10% limit was designed to protect the financial capacity of the undertaking concerned and therefore capped the subsidiary's fine for the first period at about 2.8 million euros, while accepting that the subsidiary was held liable for an additional 49 million euros with respect to the second period (albeit jointly and severally with the parent company). However, at the time of the prohibition decision, there is only one subsidiary with a certain financial capacity. Only this can be decisive. It is also unconvincing that the ECJ refers for its approach to the principle of personal responsibility and the principle that penalties must be specific to the offender and the offence,[132] even though the Court had decided less than six months earlier in *Siemens Österreich* that these principles "relate only to the undertaking *per se*, not the natural or legal persons forming part of the undertaking".[133]

Moreover, the ECJ in *YKK* seems to have confused the question of liability with the calculation of fines.[134] Contrary to what the ECJ claimed in the grounds of the judgment,[135] it is not convincing that the concept of an "undertaking participating in the infringement", to which reference is made in Article 23(2) Regulation 1/2003, "cannot be capable of differing inter-

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[129] Case C-408/12 *YKK and Others v Commission* ECLI:EU:C:2014:2153. See also Case C-637/13 P *Laufen Austria v Commission* ECLI:EU:C:2017:51, paras 44–51.

[130] *YKK and Others v Commission* (n 129), paras 55–68.

[131] Ibid, paras 95–99.

[132] Ibid, para 66.

[133] *Commission v Siemens Österreich and Others* (n 9), para 56.

[134] See also *YKK and Others v Commission* (n 129), para 65, where the ECJ refers to an earlier ruling on the attribution of liability to make an argument regarding the calculation of fines.

[135] Ibid, para 59.

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pretations" for the purposes of attributing liability and applying the 10% cap. In fact, such a differentiated approach would not only be possible, but it would also be good policy. As both the ECJ and the GC have acknowledged,[136] the relevant point in time for determining the 10% limit is – and must be – the date on which the prohibition decision is adopted. It is therefore only at this time that the economic strength of the subsidiary can be determined. This view appears to be shared by the ECJ, which, in *YKK*, based the calculation of all 10% limits on turnover in the year preceding the decision.[137] However, it makes no sense to approximate the economic strength of the subsidiary with two different values, one taking into account the turnover of the parent company and the other not. Either the subsidiary can tap into the resources of the parent company or not. If the assumption is (and this is generally correct) that the economic power of a group of companies can only be assessed uniformly, then this must also apply in cases like *YKK*.

A related problem is that the ECJ's approach runs the risk of inviting evasive behaviour. It is obvious that turnover can easily be shifted within corporate groups. As group managements inevitably become aware of cartel investigations, they may, in future "YKK cases", artificially reduce the turnover of the subsidiaries concerned. At the very least, the Commission should, therefore, not refer to the year preceding the decision (when companies are usually well aware that fines are about to be imposed), but to a period before the investigations become known. However, it would be even better if the Courts were to abandon the YKK differentiation and allow the 10% cap to be calculated uniformly for the entire group at the time of the decision, irrespective of who was involved in the competition law infringement at what time and in what form.

4.4 Inability to Pay

While the 10% turnover limit is a rather crude attempt to ensure that fines are proportionate and do not overburden their addressees economically, there is another instrument which gives the Commission greater leeway in individual cases. Under Point 35 of the Fining Guidelines, the Commission may, upon request, take account of the undertaking's inability to pay in a specific social and economic context.[138] The rationale behind this is that it would be a disservice to competition if the number of companies in the market were to be reduced as a result of the Commission's intervention.[139] The Commission also seeks to limit the social and economic consequences for uninvolved third parties, such as employees or business partners in upstream or downstream markets.[140] But the requirements are high. It is clear from Point 35 and the case law, that even a high risk of insolvency is not sufficient

[136] *Laufen Austria v Commission* (n 129), para 48; *YKK and Others v Commission* (n 129), para 64; Case T-411/10 RENV *Laufen Austria v Commission* ECLI:EU:T:2017:598, paras 39–41.

[137] *YKK and Others v Commission* (n 129), paras 58, 60, 68, 97.

[138] See also Information Note of 12 June 2010, Sec(2010) 737/2.

[139] Alison Jones, Brenda Sufrin & Niamh Dunne, *Jones and Sufrin's EU Competition Law* (8th edn, OUP 2023) 980–81; Antoine Colombani, Jendrich Kloub & Ewoud Sakkers, 'Cartels' in Jonathan Faull and Ali Nikpay (eds), *The EU Law of Competition* (3rd edn, OUP 2014) para 8.690.

[140] Cf Case C-308/04 SGL Carbon v Commission ECLI:EU:C:2006:433, para 106.

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it itself.[141] The decisive factor is not the consequences for the individual company, but the damage to society. Thus, a fine reduction under Point 35 will only be considered if the Commission is convinced that the normal fine would not only put the infringing company in difficulty but would also have other serious consequences.

With regard to groups of companies, the Commission, with the support of the Courts, is taking a very broad approach.[142] It is clear that the focus is on the economic unit and not on its individual members. The Commission even takes into account relations with outside financial partners such as banks and includes in its analysis the relations with shareholders (including those of the parent company), examining, inter alia, their ability to assist the undertaking concerned financially. It is difficult to review the practice in detail because the question of solvency is, of course, a sensitive issue, and the Commission therefore redacts the published version of its decisions very generously to ensure confidentiality. More information can sometimes be found in court decisions. In *Moreda-Riviere Trefilerías*,[143] for example, one of the judgments following the Commission's *Prestressing steel* decision,[144] the GC also had to review the Commission's assessments of the applicants' ability to pay. Even the applicants – four members of a group of companies – had not objected to the fact that the Commission had primarily focused on the solvency of the parent company. The Court has also confirmed that it is not objectionable for the Commission to affirm the solvency of the group when, although the parent company does not have sufficient resources to pay the fines, it can obtain the money on the market because it still enjoys the confidence of its creditors.[145] Furthermore, the Court confirmed that the solvency of the shareholders of the parent company can also be taken into account. This applies even if the Commission could not hold them liable for the infringement.[146]

It is obvious that this decision-making practice can have considerable economic consequences for the companies concerned. But it is in line with the above finding that it is the true economic strength of the whole corporate group that must matter for the calculation of fines.[147] Any failure to do so would inevitably invite strategic behaviour and could encourage companies to deliberately bankrupt the subsidiaries concerned by transferring assets to other parts of the group. The Commission has recognised this and expressly refers to the risk of inviting "financial engineering and corporate restructuring, aimed at avoiding the payment of the fine" in its 2010 information note on the application of the inability-to-pay rule.[148] Given the often substantial level of competition law fines, this is a serious concern.

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[141] Case T-352/09 *Novácke chemické závody v Commission* ECLI:EU:T:2012:673, paras 188–190.

[142] See e.g. *Retail Food Packaging* (Case AT.39563) Commission Decision C(2020) 894 [2021] OJ C245/13, paras 71–93; *Mushrooms* (Case AT.39965) Commission Decision C(2016) 1933 [2017] OJ C67/5, paras 151–169. See also European Commission, Questionnaire Regarding Inability to Pay, October 2015.

[143] Case T-426/10 *Moreda-Riviere Trefilerías and Others v Commission* ECLI:EU:T:2016:335.

[144] *Prestressing steel* (Case COMP/38.344) Commission Decision C(2010) 4387 [2011] OJ C339/7.

[145] *Moreda-Riviere Trefilerías and Others v Commission* (n 143), paras 509–515.

[146] Ibid, paras 521–525.

[147] See text accompanying nn 40–41 above.

[148] Information Note (n 138), para 4.

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Although it may have severe consequences in individual cases, the Commission's practice therefore seems generally appropriate and justified.

5. CONCLUSION

The analysis in this chapter has shown that the EU Courts do not sufficiently distinguish between the different purposes for which they refer to groups of companies rather than individual legal entities in competition law. In particular, they do not sufficiently take into account that the calculation of fines is based on different considerations than the determination of liability. In order to avoid the difficulties that have arisen in the past when the Commission and the Courts have calculated fines for companies that are part of groups, the following should be considered:

First, where several members of a group of companies are held liable, there is usually a strong case for setting a single fine. It is very unlikely that the final distribution of the fine within the group can be controlled by the prohibition decision. Moreover, the EU Courts have rightly ruled that the internal allocation of the fine does not fall within the competence of the EU institutions.

Second, the relevant period for determining liability is the period in which the competition law infringement took place. However, the relevant time for the calculation of the fine is the time of the prohibition decision. This is because one of the most important objectives of imposing fines is specific deterrence, and therefore, the assessment of fines must be forward-looking.

Third, fines will only have a deterrent effect on groups of companies if the calculation takes into account the economic strength of the group as a whole. Therefore, when the Commission imposes a fine on a company which is part of a group, it should be entitled to rely on consolidated accounts as defined in Chapter 6 of the Accounting Directive. This should not depend on whether the Commission also holds other members of the group liable.

Fourth, the calculation of the fine should always be based on the group as it exists at the time of the prohibition decision. This should also apply to the application of the recidivism multiplier, which the Commission uses according to Point 28 of the 2006 Fining Guidelines. It is not convincing that the GC wants to restrict the multiplier's application to individual members of the group. The reasons for applying the multiplier are typically present in all members or none.

Fifth, the deterrence multiplier should be applied whenever the turnover of the respective group of companies justifies it. It should be applied to all liable companies that belong to the respective group of companies at the time of the prohibition decision.

Sixth, the application of the 10% turnover cap should take into account the turnover of the whole group as it exists at the time of the prohibition decision. It is therefore correct that the Commission should take into account whether an economic unit was broken before the prohibition decision. But it should also take into account whether a new unit has been created. The *YKK* doctrine, according to which a separate application of the 10% cap is necessary for periods during which a company that later becomes part of an economic unit was still independent (i.e., not yet controlled by a member of the economic unit), should be abandoned.

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Finally, exceptions due to inability to pay should only be granted if the economic viability of the entire group of companies is threatened. Focusing on a single member of the group would inevitably invite circumvention of the law by transferring assets within the group.

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11. Family Ties and the Boundaries of the Firm in Antitrust Law

Mariana Pargendler, Maria Luiza Mesquita e Silva and Lucas Víspico

1. INTRODUCTION[1]

The tension between economic substance and legal entity boundaries raises numerous questions for the application of antitrust law.[2] Veil peeking or regulatory departitioning – understood as the disregard of corporate separateness for purposes of the imputation of legal rights and duties – has long been commonplace in the field.[3] Although only natural and legal persons may be parties to legal proceedings and addressees of legal sanctions, numerous antitrust law rules rely on the broader concepts of enterprise, undertaking, or single economic unit, which often aggregate different legal and natural persons.[4] The concept of an undertaking is used both as a sword, in expanding the scope of merger review and of intra-group liability for anticompetitive agreements to account for related entities, and as a shield, serving as a defense to antitrust scrutiny of agreements between entities belonging to the same group. More recently and controversially, the Court of Justice of the European Union (EU) has relied on the concept

[1] We thank Amanda Athayde, Kevin Davis, Teodora Groza, Luther Lie, Daniel Favoretto Rocha, Florence Thepot, Anna Tzanaki, and participants in the Handbook workshop at the University of Mannheim for helpful comments and discussions. We are grateful to Beatriz Brichucka, Begüm Çiçekdag and Bruna Zanini for excellent research assistance.

[2] See, e.g., Herbert Hovenkamp, 'American Needle and the Boundaries of the Firm in Antitrust Law' (2010) 14 https://ssrn.com/abstract=1616625 accessed 3 April 2023 (concluding that the "corporate form under state law does not matter" in the U.S. antitrust jurisprudence); Herbert Hovenkamp, 'The Power of Antitrust Personhood' (2023) 25 U Pa J Bus L 891 (arguing that gaps in antitrust law's treatment of personhood have unduly favored vertical integration over contractual integration); Anna Tzanaki, 'Varieties and Mechanisms of Common Ownership: A Calibration Exercise for Competition Policy' (2022) 18 J Compet Law Econ 168 (describing the challenges associated with a formalistic conception of *de jure* control under EU merger policy).

[3] Mariana Pargendler, 'Veil Peeking: The Corporation as a Nexus for Regulation' (2021) 169 U Pa L Rev 717.

[4] For a discussion, see Marcos Araujo Boyd, 'Undertakings and Legal Entities as Addressees of Articles 101 and 102 TFEU' (in this Handbook). For a proposal to distinguish the concepts of undertaking and single economic unit, see Stephen Daly and Alison Jones, 'The Undertaking and Single Entity Doctrine in EU and UK Competition Law: Proposals for a Refined Approach' (in this Handbook); Carsten Koenig, 'Enforcement of EU Competition Law Against Groups of Companies: The Calculation of Fines' (in this Handbook). While Sections 1 and 2 of the Sherman Act address "persons," EU competition rules focus on "undertakings." See Marcos Araujo Boyd, 'Should Children Pay for Their Parent's Sins? The Sumal Preliminary Reference' (2021) 12 J Eur Compet Law Pract 25.

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of an undertaking to impose liability on affiliated companies within the group, thereby mitigating the attribute of asset partitioning provided by the corporate form.[5]

Most cases and scholarly writings on the definition of an undertaking concern whether or not to peek behind the corporate veil of *legal persons* linked by equity ties to treat them as a single economic unit for purposes of the application of antitrust law rules. This chapter takes a different view by focusing on veil peeking of *natural persons* under antitrust law. As one of us has argued in previous work, separate personality – be it of legal persons or of natural persons – creates a distinct nexus of imputation of legal rights and duties, but does not necessarily entail legal insulation from other persons in corporate law as in other areas of law.[6] Legal personality of legal and natural persons does not operate as a nonconductor, but rather as a semi-permeable membrane.[7] This chapter underscores this permeability in antitrust law by showing how the presence of family connections between different individuals can lead to different outcomes in antitrust enforcement.

Specifically, we highlight how various decisions around the world have considered family ties in the contexts of merger control and review of anticompetitive agreements. The cases we focus on do not merely concern family-controlled firms, which is the dominant form of business ownership around the world. Nor do they merely concern decisions that aggregate various entities controlled by the same group of family members. In the latter scenarios, the presence of family control – as opposed to other types of controlling shareholders – does change the analysis. Rather, we concentrate on a distinct set of fact patterns, in which antitrust authorities rely on family ties to legally connect entities that are controlled by *different persons*.

The Mataboi case in Brazil offers an illustrative example of such an approach. Brazil's antitrust authority (*Conselho Administrativo de Defesa Econômica* – CADE) initially sought to undo the acquisition of the slaughterhouse Mataboi by JBJ in 2017, not because the acquisition posed a threat to competition if JBJ were analyzed in isolation, but because of JBJ's links to the giant meat company JBS. Interestingly, while there were no significant equity ties between JBJ and JBS, there were relevant *family ties* connecting the two companies: the controlling shareholder of JBJ was a *brother* of the controlling shareholders of JBS, and their *father* was a shareholder and board member of JBS. This case also shows how the reliance on family ties in antitrust enforcement can be contested: the deal moved forward after a court issued a preliminary injunction suspending CADE's decision seeking to undo the deal, although subject to concessions made in a settlement with CADE.[8]

The Mataboi decision is not unique in spotlighting the role of family connections in antitrust enforcement, nor is the tendency limited to Brazil. We find cases that rely on family

[5] Case C-882/19 *Sumal, SL v Mercedes Benz Trucks España*, EU:C:2021:800. See also Carsten Koenig, 'An Economic Analysis of the Single Economic Entity Doctrine in EU Competition Law' (2017) 13 J Compet Law Econ 281.

[6] For previous general articulations of this argument for legal and natural persons, see Mariana Pargendler, 'Regulatory Partitioning as a Key Function of Corporate Personality' in Elizabeth Pollman and Robert Thompson (eds), *Research Handbook on Corporate Purpose and Personhood* (Edward Elgar 2021); Mariana Pargendler, 'The Fallacy of Complete Corporate Separateness' (2024) 14 Harv Bus L Rev Online 1. For an analysis of this topic in corporate law, see Mariana Pargendler, 'The New Corporate Law of Corporate Groups' (2024) 14 Harv Bus L Rev 339.

[7] Pargendler, 'The Fallacy of Complete Corporate Separateness' (n 6).

[8] See Part 2.2.1 below.

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links in the application of antitrust rules in Argentina, Brazil, Indonesia, and Turkey. Antitrust authorities have considered family ties in various contexts relating to merger review, such as in calculating the turnover threshold for merger notification (in Argentina and Turkey), in assessing the anticompetitive effects of a proposed merger (as in Brazil's Mataboi case and in Turkey), and in defining the occurrence of a change of control for purposes of notification (in Turkey). Competition authorities have also taken family ties into account when scrutinizing agreements in restraint of trade, but to different effects. Authorities in Brazil and Indonesia have cited family ties between shareholders of different legal entities as evidence supporting a finding of bid rigging; in other words, family ties operated as a *sword* to support convictions. By contrast, the Turkish competition agency has used family ties as a *shield* in recognizing a single entity defense to bid rigging of companies controlled by members of the same family.

Although the European Commission's 2008 Consolidated Jurisdictional Notice explicitly mentions the potential relevance of "family links" for purposes of defining control in the context of merger review,[9] antitrust cases that hinge on family ties between different natural persons appear to be much more common in the Global South.[10] This finding is consistent with the particularly strong prevalence of family ownership of enterprises in developing countries as an adaptation to a weak institutional environment.[11] The relevance of family ties in antitrust enforcement in developing countries points to a heretofore unnoticed source of variation in comparative antitrust law across Global South-North lines, and shows the adaptability of Global South institutions to local circumstances.

The role of family ties in antitrust enforcement also provides lessons for the interplay between different "persons" under the law and the legal definition of the boundaries of the firm. First, it confirms that legal personhood does not confer complete legal insulation to either legal or natural persons.[12] Second, it shows that, unlike exceptions to asset partitioning in the form of veil piercing, the mitigation of regulatory partitioning among family members does not require a showing of fraud or abuse.[13] Third, the treatment of family ties confirms

[9] Commission Consolidated Jurisdictional Notice under Council Regulation (EC) 139/2004 on the control of concentrations between undertakings (EC Merger Regulation) [2008] OJ C95/01. Family ties can also play a relevant role in assessing the abuse of a collective dominance position. See Joined Cases C-395/96 P and C-396/96 P *Compagnie maritime belge transports SA, Compagnie maritime belge SA and Dafra-Lines A/S v Commission of the European Communities* [2000] ECR 2000 I-01365, Opinion of AG Fennelly, para 28 (arguing that economic links "might be the use of model conditions of supply drawn up by a common trade association […], cross-shareholdings, common directorships or even family links with economic consequences").

[10] We use "Global South jurisdictions" and "developing countries" interchangeably throughout this chapter.

[11] Randall Morck and Bernard Yeung, 'Family Control and the Rent-Seeking Society' (2004) 28 Entrep Theory Pract 391 (describing the advantages of oligarchic families for political rent-seeking); Ronald J. Gilson, 'Controlling Family Shareholders in Developing Countries: Anchoring Relational Exchange' (2007) 60 Stan L Rev 633 (suggesting that family-owned corporations, as long-term repositories of reputation, have advantages in anchoring relational exchanges in environments with weak institutions of contract enforcement).

[12] See Pargendler, 'The Fallacy of Complete Corporate Separateness' (n 6).

[13] Unlike veil peeking, veil piercing, which tempers the separation between the entity's assets and those of its members, generally requires a showing of fraud or commingling of assets. See Pargendler (n 3).

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the notion – highlighted elsewhere in this Handbook – that the use of veil peeking or regulatory partitioning to define an undertaking or single economic unity in antitrust law may take different forms depending on the underlying legal question.[14] Recall that Brazil's competition authority has considered family ties in expanding the scope of merger review, but has been unwilling to recognize that family links give rise to a single economic entity as a defense to bid rigging.

Before proceeding, one caveat is in order. As previously mentioned, we have circumscribed our scope of analysis to cases in which authorities relied on family ties to find connections between natural persons and thereby impute relationships to different companies that are not otherwise linked by significant equity ties. We have excluded cases – found in EU jurisprudence, Argentina, and Brazil that are sometimes discussed under the rubric of "family links" – in which the same family group or individual family member controls different companies or there are family ties among shareholders of the same company.[15] In our view, the latter cases

[14] See Araujo Boyd (n 4); see also Daly and Jones (n 4).

[15] In *Dansk Rørindustri*, the Grand Chamber of the Court of Justice confirmed the European Commission's understanding that treated the Henss/Isoplus group as a single undertaking and held several of its companies jointly and severally liable. Although it mentioned that "Mr. Henss [...] and his wife held all the shares of the companies", the decisive aspect of the case was the fact that Mr. Henss controlled the companies and exerted a strong influence over them. The family connection did not affect the finding of control in this case. Case C-189/02 P *Dansk Rørindustri and Others v Commission* [2005] ECR I-05425. Similarly, a 2017 decision by CADE in Brazil considered the turnover of other companies in which Jacob Barata, shareholder and president of Util, held an equity interest of 20% or more in assessing whether Util had to notify a transaction. CADE mentioned that the family ties between Jacob Barata and other Util shareholders, in addition to his managerial post and shareholdings in the company, would provide evidence of his potential influence over Util. The authority concluded that Util and the other companies in which he held 20% or greater equity interest formed a single "economic group." *União Transporte Interestadual De Luxo S.A. e Expresso Gardênia Ltda* Case No 08700.011294/2015-12 (Decision of the Brazilian Administrative Council for Economic Defense, 23 November 2017). In the *Anhanguera* case, the Brazilian antitrust authority noted the complex corporate arrangements through which the Rodrigues family exerted its influence not only on the acquirer but also on other companies. CADE ultimately fined family members for misleading disclosures about their shareholdings. *Anhanguera Educacional Ltda* Infraction Notice No 08700.00545112013-80 (Decision of the Brazilian Administrative Council for Economic Defense, 24 June 2013). Other cases have alluded to family control across distinct companies. See Case IV/M.754 *Anglo American Corporation/ Lonrho*, Commission Decision 98/335/EC [1998] OJ L149 (consolidating all Lonrho stakes connected to the Oppenheimer family to determine whether Lonrho would be under the sole influence of Anglo American Corporation's influence, which was controlled by the family); Case C-407/08 P *Knauf Gips v Commission* [2010] ECR I-06375 (treating different companies owned and managed by the Knauf family as a single economic unit); *AMX Argentina S.A. y Telmex Argentina S.A* Case OPI No 190 (Resolution No 542 issued by the Secretary of Domestic Trade pursuant to Opinion No 844 issued by the Argentinian Antitrust Commission, 17 December 2010) (finding that, because Slim Helú and his six children controlled the companies before and after the transaction, this constituted a mere corporate restructuring that did not require notification). But see Case C-196/99 P *Siderúrgica Aristrain Madrid SL v Commission of the European Communities* [2003] ECR I-11005 (finding that the simple fact that the same person or family holds shares in two separate companies is insufficient in itself to establish an economic unit between them). While

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are best interpreted as instances of common ownership and control that are not conceptually distinct just because the relevant controller is a family rather than any other type of controlling shareholder. While family control may well have implications for antitrust enforcement,[16] our goal is to spotlight antitrust law's willingness to disregard legal separation between different natural persons in defining the boundaries of the firm and the application of its rules.

The remainder of this chapter is structured as follows. Part 2 examines cases in which competition authorities in Argentina, Brazil, and Turkey considered family ties in determining the trigger for merger notification or assessing the anticompetitive effects of a merger. Part 3 describes how family links have been used to support convictions for anticompetitive agreements in restraint of trade in Brazil and in Indonesia. By contrast, Turkey's competition authority has relied on family ties to recognize a single entity defense in a case of bid rigging. We conclude by reflecting on the implications of our findings for the broader understanding of regulatory partitioning and veil peeking, as well as for comparative antitrust law.

2. FAMILY TIES AND MERGER CONTROL

Various decisions across jurisdictions have considered family links in cases of merger control, be it in calculating the minimum financial threshold (turnover or equivalent) for notification, in determining the occurrence of a change of control, or in assessing the anticompetitive effects of the transaction.

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our analysis in this chapter focuses on merger review and control of anticompetitive agreements, there are also cases of family ties in EU state aid law. In *Micula*, the European Commission found that two brothers, who collectively held 99.96% of the European Food and Drinks Group, formed a single economic unity together with three other companies of the group. Since the European Union's state aid law is applicable to undertakings, it concluded that neither the two brothers individually nor their three companies could receive compensation for the losses suffered by an abrupt suspension of investment incentives. According to the Commission, this would constitute a selective economic advantage incompatible with the Treaty on the Functioning of the European Union. Case ARB/05/20 *Micula/Romania*. Commission Decision 2015/1470 [2015] OJ L232/43. In another case concerning state aid, the European Court of Justice confirmed that HaTeFo was linked to the X company not only because of their financial relationship but also due to the family ties among their respective shareholders. In that case, the individuals A, B (A's spouse) and C held 24.8%, 62.8% and 12.4% of the shares in HaTeFo, while A and his mother D held equal shares in X. A and C were managing directors in both companies. The Court noted that, if individually considered, HaTeFo could be qualified as a micro, small or medium enterprise (SME). However, considering the company's financial relationship and the family ties among their shareholders, it asserted that they should be treated as "linked enterprises." After taking X's number of employees and annual turnover into account, it concluded that HaTeFo did not qualify as an SME. Case C-110/13 *HaTeFo GmbH v Finanzamt Haldensleben* [2014] EU:C:2014:114.

[16] See, e.g., Mario Daniele Amore and Riccardo Marzano, 'Corporate Ownership and Antitrust Violations' (2022) 65 J L Econ 369 (finding that family firms are less likely to be involved in antitrust indictments).

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2.1 Determination of the Trigger for Merger Notification

2.1.1 Argentina

In 2013, Argentina's competition authority (*Comisión Nacional de Defensa de la Competencia* – CNDC) took family links into account in calculating the turnover threshold required for merger review. Alimentaria Conosur ("Alimentaria," previously called Conosur Comunicaciones) had purchased from Inverinter approximately 98% of the shares of Lácteos Conosur, a producer of milk, *dulce de leche*, and yogurt.[17] The question before the CNDC was whether the parties' combined volume of business met the minimum threshold of AR$200,000,000 then required for mandatory merger review.[18] While the parties argued that only the volume of business of Lácteos Conosur should be considered, the CNDC examined the shareholder composition of Alimentaria and considered existing family ties to consolidate other businesses for the purpose of calculating total turnover.[19]

The Commission noted the existence of family links between Alimentaria shareholders (a mother and two sons), who together held 50% of the shares of the company, and the father and husband who, though not a shareholder in Alimentaria, controlled other companies.[20] Interestingly, the decision referred to the European Commission's approach of considering family links on a case-by-case basis to assess de facto control.[21] Since the links in this case were between "*padre e hijos*" (father and sons), the CDNC deemed the companies controlled by the father to be part of a single control group, and consolidated their respective turnovers.[22]

2.1.2 Turkey

Turkey's competition authority (*Rekabet Kurumu*) has consistently used family ties to define the boundaries of an economic unit for purposes of merger notification, as exemplified by the

[17] See Alfredo M. O'Farrell and Miguel Del Pino, 'Control structure based on family ties – new precedent' (*Lexology*, 5 February 2014) https://www.lexology.com/library/detail.aspx?g=36a0bb2f-0fa2-48be-93f6-cf0ce4adbcaa accessed 5 April 2023; see also *Inverinter SA, Conosur Comunicaciones S.A. La Suipachense Cooperativa de Productos de Leche Limitada* Case OPI No 226 (Resolution No 40 issued by the Secretary of Domestic Trade pursuant to Opinion No 992 issued by the Argentinian Antitrust Commission, 8 May 2013) (on the need for review of the transaction); *Conosur Comunicaciones S.A. e Iverinter S.A.* Case CONC No 1072 (Resolution No 646 issued by the Secretary of Domestic Trade pursuant to Opinion No 1167 issued by the Argentinian Antitrust Commission, 26 November 2015) (addressing the potential anticompetitive implications of the transaction).

[18] Law No 25.156/1999, articles 6 and 8 (Argentina).

[19] See O'Farrell and Del Pino (n 17); *Inverinter* (n 17) para 46.

[20] *Inverinter* (n 17) para 45.

[21] ibid.

[22] ibid para 46. The authority considered the volume of business of four other companies: (i) Agropecuaria Las Garzas, in which the father and husband held 49.43% of the shares while his two sons and wife held 10%, 16.429%, and 10%, respectively; (ii) Agropecuaria San Genaro, in which the father and husband held 50% of the shares while his two sons and wife held 16.667% each; (iii) Vuelta de Obligado; and (iv) Yatasto, in which the father and husband held 66% and 60%, respectively.

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recent and prominent case involving clothing and denim company Mavi.[23] Founded in 1991 by Sait Akarlilar, Mavi achieved significant success and went public in 2017.[24] In 2018, Blue International, one of Mavi's largest shareholders, sold its holdings to other members of the Akarlilar family, namely to Sait's wife and two children.[25] A key question before the authority was whether this transaction required a merger filing, which applies to transactions leading to a change of control if the turnover criterion is met.[26]

Under Turkey's Merger Guidelines, sole control exists (i) when the acquiring party has the power to determine strategic commercial decisions or (ii) when it is the sole undertaking having veto rights with respect to strategic commercial decisions of another undertaking ("negative sole control").[27] Prior to the transaction, Mavi's board had six directors, two appointed by members of the Akarlilar family (other than Sait), one appointed by Blue International as a Group A shareholder, and three appointed by public shareholders as Group B shareholders.[28] The authority found that, under this previous structure, Mavi was not controlled by a single shareholder and was thus subject to shifting alliances.[29]

According to the Turkish authority, the "family links" and "common interests" of members of the Akarlilar family meant that, following the transaction, the holdings of Erak, a jeans manufacturer under the sole control of Sait Akarlilar, and those of his wife and children in

[23] Gönenç Gürkaynak, 'Family ties – Competition Board assesses Akarlilar family's acquisition of Mavi', (*Lexology,* 22 August 2018) https://www.lexology.com/commentary/competition-antitrust/turkey/elig-grkaynak-attorneys-at-law/family-ties-competition-board-assesses-akarllar-familys-acquisition-of-mavi accessed 5 April 2023. See also Gönenç Gürkaynak, 'Turkey: No Room for Competition within the Family – Family Links under the Turkish Merger Control Regime: The Turkish Competition Board Unconditionally Approved the Transaction Concerning the Acquisition of Sole Control over Mavi by the Akarhlar Family' (*Mondaq,* 22 October 2018) https://www.mondaq.com/turkey/antitrust-eu-competition-/740286/no-room-for-competition-within-the-family-family-links-under-the-turkish-merger-control-regime-the-turkish-competition-board-unconditionally-approved-the-transaction-concerning-the-acquisition-of-sole-control-over-mavi-by-the-akarhlar-family accessed 5 April 2023. Similarly to the European Commission's 2008 Consolidated Jurisdictional Notice, Turkey's merger guidelines also refer to the use of family links in assessing indirect or *de facto* control. See Guidelines on Cases Considered as a Merger or an Acquisition and the Concept of Control No: 13-45/RM (9) 2013 (Turkey) (hereinafter "Turkey's Merger Guidelines").

[24] Reuters Staff, 'Turkey's Mavi Majority Stake to Be Held by Akarlilar Family after IPO - CEO' (*Reuters*, June 6, 2017) https://www.reuters.com/article/turkey-mavi-ipo-idINFWN1J302C accessed 5 April 2023; See also Melanie Gropler, 'Anniversary: Mavi - How Turkish Jeans Have Conquered Germany' (*The Spin Off,* November 29, 2016) https://www.the-spin-off.com/news/stories/Anniversary-Mavi-How-Turkish-jeans-have-conquered-Germany-12714 accessed 5 April 2023.

[25] Gürkaynak, 'Family ties' (n 23).

[26] Gürkaynak, 'Family ties' (n 23). See also Gürkaynak, 'Turkey: No Room for Competition within the Family' (n 23); Communiqué Concerning the Mergers and Acquisitions Calling for the Authorization of the Competition Board (Communiqué No 2010/4) (Turkey).

[27] ibid; see also Turkey's Merger Guidelines (n 23).

[28] Gürkaynak, 'Family ties' (n 23).

[29] Gürkaynak, 'Family ties' (n 23); see also Gürkaynak, 'Turkey: No Room for Competition within the Family' (n 23).

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Mavi would qualify as a "single economic unit."[30] It concluded that Mavi would be under the negative sole control of the Akarlilar family after the transaction, thus triggering the requirement of merger review due to a change in the control structure.[31] Additionally, it consolidated the holdings of Erak and the members of the Akarlilar family for purposes of calculating the turnover of the parties in Turkey.[32] The authority argued that, in assessing relationships between natural persons, "common interests" relate not to the concept of control but to the absence of motivation to compete with one another.[33]

2.2 Assessment of Anticompetitive Effects in Merger Review

2.2.1 Brazil

As previously mentioned, the 2017 merger review of the Mataboi case by Brazil's antitrust authority is emblematic of the relevance of family ties as the "main argument" behind initially seeking to undo the previously consummated indirect acquisition of Mataboi by JBJ Agropecuária ("JBJ").[34] While Mataboi engaged in the business of cattle slaughter and the sale of fresh beef and its byproducts, JBJ, owned by José Batista Júnior, operated in the business of raising and slaughtering cattle and selling fresh bovine meat.[35] CADE noted that, individually considered, the transaction would not pose any threat to competition, since JBJ did not own any slaughterhouse units.[36]

However, in assessing the market definition, the authority took into account the existence of family relationships between the controlling shareholder of JBJ and the controlling shareholders of JBS, then the world's second largest,[37] and currently the world's largest, meat producer.[38] Since its founding, JBS had been controlled by members of the Batista family, including founding patriarch José Batista Sobrinho, a shareholder and then member of the board of directors of JBS; Wesley Batista, shareholder, CEO, and vice chair of the board of directors; and Joesley Mendonça Batista, shareholder and chair of the board of directors. Joesley and Wesley Batista are sons of José Batista Sobrinho and brothers of José Batista Júnior, the controller of JBJ. At the time of the Mataboi acquisition, José Batista Júnior held 99.998% of the equity interests in JBJ, while his father, José Batista Sobrinho, held a mere 0.002%[39] –

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[30] Gürkaynak, 'Turkey: No Room for Competition within the Family' (n 23).

[31] Gürkaynak, 'Family ties' (n 23); see also Gürkaynak, 'Turkey: No Room for Competition within the Family' (n 23).

[32] ibid.

[33] Gönenç Gürkaynak, 'Turkey: No Room for Competition within the Family' (n 23).

[34] OECD, *Working Party No. 3 on Co-operation and Enforcement, The standard of review by courts in competition cases – Note by Brazil* (OECD DAF/COMP/WP3/WD(2019), 2019); see also *JBJ Agropecuária Ltda, Frigorífico Mata Boi S/A and others* Case No 08700.007553/2016-83 (Decision of the Brazilian Administrative Council for Economic Defense, 18 October 2017).

[35] ibid.

[36] ibid.

[37] JBS, 'Relatório Anual e de Sustentabilidade 2016' (*JBS*, 2016) 20 https://jbs.com.br/wp-content/uploads/2020/06/relatorio_anual_e_de_sustentabilidade_2016_jbs.pdf accessed 9 April 2023.

[38] JBS, 'Perfil Corporativo' (JBS RI) https://ri.jbs.com.br/a-jbs/perfil-corporativo/ accessed 9 April 2023.

[39] *JBJ Agropecuária* (n 34).

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likely a result of Brazilian law then requiring limited liability companies to have at least two members.

CADE contended that the relationship between the controllers of JBS and JBJ could result in an "alignment of incentives," thereby potentially reducing competition between the two companies.[40] The decision pondered that, though the father's minor equity stake did not give him influence over JBJ, it served as evidence of the close relationship between father and son, which is "normally already a relationship of great proximity".[41] It noted that "the son chose precisely the father to be his partner, even if to meet other objectives",[42] which served as "strong circumstantial evidence that the family and confidence ties remained strong".[43] The opinion concluded that, given JBS's market dominance, possible coordination between JBJ and JBS or their joint exercise of market power would trigger competitive concerns.[44]

The authority also alluded to various other connections evidencing the strength of the family's ties. When Wesley and Joesley were removed from managerial positions at JBS in connection with a major corruption scandal in 2016, José Batista Filho was chosen to fill the position of interim CEO of JBS, but this did not ultimately materialize due to judicial intervention. CADE recognized that, even though this incident did not, by itself, offer proof of alignment of interest between the companies, it served as "circumstantial evidence of the importance of family relationships in the management of the enterprises."[45]

Interestingly, while CADE's decision found "strong incentives for coordination" between JBJ and JBS, it refused to qualify JBJ and JBS as constituting an "economic group" (undertaking) under the applicable regulations, which relied exclusively on stock ownership and control.[46] Rather than using family ties to treat different legal entities as an economic unity, as is often done by foreign authorities, CADE found that family relationships in this case were an independent basis to find threats to competition, and ordered the parties to undo the deal.[47]

JBJ and Mataboi subsequently challenged this decision in federal court. The Federal Court of Appeals (*Tribunal Regional Federal da Primeira Região*) granted a preliminary injunction suspending CADE's ruling. The court reasoned that, while the legal system allows for "homini presumptions" (in this case, the idea that family ties would lead to possible acts of anticompetitive coordination), the parties should have the opportunity to demonstrate otherwise in court.[48]

Following this injunction, CADE (whose composition by then had largely changed) entered into a settlement with JBJ, Mataboi, and José Batista Júnior, allowing the acquisition to move forward subject to certain conditions.[49] Councilor Sérgio Ravagnani dissented from

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[40] ibid.
[41] ibid.
[42] ibid.
[43] ibid.
[44] ibid.
[45] ibid.
[46] ibid.
[47] ibid.
[48] *JBJ vs CADE* Case No 1011247-97.2017.4.01.0000 (Decision of the Federal Regional Tribunal from the 1st Region, 15 March 2018). See also OECD (n 34).
[49] *JBJ Agropecuária Ltda, Frigorífico Mata Boi S/A and others* Case No 08700.007553/2016-83 (Decision of the Brazilian Administrative Council for Economic Defense, 16 June 2021).

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the decision to approve the settlement, arguing that the companies "had a history of non-deference to this antitrust authority", and that the proposed remedies "do not actually change the background scenario that produced the competition concerns".[50]

The agreement provided for "behavioral and structural measures" that purportedly aimed to prevent coordination between JBJ and JBS. These included the adoption by Mataboi (then renamed Prima Foods) of corporate governance practices applicable to publicly traded companies; a prohibition on José Batista Junior or his relatives – with the curious and notable exception of his children – serving as officers or board chair in Mataboi; the creation of an antitrust compliance program in Mataboi, but only in the event of an IPO; the prohibition of José Batista Júnior, his relatives and key officers serving simultaneously at JBJ/Mataboi and JBS, subject to a quarantine of three months in both directions; and the provision of annual reports on the price of animal protein charged to counterparties for a period of five years. CADE's decision approving the settlement agreement argued that the proposed terms addressed the concerns of its original decision in (i) "annulling the corporate relationship between the groups of JBJ and JBS," (ii) establishing prohibitions preventing persons associated with one group from being simultaneously present in the other, and (iii) addressing the structure of JBJ and Mataboi, including "mechanisms of internal governance and compliance, increasing the costs involved in the practice of an anticompetitive strategy resulting from the approximation with JBS."[51] While it is highly questionable that these measures may neutralize coordination through family links, they follow an existing pattern in CADE enforcement of requiring corporate governance concessions in lieu of blocking consolidations.[52]

2.2.2 Turkey

Turkey's competition authority has also used family ties to assess anticompetitive effects in the context of merger review. In a case involving the privatization of power companies, *Rekabet Kurumu* considered the existing family ties between the shareholders of two bidders, MMEKA and Aksa, to treat them as one undertaking.[53] Mehmet Kazanci, Esin Kazanci, and Begüm Kazanci were relatives and jointly controlled MMEKA through Stargate, while the

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[50] ibid.

[51] ibid.

[52] For a prominent example of this practice, see *Rumo Logística Operadora Multimodal S.A and others* Case No 08700.005719/2014-65 (Decision of the Brazilian Administrative Council for Economic Defense, 25 February 2015) (allowing the acquisition of América Latina Logística (ALL) by Rumo Logística to proceed despite concerns about incentives for engaging in discriminatory and exclusionary conduct, subject to the adoption of corporate governance measures, such as internal committees in charge of pricing decisions). See also Rodrigo Fialho Borges, 'Descontrole de estruturas: dos objetivos do antitruste às desigualdades econômicas' (Doctorate thesis, University of São Paulo Law School, 2020) (describing how CADE has approved the vast majority of mergers and acquisitions without restrictions, and how the few restrictions imposed are ancillary or behavioral in nature). For a broader account of the use of corporate governance changes as a substitute for market and regulatory solutions, see Mariana Pargendler, 'The Corporate Governance Obsession' (2016) 42 J Corp L 359.

[53] OECD, *Annual Report on Competition Policy Developments in Turkey*, DAF/COMP/AR(2011)15, 2011 10–11. See also *İş-Kaya İnşaat Sanayi ve Ticaret Ltd. Şti.-MMEKA Makine and others* Case No 10-78/1645-609 (Decision of the Turkish Competition Authority, 16 December 2010).

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Kazanci family holding company controlled Aksa.[54] Ali Metin Kazanci, Mehmet Kazanci's father, was the majority shareholder of the holding company, which had various family members as shareholders.

After considering the bidders as one undertaking, the agency analyzed the market structures that would result from the proposed acquisitions.[55] It decided to block certain purchases because they would result in a dominant position and decrease competition in relevant markets.[56] The decision acknowledged that treating different legal entities as one undertaking due to family links could potentially clash with principles such as freedom of enterprise, contract, and competition.[57] It clarified that a person who is part of a family corporation can carry out activities independently as an exercise of freedom of enterprise. However, the ruling stated that in cases where the existence of family links implies a unity of interests, there are grounds for applying competition law rules which can restrict such freedoms.[58]

3. FAMILY TIES AND ANTICOMPETITIVE AGREEMENTS

Antitrust authorities have also considered family ties in cases of anticompetitive agreements. While various decisions rely on family links as evidence of bid rigging, the Turkish authority has used family connections in recognizing a single entity defense to charges of bid rigging.

3.1 Evidence of Anticompetitive Agreements

3.1.1 Brazil

In Brazil, the analysis of family ties is particularly common with respect to horizontal agreements in the form of cartels or, more frequently, bid rigging cases. As illustrated in the Annex (Table A11.1), Brazil's CADE expressly considered the presence of family ties in 12 bid rigging cases and in one cartel ruling since 2014.[59] Because cartels and bid rigging constitute a restriction of competition "by object" under Brazilian law, a conviction only requires evidence of the existence of the anticompetitive agreement, which may include circumstantial evidence, such as family ties between shareholders of different companies seeking a government contract. In all of these cases, CADE has considered family ties to be a strong indicator of the existence of anticompetitive agreements.

Although the participation of different companies whose shareholders are related in public procurement processes is not illegal, CADE considers family ties as a factor warranting further investigation in each case. From its perspective, the existence of family ties may be a sign of collusion in the bidding process, leading to the absence of real competition between the

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[54] İş-*Kaya İnşaat* (n 53) 38–39.

[55] Erdem-Erdem Law Office, *Newsletter 2010* (Ercüment Erdem ed, 1st edn, Erdem-Erdem 2011) 342.

[56] ibid.

[57] Cigdem Bal, 'Turkey: The Concept of Undertaking Under Turkish Law' (*Mondaq,* 4 October 2011) https://www.mondaq.com/turkey/trade-regulation-practices/147632/the-concept-of-undertaking-under-turkish-law accessed 9 April 2023.

[58] ibid.

[59] See Annex, Table A11.1.

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participating companies. Family links are deemed to facilitate the exchange of information between "competitors" about relevant commercial variables and may favor the coordination of strategies.[60]

In assessing bid rigging cases, CADE first analyzes whether the companies involved belong to the same "economic group." However, as mentioned above, CADE does not consider kinship between shareholders of different companies as a relevant criterion for the recognition of an economic group or undertaking. Consequently, it presumes that these are unaffiliated and competing companies, with the question being whether there is collusion between them.

In 2015, CADE investigated the occurrence of bid rigging in connection with seven bids for the concession regarding the operation of coffee shops and snack bars in Brazilian airports.[61] In examining the facts to ascertain the occurrence of collusion, it highlighted the "affinity and family ties" between shareholders of the seven bidders.[62] The presence of such ties was treated as circumstantial evidence of collusion, serving as an element from which one may infer the occurrence of unlawful conduct.[63] Four of the companies investigated (Confraria André, Alimentare, Delícias da Vovó and Boa Viagem) had interpersonal relationships among their shareholders, as illustrated by Figure 11.1.[64]

During the investigations, the authority found "close friendship ties" between the managing shareholder of Alimentare, members of his family, and the managing shareholder of Boa Viagem and Delícias da Vovó, who is also the brother of the managing shareholder of Confraria André Ltda. CADE found this web of relationships to be extremely relevant.[65] In the opinion of Reporting Councilor Sérgio Ravagnani, even if the defendants denied any communication between the companies prior to the bids or claimed that there was no direct evidence of their collusion – which was not the case – the family ties, affinity and friendship between shareholders of the four companies were enough to compromise the competitive bidding process.[66] The decision imposed a fine and a debarment sanction on the companies involved to prevent participation in public procurement processes for a period of five years.[67]

Beyond the context of bid rigging, CADE has also taken family ties into account in one cartel ruling. On that occasion, the authority investigated several fuel stations that operated in

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[60] According to CADE's guidelines, "[c]ompanies with a kinship or relationship between partners: can be considered both an antitrust violation, and fraud in a procurement process, since the relationship between partners is only a circumstantial piece of evidence of a close relationship between bidders, which must be assessed together with the rest of the evidence." Administrative Council for Economic Defense, Guide for Fighting Cartels in Procurements (Brazil, 2019). Family ties have also been used for other purposes in bid rigging cases. A 2016 decision mentioned the fact that the commercial officer was the son-in-law of the company's president as a factor intensifying his decision-making authority to participate in a collusive scheme with other companies. *Aurobindo Farmacêutica do Brasil Ltda and others* Case No 08012.008821/2008-22 (Decision of the Brazilian Administrative Council for Economic Defense, 20 January 2016).

[61] *Infraero, Delícias da Vovó Ltda and others* Case No 08700.007278/2015-17 (Decision of the Brazilian Administrative Council for Economic Defense, 18 May 2022).

[62] ibid.

[63] ibid.

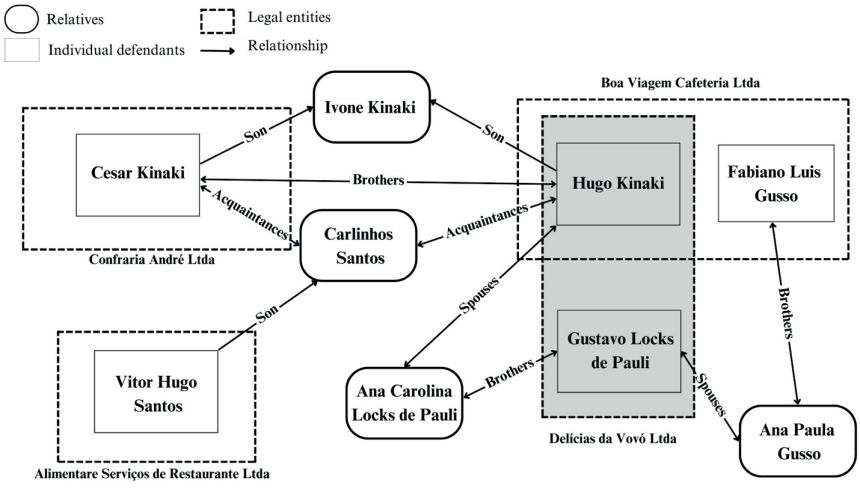
[64] ibid.

[65] ibid.

[66] ibid.

[67] ibid.

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Source: Authors' own elaboration based on information derived from the case.

Figure 11.1 Personal connections among bidders for airport concessions

the state of Espírito Santo.[68] In addition to identifying an artificial price increase between the years of 2006 and 2007, CADE intercepted and analyzed telephone calls between the several owners of the businesses involved in the practice, three of whom were cousins.[69]

While the cousins argued that their conversations did not aim at commercial alignment and consisted of mere family discussions, CADE contested this view, concluding that, while not illegal, the existence of family ties between those who own different companies can be "an element that facilitates cartels, if other market characteristics that favor collusions are present."[70] Considering other documentary evidence collected during the course of the proceedings and the characteristics of the relevant fuel resale market – such as price transparency, product homogeneity, and similar cost structures – the authority concluded that the conversations between family members who own competitor companies denoted a cartel arrangement. It therefore convicted the natural and legal persons involved in the agreement.[71]

3.1.2 Indonesia

The Indonesian Competition Commission (*Komisi Pengawas Persaingan Usaha* – KPPU) has confronted various cases of bid rigging involving family ties.[72] Under Indonesian law, compa-

[68] *Arara Azul Rede de Postos Ltda and others* Case No 08012.008847/2006-17 (Decision of the Brazilian Administrative Council for Economic Defense, 22 May 2015).

[69] ibid.

[70] ibid.

[71] ibid.

[72] KPPU, *Kompetisia Newsletter on Indonesian Competition Law and Policy Newsletter No 05* (KPPU, 2010) 5; See also KPPU, 'KPPU decided Public Work Office of Makassar City violated the Law' (*KPPU RI*, 23 September 2016) https://eng.kppu.go.id/kppu-decided-public-work-office

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nies are prohibited from conspiring with others with the purpose of winning public tenders.[73] However, while price fixing and boycotts are treated as per se violations, a rule-of-reason approach applies to bid rigging.[74]

In 2016, the KPPU decided a case of bid rigging in the procurement of road rehabilitation and maintenance in Makassar City.[75] According to the investigations, several companies and public officials worked together to manipulate the bidding process. The KPPU identified family ties between two brothers who had stakes in different participants. While one brother held 10% of shares in PT Win Wahana Cipta Marga and 95% of shares in PT Mulia Trans Marga, the other was the sole owner of PT Gangking Raya.[76] In assessing the existing family ties in connection with other documentary evidence, the authority concluded that the parties had infringed Indonesia's competition law, thus imposing fines on the companies involved and prohibiting them from participating in similar procurement processes with the Public Works Office of Makassar City for two years.[77]

3.2 Family Ties as Grounds for a Single Entity Defense

In Turkey, defendants have successfully invoked family ties as a defense against accusations of illegal horizontal restraints. Under Turkish law, concerted practices are considered unlawful only if there is a plurality of independent commercial actors.[78] Practices within the same undertaking are therefore immune from antitrust enforcement.[79]

In a 2012 bid rigging case, the *Rekabet Kurumu* investigated four companies for working together to guarantee that one of them would win a government contract for road construction.[80] The authority noted several elements indicating that the companies were a single economic unit, including the use of guarantee letters from the same financial institutions, the

-of-makassar-city-violated-the-law/ accessed 9 April 2023; KPPU, 'ICC Issued a Decision on the Tulungagung Bid Rigging Case' (*KPPU RI*, 23 February 2022) https://eng.kppu.go.id/icc-issued-a-decision-on-the-tulungagung-bid-rigging-case/ accessed 9 April 2023.

[73] According to Art. 22 of Law No. 5 of 1999 on the Prohibition of Monopolistic Practices and Unfair Business Competition, as last amended by Law No. 6 of 2023 on the Enactment of Government Regulation in Lieu of Law No. 2 of 2022 on Job Creation into Law (Indonesia): "Business actors shall be prohibited from conspiring with other parties with the aim of determining the awardees of tenders which may cause unfair business competition."

[74] Farid Nasution et. al, 'Restraints of Trade and Dominance in Indonesia: Overview' (*Thomson Reuters Practical Law*, 1 December 2022) https://uk.practicallaw.thomsonreuters.com/5-572-2265?transitionType=Default&contextData=(sc.Default) accessed 9 April 2023.

[75] KPPU, 'KPPU decided Public Work Office of Makassar City violated the Law' (n 72).

[76] *PT Timur Utama Sakti and others* Case No. 19/KPPU-I/2015 (Decision of the Indonesia Competition Commission, 20 September 2016).

[77] ibid; KPPU, 'KPPU decided Public Work Office of Makassar City violated the Law' (n 72).

[78] Cigdem Bal (n 57).

[79] Kerem Cem Sanli and Sahin Ardiyok, 'The Legal Structure of Competition Policy in Turkey' in Tamer Çetin and Fuat Oguz (eds), *The Political Economy of Regulation in Turkey* (Springer 2011) 85.

[80] *Bayburt İnşaat* Case No 12-24/666-188 (Decision of the Turkish Competition Authority, 3 May 2012).

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same accountant, and the same address.[81] Moreover, the companies' shareholders were relatives and had the same surnames. Based on these factors, the authority concluded that the four separate legal entities operated as one single economic unit and were thereby exempt from antitrust enforcement in Turkey.[82]

4. CONCLUSION

Scholarly debate on the definition of an undertaking in antitrust law has focused primarily on equity ties between different legal persons. This chapter spotlights a distinct, and thus far neglected, theme: the use of family ties in defining the boundaries of the firm for purposes of antitrust enforcement. Family ties typically serve to expand the scope of antitrust enforcement, such as by including firms owned by close family members in calculating the minimum threshold for merger review or by using family connections as circumstantial evidence of coordination in cartel and bid rigging cases. However, we have also identified the use of family ties as a shield, as when the Turkish authority invoked family connections as evidence of a single economic unity in setting aside accusations of bid rigging.

The use of family ties in antitrust law also provides an interesting example of veil peeking across *natural persons* that operates irrespective of fraud or abuse. While apparently less relevant in antitrust practice in the Global North to date, family links have played a relevant role in antitrust cases in various developing countries, such as Argentina, Brazil, Indonesia, and Turkey. This shows the ingenuity of antitrust authorities in developing countries in adapting to local circumstances, and points to a new area for future research.

[81] ibid.
[82] ibid.

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APPENDIX 11

Table A11.1 Family ties in enforcement decisions regarding anticompetitive agreements – Brazil

Case	Conduct	Family link	Industry	Date of decision	Conviction
08012.006199/2009-07 - Construction material for the city hall of Lages/SC	Bid rigging	Son	Painting and plumbing materials	December 16, 2014	Yes
08012.008184/2011-90 - Traffic lights in Jahu	Bid rigging	Spouse, son	Traffic signs	April 10, 2015	Yes
08012.008847/2006-17 - Vitoria's fuel gas stations	Cartel	Cousin	Fuel resale	May 22, 2015	Yes
08012.000030/2011-50 - Scar Rio n.1	Bid rigging	Son	Car fleet maintenance	December 10, 2015	Yes
08700.006551/2015-96 - Scar Rio n.2	Bid rigging	Son	Car fleet maintenance	October 24, 2016	Yes
08012.009645/2008-46 - Pharmaceuticals	Bid rigging	Sibling	Foodstuffs for particular nutritional uses	November 11, 2016	Yes
08012.000742/2011-79 - Detran-RJ	Bid rigging	Spouse, mother-in-law, sibling, cousin	Third party services	November 13, 2018	No
08012.004280/2012-40 - Information technology companies in DF	Bid rigging	Sibling	IT services	November 4, 2019	Yes
08700.004455/2016-94 - Stationery stores	Bid rigging	Spouse, stepdaughter	School and office materials	August 20, 2021	Yes
08012.009611/2008-51 - Revolving doors	Bid rigging	Brother-in-law; spouses	Metal detector security doors	February 22, 2022	No
08700.007278/2015-17 - Delícias da Vovó	Bid rigging	Son, spouse, sibling	Cafeteria services in airports	May 18, 2022	Yes
08700.000269/2018-48 - Construction works in municipal schools of Juazeiro	Bid rigging	Son	Civil construction services for schools	March 15, 2023	Yes
08700.008098/2014-71 - Positivo	Bid rigging	Cousin	IT equipment	Decision pending	Decision pending

Note: Total of 10 convictions, two dismissals and one pending decision.
Source: Author's own elaboration based on publicly available information sourced from CADE's case research platform.

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PART III

CORPORATE ORGANISATION AND EFFECTS ON COMPETITION

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12. Common Ownership in Europe and the US: A Network Analysis Approach

Nuria Boot, Albert Banal-Estañol and Jo Seldeslachts

1. INTRODUCTION[1]

Common ownership, i.e., the same owners holding shares in several companies at the same time, has been shown to be an increasingly pervasive feature of US industries, both at the sector level, e.g., in airlines,[2] banking[3] and pharma,[4] as well as more generally across the S&P 500 firms[5] and across all publicly listed firms.[6] The rise in common ownership in the US can be traced back to the increasing holdings of investment management companies, with BlackRock, Vanguard and State Street as leading examples.[7,8] These trends are important as common ownership has been shown to have effects on these commonly held firms'

[1] We thank Jonas Nieto for excellent research assistance.

[2] José Azar, Martin Schmalz and Isabel Tecu, 'Anticompetitive effects of common ownership' (2018) 73 The Journal of Finance 1513, 1565.

[3] José Azar, 'Common Shareholders and Interlocking Directors: The Relation Between Two Corporate Networks' (2022) 18 Journal of Competition Law & Economics 75, 98.

[4] Melissa Newham, Jo Seldeslachts and Albert Banal-Estañol, 'Common Ownership and Market Entry: Evidence from the Pharmaceutical Industry' (2018) DIW Berlin Discussion Paper No. 1738.

[5] José Azar and Xavier Vives, 'Revisiting the Anti-competitive Effects of Common Ownership' (2022) European Corporate Governance Institute – Finance Working Paper 827/2022; Matthew Backus, Christopher Conlon and Michael Sinkinson, 'Common Ownership in America: 1980-2017' (2021) 13 American Economic Journal: Microeconomics 273, 308. This last paper, as well as ours, provide an analysis of the common ownership links across a 'cross-industry' sample of firms, i.e., independently of the sector in which they operate. In this sense, the approach is broader than the links among competing firms.

[6] Albert Banal-Estañol, Jo Seldeslachts and Xavier Vives, 'Ownership Diversification and Product Market Pricing Incentives' (2022) European Corporate Governance Institute–Finance Working Paper 858.

[7] José Azar, 'The Common Ownership Trilemma' (2020) 87 The University of Chicago Law Review 263, 296; Backus, Conlon and Sinkinson (n 5) 308.

[8] Investment management is the professional management of various securities (such as stocks and bonds) and assets on behalf of investors. Investment management services can be provided by investment management companies or financial institutions.

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prices,[9] markups,[10] profits[11] and firm value,[12] as well as on firm entry,[13] investment[14] and innovation.[15,16]

European firms seemed to have stayed away from these issues, either because European firms have traditionally been characterized by high levels of ownership by large, non-common investors, such as families and governments[17] or because the common investors in European firms traditionally have been relatively less-diversified financial institutions: European banks and insurance companies.[18] Recent evidence, though, shows that things may be changing in Europe too. US-based investment management companies, such as BlackRock, have grown sharply over time in the ownership structures of German companies.[19] Common ownership in the banking sector has also been increasing in Europe, particularly since the 2007–2008 global financial crisis.[20]

In a companion paper[21] we find, comparing the common ownership levels of the firms in the S&P 350 index in Europe and the S&P 500 index in the US, that firms in Europe were indeed less commonly owned than those in the US in 2004. Common ownership levels have

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[9] Azar, Schmalz and Tecu (n 2) 1565.

[10] Banal-Estañol, Seldeslachts and Vives (n 6).

[11] Lysle Boller and Fiona Scott Morton, 'Testing the Theory of Common Stock Ownership' (2020) National Bureau of Economic Research No. w27515; Andrew Koch, Marios Panayides and Shawn Thomas, 'Common Ownership and Competition in Product Markets' (2021) 139 Journal of Financial Economics 109, 137.

[12] Jun-Koo Kang, Juan Luo and Hyun Seung Na, 'Are Institutional Investors with Multiple Blockholdings Effective Monitors?' (2018) 128 Journal of Financial Economics 576, 602.

[13] Newham, Seldeslachts and Banal-Estañol (n 4).

[14] German Gutierrez and Thomas Philippon, 'Declining Competition and Investment in the US' (2017) National Bureau of Economic Research No. w23583; German Gutierrez and Thomas Philippon, 'Ownership, Concentration, and Investment' (2018) 108 AEA Papers and Proceedings 432, 437.

[15] Jie Jack He and Jiekun Huang, 'Product Market Competition in a World of Cross-ownership: Evidence from Institutional Blockholdings' (2017) 30 The Review of Financial Studies 2674, 2718.

[16] See Martin Schmalz, 'Recent studies on common ownership, firm behavior, and market outcomes' (2021) 66(1) Antitrust Bulletin 12 for a recent review of the literature. Most of the literature has focused on the unilateral effects on the commonly held firms. But there may also be broader effects, for instance less competitive pressure on rivals (see for instance José Azar and Anna Tzanaki, 'Common Ownership and Merger Control Enforcement' in Ioannis Kokkoris and Claudia Lemus (eds.) in *Research Handbook on the Law and Economics of Competition Enforcement* (Edward Elgar Publishing 2022)).

[17] Steen Thomsen, Torben Pedersen and Hans Kurt Kvist, 'Blockholder Ownership: Effects on Firm Value in Market and Control Based Governance Systems' (2006) 12 Journal of Corporate Finance 246, 269.

[18] Jo Seldeslachts, Nuria Boot and Albert Banal-Estañol, 'Common Ownership in Germany: A Network View' (2023) DIW Wochenbericht 32 429, 436.

[19] Ibid.

[20] Albert Banal-Estañol, Nuria Boot and Jo Seldeslachts, 'Common Ownership Patterns in the European Banking Sector — The Impact of the Financial Crisis' (2022) 18 Journal of Competition Law & Economics 135, 167.

[21] Nuria Boot, Jo Seldeslachts and Albert Banal-Estañol, 'Common ownership: Europe vs. the US' DIW Berlin Discussion Paper No. 2015, 2022.

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been rising on both continents since then, but faster within Europe than within the US. The analysis in that paper is based on a standard measure of common ownership, widely used in industrial economics, the so-called "lambda" or "kappa," which aims to capture the weight that managers of a firm should conceptually place on the profits of other firms due to the existence of common ownership (previous papers[22] provide a detailed explanation of this measure). We compute firm-level averages of lambda to compare firms' common ownership average levels and growth on the two continents.

As a complement to our companion paper,[23] this chapter provides a descriptive network analysis of the ownership patterns of the Top 50 firms in the S&P 350 in Europe and in the S&P 500 in the US, both in 2004 and 2015. We compare the structure and characteristics of the common ownership networks between European and US firms separately, as well as the (bipartite) network of European firms on the one hand and US firms on the other. The advantage of using descriptive network analysis is that it is more visual and, arguably, more suitable to understand and compare the degree of connectivity between two groups of firms.

We make use of two types of pairwise measure of common ownership, which determine links, and therefore define networks, on the basis of individual or joint levels of ownership, respectively. First, we define an *individual* common ownership link between two companies when there is *at least one investor* holding shares in both companies with an ownership stake in each firm above a certain threshold. Second, we define a *joint* common ownership link when investors common to both firms collectively are the *majority owners* (i.e., their ownership stakes in the two firms add to more than 50% in the two firms). The resulting individual and joint common ownership networks shed light on how common ownership evolves in Europe versus the US. As the evolution of the network depends on the ownership measure used, the effects of common ownership may depend on whether common investors exert individual influence, as a single investor, or joint influence, as a group of investors.

We find that, although they become more connected over time, Top 50 European firms remain less connected than Top 50 US firms, both through individual links at the 5% ownership threshold and through the joint common ownership links. Interestingly, this pattern is not visible for individual links above 7.5%. Although the networks defined at the 7.5% individual threshold are overall less dense, European companies are *more* connected than US companies at this threshold. In terms of joint ownership links, US companies have been highly connected throughout, whereas European networks remain more sparse. Still, for all these network definitions, individual links at 5% or 7.5% or joint links, firms on both sides of the Atlantic become more connected over time. Actually, the networks at the individual 5% threshold became almost fully connected by 2015, i.e., each of the Top 50 companies is connected to virtually every other Top 50 firm. The exception is the 10% individual links, which remain sparse throughout, both in the US and in Europe. Exactly the same patterns hold when we look at the links between European and US companies across the Atlantic, rather than within each region.

In terms of origin of the investors' links, individual links at the 5% and 7.5% levels, and especially joint links, show European investors' dominance in the European networks in 2004. Indeed, financial institutions such as the UK's Lloyds Banking Group and the insurance company Aviva were among the Top 10 blockholders in European firms. The 2007–2008

[22] Backus, Conlon and Sinkinson (n 5) 308.
[23] Boot, Seldeslachts and Banal-Estañol (n 21).

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global financial crisis had a significant impact on Europe's financial institutions. Indeed, by 2015, common ownership links between European firms through European investors had all but disappeared. The US investment management companies were responsible for almost all the (much higher number of) links between such European companies. By then, BlackRock had become the largest common owner, by far, in Europe. For links between the Top 50 US companies, these are solely through US investment companies (with the exception of Barclays Global Investors in 2004, which was, although operating from the US, at the time officially UK based).

This chapter is one of the few works that uses network analysis to study common ownership patterns. Previous work[24] provides a network analysis of the firms that are active in US pharmaceutical markets, distinguishing between "brand firms," that have R&D capabilities and launch new drugs onto the market, and "generic firms", that produce bioequivalent replications of brand-name drugs once these drugs come off patent. A prior paper[25] uses network analysis to study investor networks in a large sample of transnational corporations. Network analysis has been widely applied in the academic literature in different but related contexts to common ownership, for instance, to analyse interlocking directorships,[26] networks in the venture capital industry,[27] interorganizational ties;[28] and networks between US firms that advocate for free trade.[29]

The chapter is structured as follows: Section 2 presents the data we use to construct our common ownership networks. Sections 3 and 4 provide a network analysis of the common ownership links at the individual and joint levels, respectively. Section 5 concludes.

2. DATA

In this section, we present the source and structure of our ownership data. For each firm in our sample and for each of the two years examined (2004 and 2015), we obtain the data on the ultimate owners that own, at the end of the year, at least a block of 1% of the shares of the firm, as we assumed this to be the minimum threshold through which owners can have influence; see also prior work[30] where the same threshold is used, and the retained holdings are called "relevant shareholdings."

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[24] Albert Banal-Estañol, Melissa Newham and Jo Seldeslachts, 'Common ownership in the US pharmaceutical industry: A network analysis' (2021) 66(1) The Antitrust Bulletin 68.

[25] Stefania Vitali, James B. Glattfelder and Stefano Battiston, 'The network of global corporate control' (2011) 6(10) PLoS One e25995.

[26] Benedicte Brullebaut, Isabelle Allemand, Enrico Prinz and Florence Thépot, 'Persistence in Corporate Networks through Boards of Directors? A Longitudinal Study of Interlocks in France, Germany, and the United Kingdom' (2022) 16 Review of Managerial Science 1743, 1782.

[27] Yael V. Hochberg, Alexander Ljungqvist and Yang Lu, 'Whom you know matters: Venture capital networks and investment performance' (2007) 62(1) The Journal of Finance 251.

[28] Mark S. Mizruchi and Joseph Galaskiewicz, 'Networks of interorganizational relations' (1993) 22(1) Sociological Methods & Research 46.

[29] Michael Dreiling and Derek Darves, 'Corporate unity in American trade policy: A network analysis of corporate-dyad political action' (2011) 116(5) American Journal of Sociology 1514.

[30] Newham, Seldeslachts and Banal-Estañol (n 4).

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2.1 Sample of Firms

Our analysis uses the largest 50 firms in the S&P Europe 350 and S&P US 500 in both 2004 and 2015. The S&P Europe 350 consists of 350 leading blue-chip companies drawn from 16 European markets.[31] The S&P 500 is widely regarded as the best single gauge of large capitalization US equities. We take the initial and end points of our dataset (2004 and 2015). During this period many things occurred that might have had an impact on ownership patterns, among which was the most serious financial crisis since the Great Depression. We take the Top 50 firms in each market in both years to be able to visualize and compare networks graphically. We measure firm size in each market at each of the two years of analysis by market capitalization at the end of the year. We will call the firms in our sample the "Top 50 European or US" firms in 2004 or 2015, respectively.

2.2 Investors

We draw our ownership data from the Thomson Reuters Global Ownership Database, which includes holdings by each shareholder in each publicly listed firm worldwide for every quarter-year. For the US, Thomson Reuters collects ownership information from 13F, 13D and 13G filings, and forms 3, 4, and 5.[32] For firms outside of the US, information is sourced from stock exchange filings, trade announcements, company websites, company annual reports and financial newspapers. While our database does not suffer from data problems,[33] of the Wharton Research Data Services (WRDS) Thomson Reuters data, we refine it to account for (i) name changes that occur, mainly through investors' (full or partial) M&As during the sample period and (ii) identify ultimate decision makers (mainly based on their names). We use investors at the ultimate owner level, since it is at this level that decision power lies.

We classify investors according to their nationality. Many of the large investment management companies are from the US (including the Top 4; BlackRock, Vanguard, State Street and Fidelity), but there are also important European investors such as Norway's NBIM and the UK's Aberdeen Asset Management and Legal & General Group.

2.3 Top Investors

Tables 12.1–12.4 shows the Top 10 investors in our dataset by number of blocks (of 1%, 3%, 5%, 7.5% and 10% shareholdings; where the Table is ranked by the smallest 1% blocks in our dataset) of the Top 50 firms in Europe and in the US, both in 2004 and 2015. The patterns that emerge are very different on the two sides of the Atlantic. First, the top blockholders in the US firms are domestic US investors in both 2004 and 2015, except for Deutsche Bank and notably Barclays Global Investors (BGI) in 2004 as the top (number 1) investor. However, while the ultimate owner of BGI was the UK-based Barclays bank, BGI itself had always been based

[31] The S&P Europe 350 mirrors the sector and country weights of the broader universe of stocks from Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.

[32] See https://www.investor.gov/introduction-investing/investing-basics/glossary/schedules-13d-and-13g and https://www.sec.gov/files/forms-3-4-5.pdf .

[33] Backus, Conlon and Sinkinson (n 5) 308.

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Table 12.1 Top common investors in Top 50 firms (S&P 350 Europe) for the year 2004

Investor	Country	1%	3%	5%	7.5%	10%
Legal & General Group	UK	17	13	0	0	0
Capital Group	US	16	14	8	6	2
F&C Asset Mgmt	UK	16	1	0	0	0
M & G Investment Management Ltd.	UK	15	1	0	0	0
Aviva	UK	15	1	0	0	0
BlackRock	US	14	10	2	0	0
Lloyds Banking Group	UK	14	1	0	0	0
UBS	CH	14	0	0	0	0
State Street Global	US	13	2	0	0	0
Standard Life	UK	13	1	1	0	0

Table 12.2 Top common investors in Top 50 firms (S&P 500 US) for the year 2004

Investor	Country	1%	3%	5%	7.5%	10%
Barclays Global Investors	UK	49	41	6	0	0
State Street Global	US	49	32	7	2	0
Vanguard Group	US	48	1	0	0	0
Fidelity Investments	US	46	24	9	2	0
Northern Trust Global	US	46	0	0	0	0
Capital Group	US	37	16	6	3	1
Deutsche Bank	DE	30	0	0	0	0
Clearbridge Investments, Llc	US	28	5	0	0	0
BlackRock	US	28	1	0	0	0
J.P. Morgan Chase	US	27	1	0	0	0

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Table 12.3 Top common investors in Top 50 firms (S&P 350 Europe) for the year 2015

Investor	Country	1%	3%	5%	7.5%	10%
BlackRock	US	46	41	34	17	2
Norges Bank Investment Management (Nbim)	NO	43	7	1	1	0
Vanguard Group	US	43	0	0	0	0
Aberdeen Asset Mgt	UK	26	5	2	1	0
Capital Group	US	23	13	9	3	1
State Street Global	US	21	2	0	0	0
Legal & General Group	UK	20	7	0	0	0
UBS	CH	17	1	1	0	0
Fidelity Investments	US	15	1	0	0	0
Franklin Templeton	US	11	2	0	0	0

Table 12.4 Top common investors in Top 50 firms (S&P 500 US) for the year 2015

Investor	Country	1%	3%	5%	7.5%	10%
Vanguard Group	US	50	49	46	1	0
BlackRock	US	50	48	42	0	0
State Street Global	US	50	47	6	0	0
Northern Trust Global	US	44	0	0	0	0
Fidelity Investments	US	42	15	8	0	0
Capital Group	US	41	22	16	4	2
Bank of New York	US	31	0	0	0	0
Wellington Mgmt.	US	29	8	4	1	0
T. Rowe Price	US	26	6	1	0	0
J.P. Morgan Chase	US	20	0	0	0	0

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in the US. Thereafter, following Barclays' need to raise capital during the financial crisis, Barclays sold BGI to BlackRock, thus becoming fully US-owned, as can be seen in Table 12.4 for 2015. In Europe, on the other hand, the top investors in 2004 were mostly UK-based. But by 2015, although there is still a strong presence of European investors, with the Norwegian Government's investment fund NBIM holding shares in 43 out of 50 firms at the 1% threshold, large US investors have significantly increased their presence and are holding most top positions. The financial crisis has probably had a major impact on these tendencies as it primarily affected banks, which in turn reduced their influence. Banks were traditionally among the most important institutional investors in Europe. At the same time, the influence of investment management companies, traditionally among the largest institutional investors in the US, increased. They were probably able to use the weakness of European banks to their advantage and increasingly invest in European companies (in previous work[34] we provide a similar rationale for German companies).

Second, in the US, top investors such as BGI (thereafter BlackRock), Vanguard, Fidelity and State Street held shares in almost all top 50 S&P 500 firms in 2004, whereas in Europe the top investors held far fewer holdings. By 2015 in the US, top investors held shares in virtually all top 50 US firms, and this up to 5% (with far fewer holdings at the 7.5% and 10% thresholds). In Europe, on the other hand, except for BlackRock, holdings hardly exceeded the 3% threshold. BlackRock, however, held stakes above 7.5% in 17 European firms, while it only held such a large stake in one US firm.

3. NETWORKS BASED ON LINKS OF INDIVIDUAL COMMON INVESTORS

This section and the next provide an analysis of the evolution of the common ownership links among the Top 50 European or US firms, and between European and US firms, both in 2004 and 2015. We make use of network analysis, which uses graph theory to describe the structure and characteristics of networks of actors by focusing on the links that exist between them. Graphs are made up of "nodes" that are connected by "edges" or "links." In our setup, the nodes represent the firms, whereas the edges represent the common ownership links that exist between pairs of firms through their common owners.

In this section we describe the networks based on the links of individual common investors. An edge between a pair of firms exists if there is at least one "linking" (or common) investor that holds at least 5% (respectively, 7.5% and 10%) of shares in each of the two firms in that year. A linking investor is thus a common investor that has a large share in each firm; in other words, a link shows that there is a large common investor between two companies.[35]

We draw the common ownership links between firms, that is the edges, in different colors, depending on the nationality of the investors. A green line between two firms indicates that the linking investor between these firms is a US investor (or all of them are, if there are multiple linking investors), while a red line indicates that it is a European investor. Finally, a blue

[34] Seldeslachts, Boot and Banal-Estañol (n 18) 436.

[35] Note that there may be more than one individual common investor who links two firms. We do not show the number of linking investors in the figures for expositional reasons.

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line indicates that the pair of firms has both US and European linking investors holding more than 5% (respectively, 7.5% and 10%) of shares in each of the two firms.

To improve visibility, we draw the firms, that is, the nodes, in a circle in alphabetical order. We draw the nodes in different colors to distinguish those that are in the Top 50 both in 2004 and 2015 (in light green), those that are in the Top 50 in 2004 only (in blue) and those that are in the Top 50 in 2015 only (in purple). We make the size of the node larger if the firm is larger, in terms of market capitalization at the end of that year.

3.1 Individual Links among Europe's Top 50 Firms

We first describe the common ownership networks of the Top 50 European firms. We can observe that, in 2004, there were not many links, with most firms being entirely disconnected from each other at the 5% level (Figure 12.1, top left figure). Most of the links were driven by US investors (in green), but two were driven by European investors: Enel – Eni and Daimler – Deutsche Bank, owned by the Italian and German governments (links in red). Even fewer links existed at the 7.5% and 10% levels (top middle and top right, respectively), where there is only one link at the 10% level among European Top 50 firms in 2004 (between Vodafone and AstraZeneca).

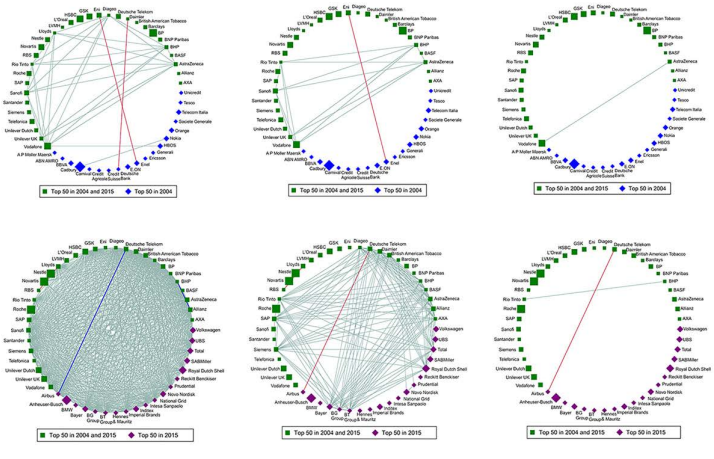


Figure 12.1 *Common ownership links among Europe's Top 50 companies based on the existence of at least one investor with an ownership stake of more than 5%, 7.5% or 10 % (left, middle, right) in each two pairs of companies in 2004 (top) and 2015 (bottom)*

By 2015, almost all Top 50 firms are connected to several other firms through US investors who held at least 5% of shares in each firm (in green, bottom left figure). Only one link existed, however, between firms that had both US and European investors as common owners of more than 5% in

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each (in blue): Airbus – Deutsche Telecom linked by US-based BlackRock and the German government. Note that, in 2004, although the European firms were naturally less connected through investors with more than 7.5% level (top middle figure) than with the 5% level (top left figure), the differences were not large. But for 2015 there was a large difference between the 7.5% level and the 5% level (bottom middle and left figures). This means that most of the common investors in 2015 held shares between 5% and 7.5%. The notable exception was BlackRock, which held more than 7.5% of the shares in 17 top 50 European companies (17 green lines in the bottom middle figure). Note that there were still only two links at the 10% level, in 2015 (bottom right figure): one link made by a European investor (red) and one by a US investor (green).

3.2 Individual Links among the Top 50 US Firms and Comparison with Europe's Top 50

We now describe the common ownership networks of the Top 50 US firms and compare them with the European networks. There are significant differences between Europe and the US, especially in 2004. In contrast to Europe, the majority of US firms already had a connection to at least one other firm in 2004 (Figure 12.2, upper left figure). By 2015, almost every pair of the Top 50 US firms had at least one common investor with a 5% stake.

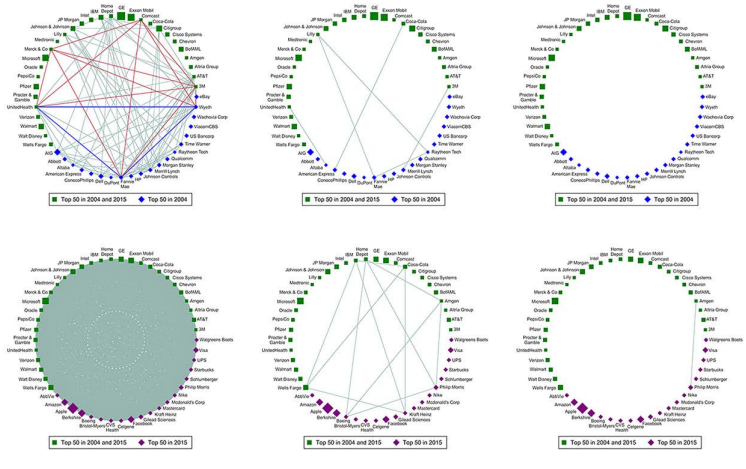


Figure 12.2 *Common ownership links among Top 50 US companies based on the existence of at least investor with an ownership stake of more than 5%, 7.5% or 10% (left, middle, right) in each two pairs of companies in 2004 (top) and 2015 (bottom)*

Interestingly, however, while almost every firm is connected at the 5% level, US firms are hardly connected when defining links at the 7.5% level (middle upper and bottom figures). This means that common owners have fairly small and symmetric stakes in all the firms in

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the US, whereas some of the European common investors make links of more than 7.5%.[36] Finally, at the 10% level, there are no links between US firms in 2004 and only one link in 2015.

Note that many of the (red) 5% links between the Top 50 US firms in 2004 were through BGI, which, despite being based in the US, was ultimately owned by UK-based Barclays bank. Following BlackRock's acquisition of BGI, BGI became fully US owned and therefore all links between Top 50 US firms in 2015 are driven by US investors (in green).

In sum, US firms are more connected than European firms, but only so at the 5% level. For higher levels of ownership, European firms are more connected, especially at the 7.5% level in 2015.

3.3 Individual Links between Europe's Top 50 and the Top 50 US Firms

When comparing links between US and European firms, we can see that the links across the Atlantic increased substantially between 2004 and 2015 at the 5% level (comparing the upper and lower left figures in Figure 12.3). In 2004, around ten US and European firms are connected to one or more firms of the other index. By 2015, almost all Top 50 S&P 500 US firms are connected to a Top 50 S&P Europe 350 firm. All links are in green, meaning that all links were created through US investors.

Interestingly, the picture is strikingly different for the 7.5% links. Between 2004 and 2015 the links between Europe's Top 50 firms and Top 50 US firms became fewer, which means that European and US firms became less connected. This is primarily driven by the fact that the large US investment management companies that hold an increasing number of stakes across the Atlantic, such as BlackRock, do not hold stakes above 7.5% in US firms. In terms of 10% links, hardly any links exist, both in 2004 and 2015. In sum, for 5% holdings, US and European firms became increasingly connected via US investment management companies, whereas this pattern does not hold for 7.5% and 10% stakes.

4. NETWORKS BASED ON LINKS OF JOINT OWNERSHIP OF COMMON INVESTORS

In this section we describe the networks based on the links of joint ownership of common investors.[37] We first compute the "average interest" of each investor, as her/his average ownership stake in the two firms (note that non-common investors will have zero shares in one of the two firms, so their average interest will be half of their ownership stake in the other firm). We then sum the average interests of all the common investors and compare this with the sum

[36] Tzanaki provides a competition framework where she draws a distinction between "concentrated" and "diffuse" common ownership, i.e., the pattern we see in European and US firms, respectively, and sheds light on the different supporting mechanisms and varying harm potential of each variety. See Anna Tzanaki, 'Varieties and mechanisms of common ownership: A calibration exercise for competition policy' (2022) 18(1) Journal of Competition Law & Economics 168.

[37] Our sample only includes (common and non-common) investors that hold a minimum of 1%, and small investors or "retail investors" are excluded. Therefore, the holdings do not add up to 100%, but rather add up to the total percentage of shares held by non-retail investors.

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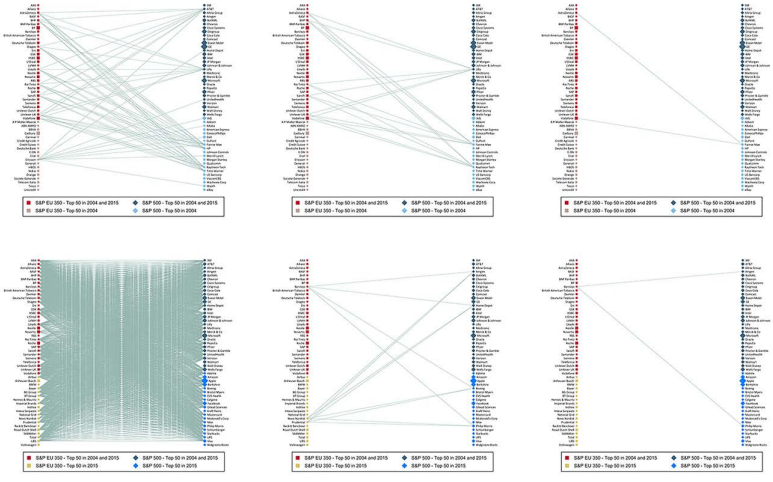


Figure 12.3 *Common ownership links between Europe's Top 50 firms and Top 50 US companies, based on the existence of at least one investor with an ownership stake of more than 5%, 7.5% or 10% (left, middle, right) in each two pairs of companies in 2004 (top) and 2015 (bottom)*

of the average interests of all the non-common investors. We consider a given pair of firms linked through a joint common ownership link if the sum of the average interests of the common owners in the two firms is larger than that of the non-common owners. Or, equivalently, if the average ownership stakes of the common owners add to more than 50% of the shares of the two firms.[38]

As in the previous section, we draw the common ownership links between firms, that is the edges, in different colors, making use of the nationality of the common investors. A green line between two firms indicates that the common investors between these firms are all US investors, and a red line indicates that they are all from Europe. Finally, a blue line indicates that the pair of firms has both US and European common investors. We also draw the nodes in different colors to distinguish firms that are in the Top 50 both in 2004 and 2015 (in light green), those that are in the Top 50 in 2004 only (in blue) and those that are in the Top 50 in 2015 only (in purple). We again make the size of the node larger if the firm is larger, in terms of market capitalization at the end of that year.

[38] Formally, this measure is defined as follows. Consider two firms (j and k) and define as N and M the set of common and non-common investors that own ownership stakes (of at least 1%) in the two or one of the two firms, respectively. Given ownership shares of a common or a non-common investor in firms j and k, respectively, their average interest is $c_i^{j,k} = \left(a_j^k\right)/2$. We consider firms j and k linked through a common ownership link if $\sum_{\cap} c_i^{j,k} > \sum_{\cap} c_i^{j,k} > \sum_{M} c_i^{j,k}$.

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4.1 Joint Ownership Links among the Europe's Top 50 Firms

The first thing to note in Figure 12.4 is that, comparing 2004 to 2015, European firms go from about half of the firms having joint common ownership links in 2004 to the vast majority of firms having joint common ownership links in 2015. However, the network is not that dense, in the sense that firms tend to only have a majority joint common ownership link with a handful of other firms. Interestingly, almost all joint links in 2004 were caused by only European investors. Instead, in 2015, all joint links were caused by US investors. Thus, joint links shifted from European to US-based investors among European firms.

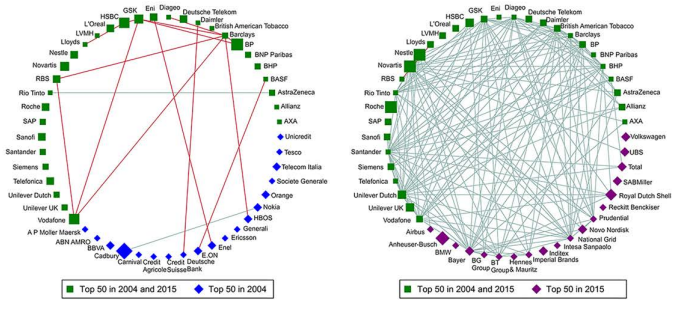


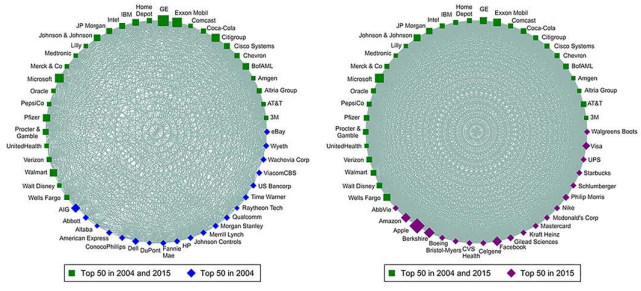
Figure 12.4 *Common ownership links among Europe's Top 50 companies in 2004 (left) and 2015 (right), based on the existence of a joint common ownership link, defined as all the common investors owning more, on average, in the two firms than the non-common investors*

4.2 Joint Ownership Links among the Top 50 US Firms and Comparison with Europe's Top 50

As Figure 12.5 shows, in contrast to European firms, US firms were already overwhelmingly jointly connected in 2004, and this has only become more pronounced in 2015. This difference is likely driven by the fact that large investors in Europe are often non-common owners (e.g., governments, foundations), and it thus becomes harder for investors with 5–10% stakes to obtain a majority as a group, i.e., a joint link; in previous work[39] we provide a detailed exposition of this factor.

[39] Banal-Estañol, Boot, and Seldeslachts (n 18) 167.

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12.5 Common ownership links among Europe's Top 50 US companies in 2004 (left) and 2015 (right), based on the existence of a joint common ownership link, defined as all the common investors owning more, on average, in the two firms than the non-common investors

4.3 Joint Ownership Links between Europe's Top 50 Firms and the Top 50 US Firms

Figure 12.6 shows that in 2004 some US and European firms are connected through joint links, but by 2015 almost all US firms share a joint link with (multiple) European firms. Note that all joint links are driven by US investors.

5. CONCLUSION

We find that, overall, Top 50 European firms are less connected than Top 50 US firms, both through individual and joint common ownership links. This is especially true in 2004 for individual 5% links: there are not many links in Europe, with the majority of firms being entirely disconnected from each other. On the other hand, by 2015, almost all European Top 50 firms are connected to other firms through US investment managers' holdings of at least 5% in each firm. A similar pattern is observed using the joint ownership measure. Interestingly, while almost all joint ownership links among European firms in 2004 were caused by European investors, *all* joint ownership links in 2015 were caused by US investors.

As regards US companies, although the Top 50 US companies were already fairly well connected in 2004 through individual 5% links, they became almost fully connected through 5% common ownership links in 2015. This is also true for our joint measure of common ownership, although we observe a less dramatic change, in part because the network was already highly connected at the beginning of the sample.

Interestingly, the picture is strikingly different for the individual 7.5% links. Both European and US firms are not that connected, but European companies are more connected than US companies, both in 2004 and 2015. At the 10% level, almost no connections exist among both among European and US firms, but in 2015, European companies have two 10% links, whereas US companies have only one.

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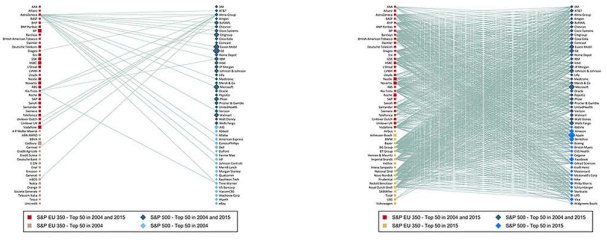


Figure 12.6 *Common ownership links between Europe's Top 50 firms and Top 50 US companies in 2004 (left) and 2015 (right), based on the existence of a joint common ownership link, defined as all the common investors owning more, on average, in the two firms than the non-common investors.*

Finally, the number of common ownership links between Top 50 European companies, on the one hand, and Top 50 US companies, on the other, has increased substantially over time for the individual 5% links. The same pattern holds for the joint common ownership links: in 2004, around 10 firms in each index were connected to one or more firms of the other index. By 2015, almost all Top US firms are connected to a Top European firm, while around 20% of European firms still shared no connection with an S&P 500 US firm. As for individual links at the 7.5% and 10% levels between European and US companies, between 2004 and 2015 the links between Europe's Top 50 and the Top 50 US firms became fewer; hence, European and US firms were less connected.

If the large US investment management companies are able to exert influence, as the empirical evidence we cite in the introduction suggests, then this increasing connectivity may have a non-negligible and growing impact on the prices, markups and profits of European firms as well. If US investment management companies can also effectively assert their power in European companies, this increasingly dense network might further lead to a softening of competition in Europe. Still, as the evolution of the network, and its connectivity, partly depends on the ownership stake used, the effects of common ownership might depend on whether common investors exert individual influence, and what level of ownership is needed, or joint influence.

This chapter provides an analysis of common ownership links among the very top firms in the two continents, independently of the sector in which they operate.[40] The impact of common ownership on product market competition, though, may depend on whether networks are dense within a given sector (or within a more narrowly-defined relevant market). Similar network structures exist, however, in particular sectors, for instance in the banking[41] and pharmaceutical[42] sectors, respectively. Still, it would be interesting to compare networks within and across sectors, and understand their potentially different effects on market outcomes.

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[40] Backus, Conlon and Sinkinson (n 5) 308.

[41] Banal-Estañol, Boot and Seldeslachts (n 18) 167; Banal-Estañol, Seldeslachts and Vives (n 6).

[42] Banal-Estañol, Newham and Seldeslachts (n 24).

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Further, it would be interesting to understand if the presence of interlocking directorships between firms, and more generally the board of directors' networks, reinforce the potential effects of common ownership on product market competition. Previous work[43] uses network analysis to study the structure and the evolution of interlocking directors between some of the large European firms. We know, at least for the US, that higher levels of common ownership are associated with a higher likelihood of sharing directors.[44] But an analysis of how the two networks compare in Europe, and their eventual effects, still remains, to our knowledge, an interesting avenue for further research.

[43] Brullebaut and others (n 26) 1782.
[44] Azar (n 3) 98.

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13. Common Ownership: The Paradox in Japan's Corporate Governance

Steven Van Uytsel

1. INTRODUCTION[1]

Japan's corporate governance model, one that could rely on strong mutual ties between companies in various industries and sectors—also known as *keiretsu*[2]—has long been considered the driving force behind Japan's economic success.[3] It was only after Japan entered an economic downturn, in the aftermath of the asset price bubble burst in 1991, that the corporate

[1] An earlier version of this paper was presented at the Kyushu University Workshop on Japanese Corporate Governance (December 8, 2022) and the ZEW–Leibniz Centre for European Economic Research in Mannheim Workshop (March 27–28, 2023). The author would like to thank the participants for their comments. The author would also like to thank Pieter Siebens, Conducting Officer Compliance, ExCo Member, RC and MLRO at MUFG Lux Management Company S.A., and Takatoshi Kondo, legal office at Daikin Industries Ltd, for discussing some of the issues raised in this paper. All mistakes remain the author's. This research has received funding from the Grants-in-Aid for Scientific Research (B) No. 21H00666.

[2] Časlav Pejović, 'Japanese Corporate Governance: Behind Legal Norms' (2011) 29(3) Penn. State International Law Review 483, 489 fn 16. The author states that "[t]here is a general consensus in the literature that the main bank, *keiretsu* and lifetime employment are the three central features of Japan's post-war system of corporate governance". However, two of the most prominent Japanese corporate governance scholars, Yoshiro Miwa and Mark Ramseyer, have recently published numerous articles and a book which suggest that all of the central features of Japanese corporate governance are "academic myths" (i.e., they do not exist). See Yoshiro Miwa & J. Mark Ramseyer, *The Fable of the Keiretsu* (U. Chi. Press 2006); Yoshiro Miwa & J. Mark Ramseyer, 'The Myth of the Main Bank: Japan and Comparative Corporate Governance' (2002) 27 Law & Soc. Inquiry 401. For a critique of Miwa and Ramseyer's contrarian research, which also supports the general view taken in this paper that the central features of Japanese corporate governance do indeed exist, see Dan W. Puchniak, 'A Skeptic's Guide to Miwa and Ramseyer's "The Fable of the Keiretsu"' (2007) 12 J. Japanese Law *273*; Dan W. Puchniak, 'Perverse Main Bank Rescue in the Lost Decade: Proof that Unique Institutional Incentives Drive Japanese Corporate Governance' (2007) 16 Pac. Rim L. & Pol'y 13.

[3] See Mitsuhiko Iyoda, *Postwar Japanese Economy: Lessons of Economic Growth and the Bubble Economy* (Springer 2010).

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governance model was questioned.[4] Especially cross-shareholding,[5] a characteristic of the *keiretsu* corporate governance model whereby companies that perceived themselves as closely related owned shares in one another, was under scrutiny.[6] This form of shareholding was said to be one of the reasons why managers in Japanese companies tend to take fewer risks or be less innovative and thus preventing the restoration of the economy.[7] Corporate governance reforms, explicitly limiting cross-shareholding or reforming accounting rules in relation to shares, diminished cross-shareholding.[8] Institutional investors bought many of the freed-up shares and were thus able to enter the corporate governance spectrum.[9] Being less intertwined with the investee companies, it was expected that the institutional investors would substantially contribute to alleviating the economic decline by enticing the corporate managers to be more competition oriented.

Institutional investors as shareholders may, however, not be without problems. There is growing literature investigating the effect of institutional investors each holding a minor stake in several competing companies, even in cases whereby the aggregate of these minor stakes is still not providing them a *de jure* controlling stake.[10] Several studies have held that this phenomenon, also known as common ownership, could lead to higher prices or fewer product choices.[11] It is still debated why this kind of ownership triggers such an effect. One view is

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[4] Ibid 69–94. The period of stagnation was originally dubbed the Lost Decade. See Guillaume Vandenbroucke, 'Comparing Japan's Lost Decade with the U.S. Great Recession' (2018) 3 Economic Synopses 1; Luke R. Nottage and Leon T. Wolff, 'Corporate Governance and Law Reform in Japan: From the Lost Decade to the End of History?' (2005) Comparative Research in Law & Political Economy. Research Paper No. 3/2005 1. The Lost Decade became Lost Decades as economic stagnation prolonged. See Yoichi Funabashi and ⁦Barak Kushner (eds), *Examining Japan's Lost Decades* (Routledge 2015), Introduction.

[5] See Gen Goto, 'The Japanese Stewardship Code: Its Resemblance and Non-resemblance to the UK Code' in Dionysia Katelouzou and Dan W. Puchniak (eds), *Global Shareholder Stewardship* (Cambridge University Press 2022), 224; Gen Goto, 'Legally "Strong" Shareholders of Japan' (2014) 3(2) Michigan Journal of Private Equity & Venture Capital Law 125; Časlav Pejović, 'Reforms of Japanese Corporate Governance: Convergence in the Eye of the Beholder' (2013) 35 Journal of Japanese Law 107.

[6] Paul Sheard, '*Keiretsu*, Competition and Market Access' in Edward M. Graham and J. David Richardson (eds), *Global Competition Policy* (Institute for International Economics 1997), 506.

[7] Takeo Hoshi and Anil Kashyap, *Corporate Financing and Governance in Japan: The Road to the Future* (MIT Press 2004) 200 and 202–203.

[8] Ulrike Schaede, *Choose and Focus: Japanese Business Strategies for the 21st Century* (Cornell University Press 2008).

[9] Ibid.

[10] See, for an overview of a substantial part of the debate, Martin Schmalz, 'Recent Studies on Common Ownership, Firm Behavior, and Market Outcomes' (2021) 66(1) Antitrust Bulletin 12. It may be that as a group, the common owners have a *de facto* controlling stake. See Anna Tzanaki, 'Varieties and Mechanisms of Common Ownership: A Calibration Exercise for Competition Policy' (2022) 18(1) Journal of Competition Law & Economics 168, 183.

[11] José Azar, Martin Schmalz and Isabel Tecu, 'The Anticompetitive Effects of Common Ownership' (2018) 73(4) Journal of Finance 1513; Mohammad Torshizi and Jennifer Clapp, 'Price Effects of Common Ownership in the Seed Sector' (2021) 66(1) Antitrust Bulletin 39; Ioannis Lianos and others, 'Financialisation of the Food Value Chain, Common Ownership and Competition Law' (2019) UCL Centre for Law, Economics and Society - Research Paper Series: 4/2019; José Azar,

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that the mere presence of institutional investors could create an environment in which managers are inclined to compete less or to act, consciously or unconsciously, in the interest of their common investors.[12]

By detailing the inclination of institutional investors in Japan towards common ownership, this chapter will posit that Japan's corporate governance might be entering a paradoxical phase. If the presence of institutional investors holding a common ownership position diverts the focus of management away from pursuing strategies that are optimal for the company, then they are potentially exacerbating the challenges associated with cross-shareholding rather than solving them.

Section 2 explains the start of the paradox by introducing how Japan embraced a corporate ownership structure characterized by cross-shareholding. Section 3 then shows that the non-applicability of competition rules to cross-shareholding made the Japanese legislator shift to financial and corporate law reforms to address the fallacies of cross-shareholding. Section 4 shows that the reforms changed the corporate ownership structure by introducing institutional investors and how these investors became common owners of competing companies. Section 5 explains how this common ownership may introduce new problems into Japan's corporate governance and thus elucidates the paradox. Section 6 concludes that cross-shareholding reforms have potentially led to another problem, i.e., common ownership.

2. THE POSTWAR GROWTH OF CORPORATE ECONOMIC NETWORKS IN JAPAN: *KEIRETSU*

2.1 *Keiretsu*, its Emergence, and Configuration

Before World War II, Japan's big companies were organized as conglomerates, with a holding company, a wholly-owned bank and several industrial subsidiaries. These were known as *zaibatsu*.[13] Because the perception grew that the *zaibatsu* contributed to the war effort

Sahil Raina, and Martin C. Schmalz, 'Ultimate Ownership and Bank Competition' (2022) 51(1) Financial Management 227. In the pharmaceutical sector, common ownership has likely delayed the marketing of generic brands. See Melissa Newham, Jo Seldeslachts, and Albert Banal-Estañol, 'Common Ownership and Market Entry: Evidence from Pharmaceutical Industry' (2017) DIW Berlin Discussion Paper No. 1738.

[12] See Einer Elhauge, 'New Evidence, Proofs, and Legal Theories on Horizontal Shareholding' (2018) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3096812 accessed 15 September 2022, 28–29 (stating that "reduction in pressure itself will likely have anticompetitive effects"); Azar, Raina and Schmalz (n 11) 232–233. For an overview of the different triggers for the anticompetitive effects of common ownership, see Jennifer G. Hill, 'The Conundrum of Common Ownership' (2021) 53(3) Vanderbilt Journal of Transnational Law 881, 896–897.

[13] *Zaibatsu* literally translates as 'wealthy clique'. Eleanor M. Hadley, *Antitrust in Japan* (Princeton University Press 1970) 20–60. See also Alex Y. Seita and Jiro Tamura, 'The Historical Background of Japan's Antimonopoly Law' (1994) University of Illinois Law Review 115, 130–135 and 138–145.

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of Japan,[14] the US, through the Supreme Command of the Allied Powers (SCAP),[15] envisioned that these conglomerates had to be dismantled and prevented from rising again.[16] Two pieces of legislation were central to this objective: the *Act on the Elimination of Excessive Concentration of Economic Power*[17] (Deconcentration Act) and the *Act on the Prohibition of Private Monopolization and Maintenance of Fair Trade*[18] (AMA).[19] Whereas the former aimed at dissolving the *zaibatsu*, the latter aimed to prevent these prewar conglomerates' resurrection[20] by incorporating provisions regulating corporate ownership in the AMA. The 1947 AMA forbade holding companies,[21] regulated shareholding among companies,[22] and limited persons from being directors in competing companies.[23]

Despite this original intent, geopolitical changes, such as the rise of communism and the war on the Korean peninsula, forced SCAP to reconsider its economic goals for Japan. SCAP shifted its policy from democratizing the economy to achieving swift economic growth.[24]

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[14] John O. Haley, *Antitrust in Germany and Japan: The First Fifty Years, 1947–1998* (University of Washington Press 2000) 28; Hadley (n 13) 4 (holding that "[t]he Allied assumption ... was that giant enterprises, benefitted greatly by a policy of foreign aggression, had supported the leadership directing foreign aggression..."). See also Seita and Tamura (n 13) 145 and 148.

[15] Matthew R. Augustine, 'A Research Guide to Research on the Allied Occupation of Japan' www.columbia.edu/~hds2/BIB95/02occupation_augustine.htm accessed 15 September 2022.

[16] For a detailed description, see Haley (n 14) 3–64.

[17] Law No. 207 of 1947, kado keizairyoku shuuchuu haijo hou [Elimination of Excessive Concentration of Economic Power Law].

[18] Law No. 54 of 1974, shiteki dokusen no kinshi oyobi kousei torihiki no kakuho ni kan suru houritsu [Law Concerning the Prohibition of Private Monopolies and the Assurance of Fair Trade].

[19] Haley (n 14) 32.

[20] Seita and Tamura (n 13) 165.

[21] The outright ban on holding companies was inscribed in Article 9 of the 1947 AMA. This ban can be explained as a direct reaction against *zaibatsu*, all characterized by a holding company structure. This provision banned setting up a company that had as its primary goal to control the business activities of a company or companies through shareholding. To prevent this article from extending to a parent-subsidiary relationship, the original Article 9 of the AMA did not apply to a company that had spun-off parts of its activities into subsidiaries. Masahiro Shimotani, 'Japanese Holding Companies: Past and Present' (2012) 29 Japanese Research in Business History 11, 14–15.

[22] Shareholding not amounting to a holding company was also regulated by the AMA in 1947. The then adopted Article 10 of the AMA banned any shareholding of nonfinancial companies in companies. Article 14 of the AMA extended this prohibition to any other person. The situation regarding shareholding was slightly different for financial companies. Financial companies (i.e., banking or insurance companies) could never hold shares of competing financial companies. Regarding other companies, Article 11 of the AMA of 1947 allowed financial companies to hold up to five percent of voting rights. See Michiko Ariga and Luvern V. Rieke, 'The Antimonopoly Law of Japan and its Enforcement' (1964) 39 Washington Law Review 437, 462.

[23] Article 13 of the 1947 AMA forbade a natural person from being a director in competing companies and from being a director in more than four companies. Ariga and Rieke (n 22).

[24] See Simon Vande Walle, 'Competition and Competition Law in Japan: Between Skepticism and Embrace' in Michael W. Dowdle, John Gillespie, and Imelda Maher (eds) *Asian Capitalism and the Regulation of Competition: Towards a Regulatory Geography of Global Competition Law* (Cambridge University Press 2013) 123–124; Haley (n 14) 39; Seita and Tamura (n 13) 116–117. To achieve this, the United States, already in 1949, approved the relaxation of some of the AMA's

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This new policy goal retracted the importance of the Deconcentration Act and allowed amending the stringent provisions of the AMA prohibiting companies from holding shares in each other.[25] In the 1960s, when foreign capital was allowed to enter Japan,[26] these AMA reforms gave the business community a chance to reconnect companies to corporate networks.[27] This reconnection resulted in the postwar phenomenon called *keiretsu*, a business conglomerate active in various industries and sectors and created through non-controlling cross-shareholding among financial and non-financial companies[28] and interlocking directorates.[29]

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provisions preventing companies from establishing formal ties with each other. The business community clarified that these provisions were a handicap in sustaining economic growth. See Haley (n 14) 53.

[25] The first revisions of the AMA happened in 1949. The revised Article 10 of the AMA allowed nonfinancial companies to hold shares in other companies on the condition that there would be no substantial restraint of competition. Article 13 of the AMA was revised to only prohibit interlocking directorates in cases where the companies were competitors. Ariga and Rieke (n 22). Other changes were implemented after Japan regained its sovereignty in 1952. The stake financial companies could hold in companies was increased to 10 percent of the voting rights. In 1977, it was decided to bring the level back to 5 percent for banking companies. Insurance companies could retain their level at 10 percent. Banking companies received a grace period of ten years until 1987 to reduce their shareholding. The decision to set the level of shareholding back at 5 percent was made after a JFTC study revealed that banks were among the top three shareholders in the major companies listed on the Tokyo Stock Exchange. Hiroshi Iyori and Akinori Uesugi, *The Antimonopoly Laws and Policies of Japan* (Federal Legal Publications 1994) 177–186. The ban on holding companies was only revised in 1997, despite the argument of the business community that the ban on holding companies "was a 'legal anomaly' on an international scale" and the claim that it "was a 'leftover GHQ policy' from the occupation." Shimotani (n 21) 13.

[26] Hadley (n 13) 205–256.

[27] The original version of the AMA originally forbade this cross-shareholding. In fact, in 1947, the AMA forbade all companies, except financial ones, from holding shares in other companies. The idea was to spread the shares that belonged to the prewar block shareholders, the zaibatsu families, and holding companies among individual shareholders. Iyori and Uesugi (n 25) 177–186. To achieve this, SCAP established a Holding Company Liquidation Commission (HCLC), which, together with Japanese government agencies, bought up shares from designated companies to resell them to employees and the public (ibid 14–15). A person already owning 1 percent or more was excluded from any further purchase. Equally, a person could not purchase more than one percent of a company's total shares. Ariga and Rieke (n 22) 462–463. This resulted in the dispersed ownership of companies immediately after the war. The aim to democratize the economy soon became problematic. In a country scattered by the war effort, the public and employees did not have the financial means to meet the need for capital. Seita and Tamura (n 13) 153. Hideaki Miyajima and Fumiaki Kuroki point out that this reform in 1964 was used to seek protection for companies against the pressures of the stock market, prompting the management of ex-zaibatsu companies to purchase shares in previously related companies. Furthermore, the government urged life insurance companies to actively buy shares. Hideaki Miyajima and Fumiaki Kuroki, 'The Unwinding of Cross-shareholding: Causes, Effects, and Implications', in Masahiko Aoki, Gregory Jackson and Hideaki Miyajima (eds), *Corporate Governance in Japan: Institutional Change and Organizational Diversity* (Oxford University Press 2007), 85.

[28] See section 2.2 Cross-shareholding as a crucial link between keiretsu companies.

[29] Pejović (n 2) 489 fn 16.

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The early *keiretsu* grew from the old *zaibatsu*. Companies that used to belong to the same *zaibatsu* started to hold shares in each other. Shareholding is often grouped around a bank, a trading company and other member companies.[30] As the economy developed, more company networks that did not have a history in the *zaibatsu* were established. Some of the new *keiretsu* grouped companies in a manufacturing-supplier relationship, others clustered distribution companies around major manufacturers, and others developed around department stores.[31] While the *zaibatsu*-linked *keiretsu* are generally termed horizontal or financial *keiretsu*,[32] there is less uniformity in naming the others. Generally, they are referred to as vertical *keiretsu*,[33] but supplier-centered *keiretsu* carry names such as industrial, manufacturing, or supplier *keiretsu*,[34] and distribution-oriented *keiretsu* is often named a distribution *keiretsu*.[35]

Horizontal *keiretsu* unite firms active in various industries with a single bank in the middle of the network, the main bank, which orchestrates "the activities of the member firms through its lending, equity, and board connections."[36] The other companies in this type of *keiretsu* often include industries like "cars, electronics, food and beverages, industrial equipment, insurance, and international trade."[37] There were initially six horizontal *keiretsu*: Mitsui, Mitsubishi, Sumitomo, Fuyo, Sanwa, and Dai-Ichi Kangyo.[38] The first four *keiretsu* are said to have counterparts in pre-World War II, the *zaibatsu*.[39] The latter two developed in the 1950s and 1960s, a period of fast economic growth, around two banks: Sanwa Bank and Dai-Ichi Kangyo Bank.[40] The so-called presidents' council or *sacho-kai*, "a regularly convening association of the presidents (*shacho*) of member firms,"[41] was typical for the horizontal *keiretsu*.

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[30] Sheard (n 6) 506.

[31] James R. Lincoln and Masahiro Shimotani, 'Business Networks in Post-War Japan: Whither the Keiretsu?' in Asli M. Colpan, James R. Lincoln, and Takashi Hikino (eds), *The Oxford Handbook of Business Groups* (Oxford University Press 2010) 151.

[32] See Mitsuo Matsushita, 'The Antimonopoly Law of Japan' in Edward M. Graham and J. David Richardson (eds), *Global Competition Policy* (Institute for International Economics 1997) 191; Sheard (n 6) 508.

[33] Ely Razin, 'Are the Keiretsu Anticompetitive – A Look to the Law' (1992) 18 North Carolina Journal of International Law 351, 368–373.

[34] See Matsushita (n 32) 191; Sheard (n 6) 508. Note that some emphasize the manufacturing stage and call this the industrial *keiretsu*. See Artur F. Tomeczek, 'The Evolution of Japanese Keiretsu Networks: A Review and Text Network Analysis of Their Perceptions in Economics' (2022) 62 Japan & The World Economy 1, 3.

[35] See Matsushita (n 32) 191; Sheard (n 6) 508.

[36] Lincoln and Shimotani (n 31) 130.

[37] Razin (n 33) 368.

[38] See Tomeczek (n 34) 3; Iyori and Uesugi (n 25) 323; Hadley (n 13) 257–290.

[39] See Sheard (n 6) 506. Mitsui, Mitsubishi, and Sumitomo, as keiretsu, carried the same name as when they were zaibatsu. Fuyo, as *keiretsu*, is seen as a direct successor of the Yasuda *zaibatsu*. See Hadley (n 13) 258–259. The composition of the Fuyo *keiretsu* also allows us to say that they had parts of the Asano and Okura *zaibatsu* incorporated into their structure. See Albrecht Rothacher, *The Japanese Power Elite* (Palgrave Macmillan 2016) 201.

[40] Sheard (n 6) 506. Compare Hadley (n 13) 258 and 262 (indicating that even the Fuyo and Dai-ichi Kangyo may find their origins in the prewar *zaibatsu*. The Fuji Bank was said to be connected to the Yasuda *zaibatsu*, while the Dai-ichi Bank stems from the Shibusawa *zaibatsu*, but the *keiretsu* as such equally had links with the Furukawa *zaibatsu* and the Kobe Kawasaki *zaibatsu*).

[41] Lincoln and Shimotani (n 31) 130.

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While the information on the membership of the presidents' council is publicly available, internal deliberations remain veiled in secrecy.[42]

The vertical *keiretsu*, whether it is the supplier or distribution *keiretsu*, does not stretch over various industries. This *keiretsu* is organized among firms in a supply chain or distribution relationship with each other. More specifically, vertical *keiretsu* relates to firms "engaged in the production of component products, the assembly of principal products, and the distribution of *keiretsu* output."[43] Eminent vertical *keiretsu* include Canon, Daihatsu, Hitachi, Honda, Nissan, Toshiba, and Toyota.[44] Unlike the horizontal variant, the vertical *keiretsu* did not develop the presidents' council. The cooperative association or *kyoryoku-kai* is said to play a similar role.[45]

The above description may give the impression that the *keiretsu* were well-delineated company networks; however, some horizontal and vertical *keiretsu* were intertwined and overlapping.[46] For example, Toyota aligned with Mitsui and had observer status within the Mitsui presidents' council, the Nimo-kai.[47] Daihatsu, affiliated with Toyota, actually belonged to the Sanwa *keiretsu*.[48] Hitachi was special as it was a member of the presidents' councils of the Fuyo, Dai-ichi Kangyo, and the Sanwa *keiretsu*.[49] Matsushita, not belonging to any of the presidents' councils, leaned toward the Sumitomo *keiretsu*.[50] It is now evident that these *keiretsu* are part of a continuum. The lines between the *keiretsu* were fundamentally redrawn at the end of the 1990s and the early 2000s when major bank consolidations occurred. Several *keiretsu*-related banks, "long[ing] the institutional leadership and public face of the horizontal *keiretsu*," [51] merged to form new financial institutions.

2.2 Cross-Shareholding as a Crucial Link Between *Keiretsu* Companies

Whether we talk about horizontal or vertical *keiretsu*, both types are characterized by close ties between companies. These ties are formalized through "cross-shareholding, personnel transfers, and preferential lending and trade."[52] Cross-shareholding (in Japanese, referred to as *kabushiki mochiai* or, in short, *mochiai*)[53] implies that *keiretsu* related companies hold shares in one another.[54] Thus, the corporate networks could grow.[55] Some companies would take a

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[42] Pejović (n 2) 504.
[43] Razin (n 33) 373.
[44] Tomeczek (n 34) 3.
[45] Lincoln and Shimotani (n 31) 130.
[46] Hadley (n 13) 300.
[47] Lincoln and Shimotani (n 31) 136–137.
[48] Ibid.
[49] Ibid.
[50] Ibid.
[51] Ibid 147.
[52] Ibid 136.
[53] Goto, 'The Japanese Stewardship Code' (n 5) 224. See also Pejović (n 5) 111 fn 12.
[54] The cross-shareholding in a Japanese corporate governance context is, in principle, between companies that belong to different industries and sectors. Although not excluded, this kind of cross-shareholding does not focus on the holding of shareholdings in competing companies.
[55] It is not possible to call it a group. Lincoln and Shimotani (n 31) 128.

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higher stake than others, but none would hold a controlling share in other companies;[56] however, combined, mutually held shares usually constitute a controlling portion of a company's shares.[57]

It can further be said that the cross-shareholding could also be stable shareholding or *antei kabunushi*,[58] which means that the shares were held for a long time.[59] Referring to a study of the Nihon Life Institute, Ulrike Schaede cautions that not all stable shareholding can be reduced to cross-shareholding. A substantial amount of the stable shareholding was held unilaterally.[60]

Data shows that cross-shareholding was at 23.6 percent in 1950, 36.8 percent in 1955, 47.4 percent in 1965, and 62.2 percent in 1974.[61] Cross-shareholding almost stabilized at around 63 percent until the early 1990s, when the shareholding of financial institutions gradually decreased, and foreign shareholding increased.[62] Data also discloses that financial companies have held the highest portion of cross-shareholding.[63]

The following figure (Figure 13.1[64]) visualizes cross-shareholding information between 1970 and 1995 with a 5-year interval. The two highest lines in Figure 13.1 illustrate the extent of the cross-shareholding. Aggregating the percentages of these lines shows that, until 1995, cross-shareholding was above 60 percent.

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[56] Goto, 'The Japanese Stewardship Code' (n 5) 224.

[57] Pejović (n 5) 112. See also Goto, 'The Japanese Stewardship Code' (n 5) 224.

[58] Goto, 'The Japanese Stewardship Code' (n 5) 224.

[59] Ulrike Schaede, 'The Strategic Logic of Japanese Keiretsu, Main Banks and Cross-Shareholdings, Revisited' (2011) Columbia Business School, Center on Japanese Economy and Business Working Paper 247.

[60] Ibid.

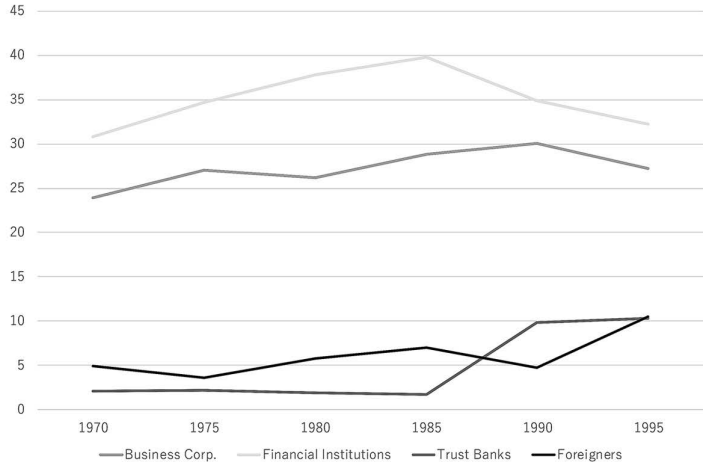
[61] Miyajima and Kuroki (n 27) 85.

[62] Ibid 86.

[63] Ibid. Two reasons can explain why financial companies have been able to secure that position. When SCAP drew its plans for postwar Japan, the aim was to break up the *zaibatsu*, including the attached banks. To guide this process, the Deconcentration Act was adopted. The law required SCAP to designate the companies that had to be dismantled. The plan was to identify such companies in four sectors: industrial, distributive and service, insurance, and banking. While the Holding Company Liquidation Commission (HCLC) was able to designate companies in the two former sectors, a change in the position of SCAP toward its plans with Japan due to geopolitical reasons meant that the deconcentration policy toward banks was forfeited. In 1948, the HCLC declared that banks would not be subject to designation, allowing them to keep the dominant position they had acquired in the prewar and wartime periods. Furthermore, the law allowed these financial companies to use their influence. The AMA explicitly stated that these companies could hold up to 5 percent, at certain times even 10 percent, of the other company's shares. Seita and Tamura (n 13) 156–157; Pejović (n 5) 113 (indicating that this was remarkable because the United States did not allow banks to hold shares in other banks).

[64] Japan Exchange Group, '2021 Shareownership Survey' (2023) https://www.jpx.co.jp/english/markets/statistics-equities/examination/01.html accessed 15 September 2022.

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Source: The data for the figure were obtained from the Japan Exchange Group, 2021 Shareownership Survey. Financial institutions include City and Regional Banks, Trust Banks, and all insurance companies.

Figure 13.1 Distribution percent of market value owned by type of shareholders

3. *KEIRETSU*: FROM COMPETITION LAW TO A CORPORATE GOVERNANCE ISSUE

3.1 Questioning Cross-Shareholding From a Competition Law Perspective

The presence of cross-shareholding, and by extension *keiretsu*, within the Japanese economy has been unquestioned for a relatively long time. Industrial organization literature even lauded the *keiretsu* structure and its cross-shareholding because it enabled management to focus on the company's growth. The *keiretsu* model guaranteed economic security through continued business transactions, making companies less dependent on high dividends. Any profits could be redirected to the further expansion of the companies.[65] Furthermore, financial companies could overcome the information gap between borrowers and lenders in a system with a high dependency on bank loans and cross-shareholding, often combined with board representatives of bank personnel or other personnel placements. It also allowed the banks to step in and sanitize companies that had run into trouble.

The first signs of criticism toward the *keiretsu*, particularly the cross-shareholding, came from the US when there was a tremendous trade imbalance with Japan at the end of the

[65] Ulrike Schaede, 'Competition for Corporate Control: Institutional Investors, Investment Funds, and Hostile Takeovers in Japan' (2006) Columbia Business School, Center for Japanese Economy and Business, Working Paper No. 248, 30.

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1980s. In the framework of the Structural Impediments Initiative, the negotiations aiming at eradicating elements causing the trade deficit, the US trade negotiators argued that *keiretsu* could induce anticompetitive results due to the structural weakening of the AMA.[66] US trade representatives argued that Japan had to take more rigorous enforcement measures against these *keiretsu* based on the AMA's remaining provisions on shareholding.[67] The US call was met with an investigation by the Japan Fair Trade Commission (JFTC) into the phenomenon of *keiretsu*.[68]

The JFTC took a narrow view and limited its investigation to the horizontal *keiretsu*, drawing the following conclusions. Each *keiretsu* had a substantial number of shares controlled by its member companies. The top shareholders belonged to the same *keiretsu*. Most shareholders were considered stable; they did not dispose of their shares for a long time. Furthermore, financial companies were found to be shareholders across different *keiretsu*. None of these findings, however, allowed for the conclusion that the provisions on shareholding in the AMA were infringed.[69]

The exclusionary effect that intragroup transactions may have had on outsiders, whether foreign or domestic, was another argument to call upon the JFTC for more control of the *keiretsu*. In this regard, the JFTC surveyed the intragroup transactions of the six big horizontal *keiretsu* at two different points in time. The general conclusion was that intragroup transactions were in decline. Another finding was that foreign companies without any relation to the *keiretsu* were barely among the top 30 trading partners. On the contrary, non-related domestic and related foreign firms were relatively well represented among the top 30 trading partners. The poor representation of foreign firms led to the question of whether any intragroup transactions represented anticompetitive conduct under the AMA's provisions on vertical agreements. More specifically, the question was raised whether these transactions hindered new market entry or excluded existing competitors from the market.

The JFTC acknowledged that longstanding transactional relationships could produce such anticompetitive outcomes; however, as is widely shared in the literature, this would

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[66] On Structural Impediments Initiative (SII), see Mark K. Morita, 'Structural Impediments Initiative: Is it an Effective Correction of Japan's Antimonopoly Policy' (1991) 12 University of Pennsylvania Journal of International Law 742; Norio Naka, *Predicting Outcomes in United States-Japan Trade Negotiations: The Political Process of the Structural Impediments Initiative* (Quorum Books 1996) 18–19; Jonathan E. Johnson III, 'Keiretsu: Their Effect on Business and How American Government and Business Can Confront Them' (1992) Brigham Young University Law Review 1155, 1164, and 1166.

[67] See United States Senate, Committee on Finance, 'United States-Japan Structural Impediments Initiative Hearing before the Sub-Committee on International Trade' (1990) 102 https://www.finance.senate.gov/imo/media/doc/hrg101-5943.pdf accessed 15 September 2022; Matsushita (n 32) 155; Naka (n 66) 22 (where the author indicates that the commitments of Japan toward *keiretsu* were mainly directed toward stricter enforcement of the AMA).

[68] Two scholars refer to the fact that the Japan Fair Trade Commission monitored large business groups, to be understood as *keiretsu*. See Schaede (n 8) 90 (also indicating that the last survey on *keiretsu* was in 2001); Iyori and Uesugi (n 25) 320–340.

[69] This can be deduced from the conclusion that the AMA is difficult to apply to *keiretsu*. See Matsushita (n 32) 191 (indicating that *keiretsu* often depend on informal arrangements). Another source for this conclusion is the continuous data collection by the JFTC on the *keiretsu*, without attaching further enforcement action to it. See Iyori and Uesugi (n 25) 320.

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require a case-by-case analysis.[70] Hence, it cannot be said that a *keiretsu* is *a priori* infringing the AMA, which depends on how the *keiretsu* members conceptualize the transactions. Reciprocal dealings, for example, would likely not infringe the AMA if they were not made exclusive. Equally, refusals to deal would only be problematic if the *keiretsu* had attained market dominance; however, market dominance would be challenging to achieve as there was fierce competition between *keiretsu*.[71]

The above led to the general conclusion that a rigid application of the AMA is not a solution to problems stemming from *keiretsu*. Traditional competition law instruments did not provide a theory of harm suitable to address such problems if they were to exist.

3.2 One Last Attempt to Expand Competition Law Towards *Keiretsu*

Paul Sheard seems to challenge the suitability of traditional competition law instruments to deal with *keiretsu* and cross-shareholding. After conceding to the above conclusions, Sheard explores whether there needs to be a new theory of harm developed for *keiretsu*.[72]

Keiretsu relies on long-term transactions between member companies; thus, this is not extraordinary. According to industrial organization literature, companies that have done business with each other have accumulated advantages over companies with no business relations. Therefore, it is normal for long-term transactions to occur within the market; however, the unique characteristic of the *keiretsu*, in which cross-shareholding plays a tremendous role, is that it could create a bias toward long-term transactions.[73]

Sheard does not elaborate on the formation of bias. On the one hand, he reverts to the industrial organization literature, stating that the decision to work with related companies reflects a mere rational decision. The cost of dealing with *keiretsu* member companies is considered inexpensive; thus, it is hard to consider this decision as a bias that would be an anticompetitive or unfair practice. On the other hand, Sheard opines that the impact on market foreclosure is minimal.[74]

Despite these two reflections, when alluding to the bias, Sheard includes one sentence on how cross-shareholding and bank financing protect the management from hostile takeovers.[75] However, he does not investigate the impact of this protection mechanism on the formation of the above-mentioned bias, which the competition law literature has neglected for a long time. This lack of research means that the competition law literature has neglected to link the *keiretsu* with the theory of a "quiet life" developed by finance and corporate law scholars.

The theory of a quiet life is an old theory that Sir John R. Hicks developed in 1935 to qualify the behavior of managers of monopoly companies. Hicks purported that managers of a monopoly company were not adequately prompted to perform their managerial duties. The monopoly situation insulates managers from the product market, so they do not have to make

[70] See, e.g., Iyori and Uesugi (n 25) 320–340; Razin (n 33) 379–405; Matsushita (n 32) 184–195.
[71] Razin (n 33).
[72] Sheard (n 6) 526.
[73] Ibid.
[74] Ibid.
[75] Ibid.

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difficult decisions.[76] However, managers are not necessarily shielded from the product market in the context of *keiretsu*. They are shielded from the control of the capital market,[77] which could have allowed them to make choices that were not necessarily pro-competitive.

3.3 Cross-Shareholding in Decline After Corporate Governance Reforms

The *keiretsu* stronghold—cross-shareholding—has been compromised from the 1990s onwards. Legal reform caused banks to retreat as one of the principal shareholders within the *keiretsu* structure. In general, the economic downturn, which started after the real estate bubble burst in 1991, made holding shares among *keiretsu* members less attractive.[78]

Financial companies have been very prominent in holding shares of *keiretsu* members. A survey in 1991 revealed that banks still had about 11 percent of the total stock market capitalization.[79] Twelve years later, this holding was reduced to 3.6 percent. The economic crisis may have contributed to this reduction. Companies had to deal with nonperforming loans and had to restructure. Furthermore, two legal reforms changed the "institutional leadership and public face"[80] of the *keiretsu*.

One of the legal reforms was the revision of the financial reporting rules, forcing Japanese firms and banks to report the results of all affiliates they have real control of in consolidated accounts. This kind of change in the accounting rules prevented the practices often employed by *keiretsu* affiliates from hiding liabilities or assets by transferring them to other affiliates. A further change in 2001, which required reporting assets at market value and thus revealing the undercapitalization of many banks, caused a rush to withdraw from cross-shareholding.[81]

Schaede described another reason for the reduction of shareholding by banks in her book *Choose and Focus*, in which she also puts a number on the amount of money banks had to withdraw from the stock market:

> But the most important trigger of the mass sell-off after 2001 was the new Law Limiting Banks' Stock Ownership. Designed to improve the stability of the banking system, this law limits a bank's total shareholdings to its size, strictly defined as 'own capital.' In fiscal year 2001, the largest four banks alone were estimated to face a shareholding overhang of about ¥ 7 trillion, which created immense pressure to reduce stakes. By way of reference, in March 2001, city banks and other banks (excluding trust banks) held ¥ 35.7 trillion worth of shares at current market value, but this declined to ¥ 18.2 trillion in March 2003.[82]

There seems to be a consensus that cross-shareholding reduction did not persevere, especially among business corporations.[83] The downward trend of cross-shareholding seems to have

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[76] John R. Hicks, 'Annual Survey of Economic Theory: The Theory of Monopoly' (1935) 3(1) Econometrica 1, 8.

[77] Goto, 'The Japanese Stewardship Code' (n 5) 224.

[78] Scott R. Anderson, 'Are Japan's Corporate Governance Reforms Working?' (2018) Investment Research 2, https://www.lazardassetmanagement.com/docs/product/-sp10-/66807/arejapan%E2%80%99scorporategovernancereforms_lazardresearch_en.pdf accessed 15 September 2022.

[79] See Schaede (n 8) 99.

[80] Lincoln and Shimotani (n 31) 147.

[81] Ibid 148.

[82] Schaede (n 8) 99.

[83] Pejović (n 5) 130–131. See also Schaede (n 8) 97–99; Pejović (n 2) 506.

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stopped around 2007 and almost stabilized.[84] Whether or not the cross-shareholding has been sold is not in itself important for the argument of this chapter; however, the reduction in cross-shareholding, opening perspectives for other investors to buy shares, is important. Data shows that foreign and domestic institutional investors (investment trusts and trust banks), foreign and domestic private equity funds, and individuals bought released shares.[85]

The following figure (Figure 13.2[86]) shows the decline of cross-shareholding from 1995 onwards. Business corporations' shareholdings are almost stable, around 20 to 25 percent. The shareholding by financial institutions, including regional and local banks and all types of insurance companies, dropped from above 30 percent to around 7 percent. Trust banks and foreigners, including institutional investors, experienced a steep increase in shareholding.



Source: The data for the figure were obtained from the Japan Exchange Group, 2021 Shareownership Survey. Financial institutions include City and Regional Banks, Trust Banks, and all insurance companies.

Figure 13.2 Distribution percent of market value owned by type of shareholder (excluding individuals and securities firms)

[84] Tomomi Takada and Katsuhiko Muramiya, 'How Cross-Shareholding Influences Financial Reporting: Evidence from Japan' (2020) 28(5) Corporate Governance: An International Review 309, 312. See also Takaya Seki, 'The Japanese Corporation: Community, Purpose, And Strategy' in Thomas Clarke, Justin O'Brien, and Charles R.T. O'Kelly (eds), *The Oxford Handbook of the Corporation* (Oxford University Press 2019) 434.

[85] Schaede (n 8) 110–125.

[86] Japan Exchange Group (n 64).

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4. NEW SHAREHOLDERS MANIFEST THEMSELVES AS COMMON OWNERS

The corporate governance reforms changed the shareholding structure. The shares that were sold due to these reforms were either bought by a new type of shareholder or by shareholders that were previously not very present in the Japanese stock market.

The *sai-shintaku* (trust of trusts) is one example of a new type of shareholder, which did not exist before 2000. Three of these *sai-shintaku* were initially created: Japan Trustee Services Bank, Trust and Custody Services Bank, and Master Trust Bank of Japan.[87] The former two formed the Custody Bank of Japan, thus reducing the number of *sai-shintaku* to two.[88] These two *sai-shintaku* specialize "in securities processing by administering the trust business of two of the four main banking groups."[89] The Custody Bank of Japan (CBJ) mainly centers around Mitsui Sumitomo Trust Holdings, Resona Bank, and Mizuho Financial Group.[90] The Master Trust Bank of Japan (MTBJ) is the specialized trust investor of Mitsubishi UFJ Trust and Banking, Nippon Life Insurance, Meiji Yasuda Life Insurance, and Norinchukin Trust & Banking.[91]

Both *sai-shintaku* have become ubiquitous with their shareholding, listed among the major shareholders of almost every publicly listed company. In this sense, they have become common owners of competing companies. If we look at the first-tier companies in the construction industry in 2022, CBJ and MTBJ are among the principal shareholders of Taisei (5.4 percent and 16.1 percent, respectively), Obayashi (8.1 percent and 16.9 percent, respectively), Shimizu (4.1 percent and 14.7 percent, respectively), and Kajima (5.1 percent and 16.0 percent, respectively).[92] Equally, this kind of shareholding is noticeable in the food industry, and more specifically, the beverages industry: Asahi Group Holdings (4.7 percent CBJ and 17.1 percent MTBJ), Kirin Holdings (4.6 percent CBJ and 13. percent MTBJ), Suntory Beverage and Food (2.1 percent CBJ and 6.8 percent MTBJ), and Sapporo Holdings (3.6 percent CBJ and 15.3 percent MTBJ).[93] The presence is also noticeable in the nonferrous mining industry: Sumiseki Holdings (1.4 percent CBJ and 9.3 percent MTBJ), Nittetsu Mining (2.8 percent CBJ and 10.6 percent MTBJ), and Mitsui Matsushima Holdings (2.2 percent CBJ and 9.5 percent MTBJ).[94]

Common ownership by the *sai-shintaku* also has a vertical dimension. The *sai-shintaku* also hold shares in companies in a supply/distribution relationship. To exemplify this, for

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[87] Ulrike Schaede, 'Corporate Governance Reform in Japan' in Knut Sogner and Andrea Colli (eds), *The Emergence of Corporate Governance: People, Power and Performance* (Routledge 2021) 161; Seki (n 84) 427.

[88] Custody Bank of Japan, 'Message from the Management' (2020) https://www.custody.jp/english/message/index.html accessed 15 September 2022.

[89] Schaede (n 8) 113.

[90] Custody Bank of Japan, 'Corporate Data' (2020) https://www.custody.jp/english/corporate/index.html accessed 15 September 2022 (enumerating the other shareholding banks in this trust); See also Schaede (n 8) 113.

[91] The Master Trust Bank of Japan, 'Corporate Overview' (2022) https://www.mastertrust.co.jp/english/corporate.html accessed 15 September 2022. See also Schaede (n 8) 114 (informing that the last-mentioned trust is the trust arm of the umbrella bank for all agricultural cooperatives).

[92] Toyo Keizai Inc., *Japan Company Handbook 2022* (Toyo Keizai Shinposa 2022) 124–128.

[93] Ibid 270–275.

[94] Ibid 102–103.

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the year 2022, CBJ has shares in Nissan Motors (1.8 percent), Toyota Motor (5.8 percent), Mitsubishi Motor (0.7 percent), Honda Motor (5.9 percent), Subaru (4.9 percent), and Mazda Motor (4.3 percent). MTBJ has 8.7 percent, 11.7 percent, 6.1 percent, 14.8 percent, 14.6 percent, and 15.8 percent, respectively. Furthermore, the *sai-shintaku* are also shareholders in several car parts manufacturers, such as Akebono Brake Industry (1.9 percent CBJ and 9.4 percent MTBJ), Tachi-S (5. percent CBJ and 5.9 percent MTBJ), or Mikuni (3.7 percent CBJ and 8.1 percent MTBJ).[95]

Yet, *sai-shintaku* are not the only institutional investors that have taken a share from the previous cross-ownership of the financial institutions. The increase in foreign shareholding also results in more shareholding by foreign institutional investors.[96] In that sense, it is common for firms from the Vanguard or BlackRock family to hold shares in, for example, the construction industry.[97] For example, the shareholding of the Vanguard family floats around 3 percent in Taisei, around 2.5 percent in Shimizu, around 3.1 percent in Obayashi, and around 2.9 percent in Kajima. The BlackRock family situates around 3.2 percent in Taisei, around 3.3 percent in Shimizu, around 3 percent in Obayashi, and around 2.8 percent in Kajima.

Besides the *sai-shintaku*, there is the Bank of Japan's (BOJ) accumulation of exchange-traded funds (ETFs) tracking the TOPIX Index and the Nikkei 225 Index, making the BOJ an indirect owner of the ETFs' portfolio companies.[98] This ownership means that the BOJ is a passive owner without voting rights and thus cannot voice its concerns regarding the company's governance. The ownership and voting rights in the portfolio companies (exercised by proxy with the proxy policies being publicized)[99] lie with the ETF sponsor companies.[100] These sponsoring companies are trust banks and asset management companies.[101] The amount

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[95] Ibid 1397–1419.

[96] Schaede (n 65) 16.

[97] See Taisei https://www.morningstar.com/stocks/xtks/1801/ownership accessed 15 September 2022; Shimizu https://www.morningstar.com/stocks/xtks/1803/ownership accessed 15 September 2022; Obayashi https://www.morningstar.com/stocks/xstu/oba/ownership accessed 15 September 2022; Kajima https://www.morningstar.com/stocks/xngo/1812/ownership accessed 15 September 2022.

[98] The literature is mostly disconnected from the concept of *keiretsu*. See Leonardo Cadamuro, 'Had BoJ Intervention Attract ETFs' Private Investment?' (2022) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4184064 accessed 15 September 2022; I Go and Kazuo Yamada, 'Passive Ownership and Accounting Conservatism: Evidence from the BOJ's ETF Purchasing Program' (2022) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4177156 accessed 15 September 2022; Takahiro Hattoria and Jiro Yoshida, 'The Impact of Bank of Japan's Exchange-Traded Fund Purchases' (2022) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3575835 accessed 15 September 2022; Hiroshi Gunji, Kazuki Miura, and Yuan Yuan, 'The Effect of the Bank of Japan's ETF Purchases on Firm Performance' (2021) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3798098 accessed 15 September 2022. Some literature mentions the *keiretsu* when making a reference to these new shareholders. See Masumi Sai and Kazuo Yamada, 'Does Passive Ownership Affect Corporate Governance? Evidence from the Bank of Japan's ETF Purchasing Program' https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3894249 accessed 15 September 2022; Seki (n 84) 427.

[99] Sai and Yamada (n 98).

[100] Ibid 2.

[101] Cadamuro (n 98) Table 3.

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of ownership administered by these banks and companies is known to the portfolio companies.[102] It has been reported that the Government Pension Investment Fund, which manages the Japanese government's pension plans, is undertaking similar investments through trust banks and asset management companies, thus making it also an indirect owner.[103]

The literature does not link indirect ownership with common ownership, which may have to do with the fact that the investment is hidden. The use of ETFs makes it difficult to provide exact data on whether there is any common ownership. However, the BOJ is said to be a top ten shareholder in 90 percent of the Nikkei 225 Index listed companies through the ETFs it bought.[104] The Nikkei Index overview shows that many of the companies included in the Nikkei 225 Index are in direct competition with each other, as it groups companies per sector.[105] Regarding the competition in the blue-chip sector, the media claims, for example, that the BOJ is the "major owner of more Japanese blue-chips than both BlackRock Inc., the world's largest money manager, and Vanguard Group, which oversees more than $3 trillion."[106]

In an academic paper, I Go and Kazuo Yamada stress that "[t]he voting rights of ETF sponsor companies have dramatically increased."[107] They further reveal that one of the sponsor companies is Nomura Asset Management, of which the "NEXT FUNDS 225" is the largest Nikkei 225 ETF.[108] Exploring this further in several databases, it is indeed noticeable that Nomura Asset Management,[109] joined by several other Japanese asset management companies that manage ETFs, holds shares across the horizontal and vertical spectrum of the market.[110]

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[102] It is not obvious how much is indirectly owned by the BOJ. The BOJ does not disclose the information on its daily purchases, but estimates have been made on how much the BOJ indirectly owns. Hiroshi Gunji, Kazuki Miura, and Yuan Yuan estimated that in 2014, indirect ownership in some companies rose to six percent of the number of shares issued. See Gunji, Miura, and Yuan (n 98) 1.

[103] The Asahi Shinbun, '2 Public Entities Hold Large Stakes in 84% of Firms Listed on TSE' (2020) https://www.asahi.com/ajw/articles/13863217 accessed 15 September 2022. See also Seki (n 84) 427 (indicating that the GPIF is most likely using the *sai-shintaku* to purchase their ETFs).

[104] Anna Kitakana, 'BOJ Seen Quietly Snapping Up Big Stakes in Japan Inc. via ETFs' (2016) https://www.japantimes.co.jp/news/2016/04/25/business/boj-seen-quietly-snapping-big-stakes-japan-inc-via-etfs/ accessed 15 September 2022; Cf Go and Yamada (n 98) 1 n. 4 (showing that 80% of the ETFs is owned by the BOJ).

[105] Nikkei Indexes, 'Components: Nikkei Stock Average (Nikkei 225)' https://indexes.nikkei.co.jp/en/nkave/index/component accepted 15 September 2022.

[106] Kitakana (n 104).

[107] Go and Yamada (n 98) 12.

[108] Ibid 12–13.

[109] Ibid 13.

[110] Among these databases, see Morningstar (https://www.morningstar.com/); Market Screener (https://www.marketscreener.com/); Financial Times (https://markets.ft.com/data/equities). For example, using the latter database, the following picture can be drawn about the shareholding of major Japanese asset management companies in the major construction industry firms: Nomura Asset Management (Taisei 5.7%; Shimizu 3.8%; Obayashi 5%; Kajima 4.95%); Sumitomo Mitsui Asset Management (Taisei 3.3%; Shimizu [missing %?]; Obayashi 3.3%; Kajima 3.3%); Nikko Asset Management (Taisei 1.9%; Shimizu 1.8%; Obayashi 2.1%; Kajima 1.8%); Daiwa Asset Management (Taisei 2.3%; Shimizu 1.7%; Obayashi 2%; Kajima 1.6%).

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5. COMMON OWNERSHIP: A PARADOX IN JAPAN'S CORPORATE GOVERNANCE?

In the Japanese corporate governance literature, the described evolution has been largely disregarded. This literature primarily emphasizes the increased prominence of institutional investors within Japan's shareholding structure and elaborates on their potential influence on corporate governance. The focus is on how institutional investors could shift managers' attention from long-term economic growth strategies to short-term profit strategies. It was anticipated that these investors might, without hesitation, voice their concerns or sell their stakes in the company, with the worst-case scenario being a decline in share prices, rendering the company vulnerable to a hostile takeover. In essence, institutional investors were expected to no longer behave as stable shareholders but rather to "increase large firms' sensitivity to profit measures, efficiency, and competitiveness."[111]

There has been ongoing discussion about whether these expectations materialized. The unwinding of cross-shareholding did not reach the extent anticipated. From 2005, it was evident that banks withdrew their shareholdings in keiretsu companies, but this was not necessarily the case for non-financial keiretsu companies. These companies maintained stable cross-shareholding levels.[112] Gen Goto acknowledged this evolution but nuanced it. While recognizing a temporary return to cross-shareholding around 2005, he emphasized the need to differentiate between large listed companies and small to medium-sized listed companies.[113] Cross-shareholding remained present in the latter type of companies and thus still significantly influences the corporate governance of those companies. It is common to observe that cross-shareholding companies are inclined to maintain business relationships and support incumbent management.[114]

Contrastingly, the corporate governance of large listed companies is more impacted by institutional investors. Finance scholars concluded that the higher the share of foreign institutional investors in a company, the greater the return on assets generated.[115] Similar conclusions were drawn for the presence of domestic institutional investors.[116] Presented with these findings, Goto questioned whether the higher returns resulted from a disciplinary effect on management or if the investors had superior skills in predicting which companies would outperform others. The study found no conclusive evidence for either alternative explanation or any reason to exclude one over the other. Goto suggested that, at least theoretically, it is plausible that institutional investors have a disciplinary effect on management.[117] Hidefusa Iida agreed that different answers could be given regarding why companies with foreign institutional investors perform better in terms of return on assets or equity,[118] prompting a call

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111 Schaede (n 8).

112 Pejović (n 5) 130–131.

113 Gen Goto, 'Legally "Strong" Shareholders of Japan' (n 5) 145.

114 Ibid 142.

115 Ibid 155.

116 Ibid 156.

117 Ibid.

118 Hidefusa Iida, 'Foreign Shareholders and Corporate Governance in Japan' (2019) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3346798 accessed 15 September 2022 (clarifying that foreign institutional investors may have a bias toward well-known and large companies but

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for further empirical studies. Current empirical studies on institutional investors' impact on the corporate governance of large listed companies have predominantly focused on foreign institutional investors.[119] Some have expanded their research scope to include domestic institutional investors, with a particular focus on the investments of one significant investor, the BOJ.[120]

Some studies on the BOJ's investment impact on companies' performance found a decrease in return on assets.[121] Other studies addressing corporate governance effects yielded two noteworthy conclusions.[122] On the one hand, increased passive ownership led to the removal of antitakeover defenses, the adoption of executive stock options, a higher ratio of outside directors and female board members, a smaller board, and higher payouts.[123] On the other hand, it has been suggested that the positive influence on corporate governance resulted from a rule in the 2017 Stewardship Code, imposing transparency duties on passive funds.[124]

The Stewardship Code in Japan was developed by the Financial Services Agency (FSA) to incentivize institutional investors to discipline the management of investee companies. Under the guidance of the FSA-established Council of Experts Concerning the Japanese Version of the Stewardship Code, principles were elaborated in 2014 to improve communication between domestic institutional investors and their investee companies. With these principles deemed insufficient, the Council of Experts mandated disclosure in 2017, requiring domestic institutional investors to reveal how they voted on each agenda item at the annual shareholding meeting.[125] The 2020 revision imposed a duty to explain the reason for votes in case of a conflict of interest between the institutional investor and investee companies.[126]

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equally indicating that the mere presence of these investors does not seem to trigger an improvement in corporate governance. Yet the fear of exit prompts company directors to aim for better performance).

[119] Ibid 17.

[120] Several studies have been conducted. Some earlier studies focused on the stock prices. See Kohei Aonoa, Hiroshi Gunjib, and Hayato Nakata, 'Did the Bank of Japan's Purchases of Exchange-traded Funds Affect Stock Prices? A Synthetic Control Approach' (2021) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3786502 accessed 15 September 2022 and Hattoria and Yoshida (n 98). Subsequent studies focused on firm performance. See Gunji, Miura, and Yuan (n 98). The latest studies also include the impact of this evolution on corporate governance. See Sai and Yamada (n 98); Go and Yamada (n 98).

[121] See Mitsuru Mizuno and Hajime Shimizu, 'The Influence of Institutional Investors on Corporate Governance and Firm Performance: Evidence from Japan' (2015) 3 Kindai Management Review 75; Miyajima and Kuroki (n 27).

[122] See Sai and Yamada (n 98); Cadamuro (n 98); Gunji, Miura, and Yuan (n 98); Go and Yamada (n 98).

[123] Sai and Yamada (n 98) 29.

[124] Ibid 30.

[125] Go and Yamada (n 98) 2.

[126] Gen Goto, 'The Logic and Limits of Stewardship Codes: The Case of Japan' (2018) The University of Tokyo Business Law Working Paper Series No. 2018-E-01, 37 fn 144, where he states that "[f]or example, Professor Kenjiro Egashira lists the inactivity of domestic institutional investors as one of the basic foundations of the traditional Japanese corporate governance system and claims that the 2014 Reform of the Companies Act introducing the 'comply or explain' rule on the appointment of at least one outside director would fail to change the behavior of Japanese listed companies as long as domestic institutional investors stay the same". See Kenjiro Egashira,

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While the Stewardship Code is considered a corporate governance instrument promoting transparency, its efficacy as a solution to the inertia of domestic institutional investors in disciplining investee company managers requires irrefutable evidence. What may be considered evidence of institutional investors encouraging managers to act for the good of the company is also used by some in the common ownership literature to argue that managers give preference to common shareholders' interests.[127] If this situation were to arise in Japan, the conclusion would be that corporate reforms facilitating institutional investors have substituted one problem with another. Cross-shareholding, identified as a cause of reduced managerial incentives for efficiency and innovative strategies, is evolving into common ownership, increasingly linked to anticompetitive outcomes or inefficient investment environments.[128]

It is still too early to conclude whether the influence exerted by common owners-institutional investors in Japan is having any of the just-described consequences. Due to the lack of exact data on the spread of common ownership, one could speculate in both directions.

The need to keep close attention to common ownership lies in the phenomenon of the *keiretsu* and cross-shareholding. *Keiretsu* have been known for being active in various industries. It was not so that one *keiretsu* network concentrated in one or two industries. Competition between keiretsu companies in an industry was said to be fierce. Despite the competition, many of the *keiretsu* occupied industries had developed into oligopolistic markets.[129] The entry of institutional investors as common owners may aggregate the market power of the companies within the oligopolistic industries. Cross-shareholding has decreased but not vanished. Hence, the stability the existing levels of cross-shareholding offer to the management may be further fortified by the new common owners. If the cross-shareholding makes the management lazy towards competition and innovation, common owners may not induce the management "to pursue bold, long-term, or transformative investments as they are hard to evaluate and might be misperceived by shareholders as inefficient investments."[130]

The relatively little attention paid to common ownership in Japan could equally be explained by characteristics of Japanese corporate governance.[131] It is only recently that executive stock

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Kaishaho no kaisei ni yotte nihon no kaisha ha kawaranai [Japanese Companies Would Not Change Regardless of the Companies Act Reform] (2014) 86(11) Horitsu Jiho 59, 60."

[127] Einer Elhuage, 'The Causal Mechanisms of Horizontal Shareholding' (2021) 82 Ohio State Law Journal 1, 6–23.

[128] See n 11 above. For inefficient investments, Zohar Goshen and Doron Levit, 'Common Ownership: Shareholders Win and Employees Lose' (2021) ECGI Law Working Paper N° 584/2021 9.

[129] Julie A. Shepard, 'Using United States Antitrust Laws Against the Keiretsu as a Wedge into the Japanese Market' (1993) 6 Transnat'l Law 345, 363.

[130] Zohar Goshen and Doron Levit, 'Agents of Inequality: Common Ownership and the Decline of the American Worker' (2022) 72 Duke Law Review 1, 6.

[131] For an overview of the little discussion in Japan, see Noboru Kawahama, 'Kyōtsū kabunushi (common ownership) no kyōsō mondai - kōporētogabanansu to dokusen kinshi-hō no kyōtsū kawai to shite' [Competition Issues of Common Ownership—Common Challenges of Corporate Governance and the Antimonopoly Law], in Yasuhiro Ozaki, Izumi Kawashima, and Yasunobu Wakabayashi (eds), *kōkaikaisha-hō to shihon'ichiba no hōri: Uemura Tatsuo sensei koki linen* [Public Company Law and Legal Theory of Capital Markets: Professor Tatsuo Uemura's 70th Anniversary Commemoration] (Shōji Hōmu 2019) 253; Ryutaro Nakayama, Tatsuya Tsunoda, and Takuma Iwasaki, 'Common ownership o meguru shomondai - kyōsō-hō kōporēto hōsei no

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options, even though inscribed in the commercial code since 1997,[132] are increasingly implemented.[133] Moreover, a key element incentivizing managers to shift their attention to common owners, being industry performance executive stock option,[134] is still rare in Japan. When Hitachi implemented this kind of scheme, the Nikkei Asia reported that only a handful of companies in Japan have such a scheme.[135]

6. CONCLUSION

The existence of common ownership and its potential impact in Japan have not yet been discussed. This chapter aims to be the start. In unraveling Japan's evolution toward common ownership, this chapter can only conclude that it creates a potential paradox within Japan's corporate governance.

The paradox has much to do with how corporate governance has developed in the post-war period. Competition law has long prevented Japanese companies from taking shares in each other. When it became possible, a cap was put on the percentage of shares that could be held. This led to a situation in which companies that considered themselves friendly to each other started taking shares in each other, thus establishing cross-shareholding. When the corporate governance literature considered cross-shareholding to be problematic, the Japanese legislator implemented regulatory reforms to unwind that form of shareholding. The shares that became available on the market were bought up by institutional investors.

The institutional investors do not limit their investment to a group of companies that considered themselves belonging to one network, the *keiretsu*. This results in institutional investors investing in companies that are competing with each other, thereby creating common ownership. Common ownership may not be without problems. There is growing literature suggesting that, in concentrated markets, common ownership could also lead to inefficient managerial decisions. Thus, whereas the problem of cross-shareholding may be addressed by the law reforms in Japan, another problem may have been introduced. Yet, this conclusion should include one caution: more empirical research is required to see whether any of the negative connotations of common ownership have taken root in Japan.

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kanten kara' [Issues Surrounding Common Ownership—From the Perspective of Competition and Corporate Law] in Hideki Kanda and Capital Markets Research Institute (eds), *Kigyō hōsei no shōrai tenbō—shihon'ichiba seidō no kaikaku e no teigen* [Future Prospects of Corporate Legislation—Proposals for Reform of Capital Market System] (Shihon Shijō Kenkyūkai 2019) 390.

[132] See Sadao Nagaoka, 'Determinants of the Introduction of Stock Options by Japanese Firms: Analysis from the Incentive and Selection Perspectives' (2005) 78(6) The Journal of Business 2289.

[133] Yoichiro Hiroi, 'Hitachi Links Exec Pay to Stock Gains against Siemens, Accenture: Unusual Scheme for Japan Gives Management More Skin in the Game' Nikkei Asia (21 June 2023), https://asia.nikkei.com/Business/Companies/Hitachi-links-exec-pay-to-stock-gains-against-Siemens-Accenture.

[134] Miguel Antón et al., 'Common Ownership, Competition, and Top Management Incentives' (2023) 131(5) Journal of Political Economy 1294.

[135] Ibid.

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14. Addressing Common Ownership Through Abuse of Collective Dominance

Giorgio Monti

1. INTRODUCTION[1]

Article 102 TFEU applies to a dominant position held jointly by more than one undertaking, but the precise contours of the concept of collective dominance are unclear.[2] The only time the concept of collective dominance was used in a systematic manner was when considering mergers in oligopoly markets under the first iteration of the EU Merger Regulation.[3] At the time, the Commission could only block mergers which were likely to create or strengthen a dominant position, but the Commission was quick to extend this to mergers that created a position of collective dominance when there were concerns that the merged entity would coordinate with remaining rivals in an oligopoly, and the Court of Justice confirmed this interpretation of the Merger Regulation.[4] The reform of the Merger Regulation in 2004 rendered this interpretation of the concept of collective dominance useless because the substantive test for analysing mergers changed: henceforth, the Commission was empowered to intervene when a merger would be likely to substantially impede effective competition.[5] This new legal standard for assessing mergers led the Commission to issue guidelines where the elements of collective dominance were inserted under the heading of coordinated effects instead.[6] Therefore in today's merger assessments in oligopoly markets, we find no reference to the legal concept of collective dominance but we find the Commission looking for whether the merged entity and remaining rivals are likely to coordinate their conduct post-merger.[7] This is a theory of harm that arises relatively infrequently; most mergers that come for review raise concerns about unilateral effects resulting from mergers creating or strengthening a dominant position.

Turning back to Article 102, some have discussed the extent to which we might say that there is an abuse of collective dominance to address coordinated behaviour among oligopolists

[1] The author is grateful for the very helpful comments from Florence Thépot and Anna Tzanaki while retaining responsibility for all remaining errors.

[2] Giorgio Monti, 'The Scope of Collective Dominance under Article 82 EC' (2001) 38(1) Common Market Law Review 131.

[3] Council Regulation (EEC) No 4064/89 on the control of concentrations between undertakings [1989] OJ L395/1. See e.g. Case M.190, Nestlé/Perrier [1992] OJ L356/1, para 137.

[4] Joined Cases C-68/94 and C-30/95 *French Republic and Société commerciale des potasses et de l'azote (SCPA) and Entreprise minière et chimique (EMC) v Commission*, EU:C:1998:148.

[5] Council Regulation (EC) 139/2004 on the control of concentrations between undertakings [2004] OJ L24/1.

[6] Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings [2004] OJ C31/5, paras 39–57.

[7] See, e.g., Case M.7881, *AB Inbev/SAB Miller* (24 May 2016).

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in the absence of an agreement or concerted practice, but the Commission has made no attempt to pursue this enforcement path.[8] As a result, the concept of collective dominance has remained dormant.

However, a new way of sparking life in this concept was suggested in a report to the OECD by Einer Elhauge, who posited that in the EU, the notions of collective dominance and of excessive pricing found in Article 102 provide 'a straightforward solution to the problem of horizontal shareholding.'[9]

Horizontal shareholding, or common ownership of horizontal competitors, refers to a situation where some institutional investors hold minority shareholdings in a number of firms which are in competition with each other. A spate of recent economic papers has indicated that common ownership yields anticompetitive effects in the product market.[10] The intuition is as follows: suppose institutional investors own minority shares in two rivals in a duopoly. Here, shareholder value is maximized if the two firms compete less and both price well above marginal cost.[11] Accordingly, either common shareholders have an incentive to take steps to induce the managers of the two firms not to compete aggressively against each other, or the directors will realize the interests of common shareholders and, absent any prompting by shareholders, will act in such a way as to maximize the total portfolio profits of common shareholders, taking into account their financial interests in rivals and proportionally to their common shares.[12] This conduct (which occurs without express communication) with its concomitant anticompetitive effect should trigger antitrust liability of the common shareholders or of the firms. However, some have expressed doubts: "it is not clear from the literature how shareholdings translate into action and influence upon management."[13] As will be shown in this chapter, addressing this question proves fundamental for understanding how to apply EU competition law.

More generally, from the perspective of EU competition law, the anticompetitive effects that have been identified seem to fall outside ordinary rules because competition law does not recognize what Anna Tzanaki calls diffuse common ownership, where common shareholders

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[8] See Monti (n 2); Nicolas Petit, 'The Oligopoly Problem in EU Competition Law' in Ioannis Lianos and Damien Geradin (eds), *Research Handbook in European Competition Law* (Edward Elgar Publishing 2013).

[9] Einer Elhauge, 'Tackling Horizontal Shareholding: An Update and Extension to the Sherman Act and EU Competition Law' (OECD, 6 December 2017) 3, Einer Elhague, 'How Horizontal Shareholding Harms Our Economy—And Why Antitrust Law Can Fix It' (2020) 10 Harvard Business Law Review 207, 278–279.

[10] José Azar, Martin Schmalz and Isabel Tecu, 'Anticompetitive Effects of Common Ownership' (2018) 73 Journal of Finance 1513; Martin C. Schmalz, 'Recent Studies on Common Ownership, Firm Behavior, and Market Outcomes' (2021) 66(1) Antitrust Bulletin 12.

[11] José Azar, 'The Common Ownership Trilemma' (2020) 87 The University of Chicago Law Review 263.

[12] Anna Tzanaki, 'Varieties and Mechanisms of Common Ownership: A Calibration Exercise for Competition Policy' (2022) 18(1) Journal of Competition Law and Economics 168.

[13] Simona Frazzani and others, *Barriers to Competition through Common Ownership by Institutional Investors*, Study for the Committee on Economic and Monetary Affairs, Policy Department for Economic, Scientific and Quality of Life Policies (European Parliament, Luxembourg, 2020) 51. https://www.europarl.europa.eu/RegData/etudes/STUD/2020/652708/IPOL_STU(2020)652708_EN.pdf.

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have minority ownership in all commonly held firms at the same time.[14] This phenomenon is not caught by Article 101 TFEU because the common shareholders do not enter into agreements to suppress competition directly.[15] Even ex ante, the acquisition of a minority of shares by an institutional investor does not fall within the scope of the Merger Regulation since the acquirer does not obtain control of the target.[16] This chapter examines how far the notion of abuse of collective dominance can serve as a mechanism to address anticompetitive effects in common ownership scenarios by reference to the case-law on collective dominance and the economic literature on common ownership. The application of ex ante merger control is outside the scope of this discussion, although it is clear that merger control should also be amended to allow competition authorities to forbid acquisitions that would strengthen common ownership and cause anticompetitive effects.[17]

In section 2, the limits to applying Article 101 to common ownership are set out. Having shown that this is inapplicable, section 3 turns to uncover how far firms under common ownership may be treated as holding a position of collective dominance. Here it is shown that while precedent does not support this application, an argument may be made that the effectiveness of EU competition law requires a wider interpretation of the concept of collective dominance. Criteria for identifying collective dominant positions are set out.

Having found that the scope of the concept of collective dominance might extend to some horizontal shareholders, an account is needed of what constitutes an abuse. This is discussed in section 4. Two scenarios are considered, depending on how the anticompetitive effects result.[18] In cases where institutional investors take active steps to influence directors, it is possible to find that such conduct constitutes an abuse of collective dominance by the investors. Conversely, in cases where directors respond to the ownership structure in an anticompetitive way and raise prices, it is more difficult to see a successful antitrust case emerging. The Court of Justice's case-law has made it very difficult to prove excessive pricing even by a single firm with an undoubted dominant position when it raises prices in an egregious manner.[19]

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[14] Tzanaki (n 12).

[15] It may be possible to utilize Article 101 by challenging cases where common venture capital investors insert terms in their agreements with portfolio firms (e.g. a special right to appoint directors that may be common among competing firms). On this, see Anna Tzanaki, 'EU Competition Law and Common Ownership' in Andrea Biondi and Oana Stefan (eds.) *Elgar Encyclopedia of European Law* (Edward Elgar Publishing forthcoming).

[16] Anna Tzanaki, 'Common Ownership and Minority Shareholding at the Intersection of Competition and Corporate Law: Looking Through the Past to Return to the Future?' in Marco Corradi and Julian Nowag (eds), *Intersections between Corporate and Antitrust Law* (Cambridge University Press 2023) 301–305 for a helpful taxonomy of shades of control, some of which are economically relevant but which fall outside the legal regimes.

[17] See Tzanaki (ibid, 307), doubting whether an ex ante regime can identify instances of harmful common shareholding, and Tzanaki (n 12), section IV.B, for discussions on how to shape merger policy.

[18] However, observe that there is skepticism over both: C. Scott Hemphill and Marcel Kahan, 'The Strategies of Anti-Competitive Common Ownership' (2019) 129 Yale Law Journal 1392.

[19] Giorgio Monti and Leigh Hancher, 'Excessive pricing in pharmaceuticals: Perspectives from EU antitrust and regulation' in Wolf Sauter, Marcel Canoy and Jotte Mulder (eds), *EU Competition Law and Pharmaceuticals* (Edward Elgar Publishing 2022).

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Even if an abuse is found, the firm accused of abusing its collective dominance has multiple opportunities to defend itself, whether by challenging the existence of an abuse in the first place or by showing countervailing efficiencies.[20] How might this affect the application of Article 102 in the context of common ownership? This is discussed in section 5.

Finally, in section 6, remedies are discussed. This raises the following questions. First, there is the question of attribution: who is abusing the dominant position? The firm or the institutional investor? Moreover, as fines are unlikely to prevent all anticompetitive effects, we discuss the legal difficulties in using Article 102 to order divestitures.

This chapter takes no stance as to whether horizontal shareholding is or is not an antitrust problem; this is a question for others.[21] Assuming that there is a competition concern, the chapter considers how far Article 102 goes as a promising way of addressing it. The issue has already received a thorough assessment in the hands of Florence Thépot.[22] The contribution of this chapter is to add further reservations about the capacity of collective dominance to serve as the silver bullet to address antitrust concerns about horizontal shareholding, while showing that certain anticompetitive practices may be caught by this provision.

2. THE LIMITS OF ARTICLE 101 TFEU

It is worth asking if developing the notion of collective dominance is worth the trouble if we could just say that inter-firm relations found in settings of common ownership are agreements prohibited under Article 101. However, when it comes to common ownership, the problem with Article 101 is identifying an anticompetitive agreement. There is an agreement between shareholder and the firm that the shareholder gains voting rights, for example. This agreement might be characterized as one between undertakings. But holding voting rights is not anticompetitive.[23] Holding voting rights in multiple rivals may well create an incentive to use those rights in a way to soften competition, but this cannot constitute an agreement restrictive of competition. Of course, if a set of institutional investors agree among each other to exercise their shareholding rights in a coordinated way, this is easily characterized as collusion among investors falling within Article 101, but this is not the scenario that worries policymakers and scholars. The concern is that the economic incentives resulting from common ownership cause, even without communication, anticompetitive effects in the relevant market.

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[20] Case C-680/20 *Unilever Italia Mkt. Operations Srl v Autorità Garante della Concorrenza e del Mercato*, EU:C:2023:33.

[21] The Commission considers that there may be competition problems; see Case M-7932 *Dow/DuPont* (27 March 2017), para 2352, finding that in the context of innovation competition, horizontal shareholdings 'provide indications that innovation competition in crop protection should be less intense as compared with an industry with no common shareholding.' A skeptical approach is found in Alec J. Burnside and Adam Kidane, 'Common ownership: an EU perspective' (2020) 8(3) Journal of Antitrust Enforcement 456 ('reform prescriptions that have been advanced are a solution in search of a problem').

[22] Florence Thépot, *The Interaction Between Competition Law and Corporate Governance: Opening the 'Black Box'* (Cambridge University Press 2019) chapter 5.3.

[23] But query whether special voting rights secured by the investor might be treated as having anticompetitive effects, see Tzanaki (n 15).

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In the context of vertical restraints, we sometimes encounter a setting where anticompetitive effects emerge as a result of a network of agreements. Suppose a distributor agrees to sell the goods of a manufacturer exclusively and not sell rival goods. One such agreement is not anticompetitive, but a set of similar agreements between all manufacturers and other distributors may well foreclose market access to rivals.[24] So here competition law provides that while a single contract does not violate the competition rules, a series of such contracts may do so. Observe that in this setting each agreement contains a clause that is capable of harming competition given a particular legal and economic context, for example, an exclusivity agreement. This allows Article 101 to apply because the cumulative effect of a number of individual agreements causes market foreclosure. In these settings, the appropriate remedy would be for manufacturers to terminate some of their distribution agreements to facilitate the entry of rivals.

Can we say, by analogy, that common ownership falls under Article 101 because while a single purchase of shares by one institutional investor is an agreement that has no anticompetitive effects, once many institutional investors all hold shares in the same firms which are in competition with each other, then the cumulative effects of a series of innocent shareholdings become an agreement restrictive of competition? The first thing to observe is that this theory of harm would require a showing of anticompetitive effects: we would be unable to condemn this set of agreements as restrictive of competition by object because the economic effects may be positive as well as negative. Even if anticompetitive effects were shown, the answer is in the negative: the difference is that in the vertical restraint example, the anticompetitive effects are the direct result of the application of many exclusive purchasing agreements. In horizontal shareholdings, the anticompetitive effects are less direct: they stem from the common shareholders realizing that in this configuration it pays more to use their votes in a way that reduces competition between the firms, or the company director realizing that it pays not to compete. This additional action which leads to the anticompetitive effect is not part of the agreement between shareholder and firm. It is the shareholder making a unilateral choice about how to vote, or the manager making a unilateral decision not to compete aggressively against rivals. Horizontal shareholding as such reduces the individual incentives to cut prices and compete against rivals.[25] No specific agreement is required. Perhaps it could be argued that the decision of an institutional investor to buy shares in competitors to ensure that there is common ownership across all industry actors could be assessed under Article 101, but the link between the purchase and the effects seems remote. Alternatively, one might focus on specific elements of an agreement where the shareholder obtains special voting rights: is the grant of these special voting rights an agreement that may be assessed under Article 101?[26] These approaches seem to stretch Article 101 beyond what is possible under the case-law.

It may be argued that the *Philip Morris* judgment contradicts this reading. The ECJ was clear that the acquisition of minority shareholding is an agreement within Article 101 when it 'has the object or effect of influencing the competitive behaviour of the companies on the

[24] This is well-explained in Case C-234/89 *Delimitis v Henninger Bräu*, EU:C:1991:91.

[25] Ioannis Lianos, Valentine Korah and Paolo Siciliani, *Competition Law: Analysis, Cases, & Materials* (Oxford University Press 2019) chapter 12.2.1.8.

[26] Tzanaki (n 15).

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relevant market.'[27] However, this only applies in a situation where Article 101 is applied ex ante to an acquisition. At this point in time, the Commission is assessing the risk of the agreement in question. Indeed, it has been said that the court 'emphasised the need to consider the longer-term potential impact of the transaction.'[28] It is hard to apply this precedent in an ex post setting where we witness anticompetitive conduct by firms under common ownership. Absent a more extensive interpretation of the concept of agreement, this leaves a gap and makes it necessary to explore whether these anticompetitive effects might constitute an abuse of dominance, the only other legal mechanism available in EU competition law to address firm conduct ex post.

3. COLLECTIVE DOMINANCE

3.1 The Concept of Collective Dominance

The modern law on collective dominance starts with *Flat Glass*, where the Court of First Instance (now known as the General Court) provided this definition:

> There is nothing, in principle, to prevent two or more independent economic entities from being, on a specific market, *united by such economic links* that, by virtue of that fact, together they hold a dominant position vis-à-vis the other operators on the same market.[29]

Later in *Almelo,* the Court of Justice added that the firms 'must be linked in such a way that they adopt the same conduct on the market.'[30] These dicta were rationalized by AG Fennelly in the *CEWAL* judgment: 'the twofold test – the existence of sufficient economic links to lead to an effective single market entity – is in substance one and … the latter is the predominant element. A single dominant position has to be established, i.e. that several undertakings act as a single entity and thus unilaterally on the market.'[31]

The test requires the finding of a salient link between the undertakings plus a finding that this link affords the undertakings the power to dominate the market.[32] It can be applied in product markets relatively easily: if there is a duopoly in the market for widgets, pricing is transparent and both firms have sufficient spare capacity to retaliate if one of them begins an aggressive discounting campaign, then the two firms will have an incentive to cooperate and set high prices. No conversation is necessary for the two firms to coordinate their conduct. In this setting, the two firms are collectively dominant.[33] This approach has been used to prohibit

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[27] Joined Cases 142 and 156/84 *British-American Tobacco Company Ltd and R. J. Reynolds Industries Inc. v Commission*, EU:C:1987:490, para 45.

[28] Lianos and others (n 25) chapter 12.2.1.8.

[29] Joined Cases T-68/89, T-77/89 and T-78/89 *Società Italiana Vetro SpA and others v Commission*, EU:T:1992:38, para 358 (emphasis added).

[30] Case C-393/92 *Municipality of Almelo and others v NV Energiebedrijf Ijsselmij*, EU:C:1994:171, para 42.

[31] Joined cases C-395/96 P and C-396/96 P *Compagnie maritime belge transports SA et al v Commission*, EU:C:1998:518 (*Cewal*) Opinion of AG Fennelly, para 28.

[32] Further on the definition of collective dominance, see Monti (n 2).

[33] Case T-342/99, *Airtours plc v Commission*, EU:T:2002:146, para 62.

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mergers in highly concentrated industries, but as mentioned before, it has not been applied ex post.

But AG Fennelly went on to provide a preliminary taxonomy of other kinds of links that might establish collective dominance, which includes cross-shareholdings, common directorships and family links with economic consequences.[34] This list holds some promise for including certain forms of common shareholding under the collective dominance label. We first examine similar types of relations that have been recognized by the case-law to see what hints we can find about the possibility of finding collective dominance in situations of horizontal shareholding and then discuss how far these help to include common shareholding within the ambit of collective dominance.

Turning first to minority shareholding, the Commission used Article 102 to regulate the acquisition of minority shareholdings before the coming into force of the Merger Regulation when this conferred the ability to control or influence the target firm. The theory of harm is premised upon the acquisition creating or strengthening a *single* dominant position, however. The *Gillette* decision is a helpful illustration of this.[35] Gillette was dominant in the market for wet-shaving products, and it participated in the buy-out of one of its rivals (Wilkinson Sword) by Eemland, a holding company. Gillette acquired a 22% share in Eemland. Gillette had 'no voting rights, no representation on the Board of Eemland, no representation at shareholders' meetings and no access to internal information.'[36] However, Gillette had loaned Eemland significant amounts of money. The Commission considered that in these circumstances Eemland 'will be obliged to take into account' the views of Gillette.[37] Minority shareholding, plus other aspects of the takeover, made the target dependent on Gillette, and as a result there was a real risk that Gillette would require that the shaving products made by Wilkinson Sword become a low value brand allowing Gillette to corner the high value market.[38] There are other instances where the Commission considered competition risks arising from the acquisition of minority shareholdings.[39] For example, in *Enichem/ICI* it exempted a joint venture on the condition that the parents would not acquire interests in competitors.[40] However, in none of these decisions was it necessary to rely on collective dominance: the concern is that minority shareholding would influence the commercial conduct of rivals and thereby harm competition.[41]

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[34] *Cewal* Opinion of AG Fennelly (n 31) para 28.

[35] Case IV/33.440 *Warner Lambert/Gillette* and IV/33.486 *BIC/Gillette* [1993] OJ L116/21, see especially para 24.

[36] Ibid, para 14.

[37] Ibid, para 24.

[38] Ibid, para 30. Interestingly, in this case the relevant market of shaving products in the EU is composed of four firms: Gillette, Wilkinson Sword (under the trademark of Eemland), Schick (the trademark of Warner-Lambert) and BIC. Both BIC and Warner-Lambert also had equity in Eemland, but this did not raise any competition concerns; indeed, these two firms were complainants.

[39] Enzo Moavero Milanesi and Alexander Winterstein, 'Minority Shareholdings, Interlocking Directorships, and EC Competition Rules: Recent Commission Practice' (2002) 1 Competition Policy Newsletter 15; Francisco Enrique González-Díaz, 'Minority Shareholdings and Interlocking Directorships: The European Union Approach' 2012(1) CPI Antitrust Chronicle.

[40] Case IV/31.846 *Enichem/ICI* [1988] OJ L50/18, para 53.

[41] Now that there is a Merger Regulation, these cases would fall under its scope only if it is shown that the acquisition of minority shareholdings gives the acquirer control of the target. Short

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There is one decision where minority shareholdings were found to reveal a position of collective dominance, finally confirming the intuition of AG Fennelly: the French competition authority's decision in *Genentech/Novartis/Roche*.[42] These three firms were held together by a mesh of relations, as follows: Roche controlled Genentech (first it had 60% of the shares in 2009 and since then 100% of the shares). Genentech had developed two drugs: Avastin (a cancer drug) and Lucentis (an eye drug). It granted the commercialization rights of Avastin to Roche and for Lucentis to Novartis Pharma, which was a subsidiary of Novartis, which in turn held 33% of the shares in Roche. In the view of the competition authority, the licensing agreements and the shareholdings combined to suggest that there were structural and financial links to allow it to conclude that there was a position of collective dominance held by the three firms. On the facts, the competition concern arose because according to some doctors, Avastin (which had a lower market price than Lucentis) could be prescribed for eye ailments as well. This practice risked harming the profits of Lucentis. Both Roche and Novartis had a common interest in maximizing sales of Lucentis and took steps to prevent the use of Avastin for eye treatments by issuing warnings about this use.

While the Paris Court of Appeal quashed the decision by finding that there was no abuse as well as some inaccuracies in market definition, it did not question the finding of collective dominance.[43] The facts show the usefulness of this notion: Novartis, Genentech and Roche had a common interest in preserving the segmentation of the market for the two drugs. The findings of collective dominance reveal this shared interest in acting in a coordinated manner to keep their profits high.

A second type of corporate relation that has been considered is interlocking directorates. These are settings where 'one or more companies have one or more members of their boards in common.'[44] There is one decision where the Commission found collective dominance by reference to this, *Irish Sugar*. In brief, before 1990, Irish Sugar, the major sugar processor in Ireland, held 51% of the equity of Sugar Distribution Holdings (SDH), which was the parent company of Sugar Distribution Limited (SDL), its rival on the Irish market. The managing director of Irish Sugar and other of its directors were on the boards of both SDH and SDL. There were also regular meetings among the three firms to discuss the challenges faced by SDL and SDH as a result of imports. Furthermore, there were direct economic ties as SDL undertook to buy sugar exclusively from Irish Sugar and Irish Sugar paid for all the promotional discounts offered by SDL. Putting all these features together, the Commission concluded that '[t]hese economic links created a clear parallelism of interest of the two companies

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of this, the Merger Regulation does not apply.

[42] Decision 20-D-11 of 9 September 2020.

[43] Cour d'appel de Paris, Pôle 5 - Chambre 7, Arrêt du 16 Février 2023: https://www.autoritedelaconcurrence.fr/sites/default/files/appealsd/2023-02/Arr%C3%AAt%20RG%20n%C2%B0%2020-14632.pdf.

[44] Florence Thépot, 'Interlocking directorates in Europe – An Enforcement Gap?' in Marco Corradi and Julian Nowag (eds), *The Intersections between Corporate and Competition Law* (Cambridge University Press 2023) 190, and see Monti (n 2) 139–141 focusing on collective dominance aspects.

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vis-à-vis third parties.'[45] Consequently, there was a joint dominant position on the granulated sugar market for both retail and industrial sale in Ireland.[46]

3.2 Application to Common Ownership

From the discussion above, we have two decisions which have utilized the notion of collective dominance where the corporate links between otherwise independent undertakings suggested common interests. Do these, by analogy, allow us to say that common shareholding amounts to a position of collective dominance among the common shareholders?

An argument for saying no is that the two decisions consider a wide range of corporate links between the firms. It is these multiple connection points that allow the competition authority to conclude that the firms present themselves on the market as a single dominant firm, which is the hallmark of collective dominance. Conversely, the literature on common ownership relies on much fewer connection points. For example, Elhauge has noted that the antitrust worry arises when there is both high product market concentration and 'the same set of institutional investors has large, leading stockholdings across such a concentrated product market.'[47] This might not suffice to establish collective dominance based on existing case-law if all we have is common ownership.

Conversely, it might be argued that this interpretation is too rigid. The Court of Justice has always interpreted competition law provisions with an eye to ensuring the effective application of competition law.[48] From this perspective, existing interpretations of the notion of collective dominance should not be used to limit the reach of competition law when doing so would lead to gaps in the coverage of competition law. From this purposive interpretative stance, it may be argued that common shareholding should be a sufficient factor to find that these firms hold a collectively dominant position because these types of shareholdings raise competition concerns. More specifically, both *Irish Sugar* and *Genentech/Novartis/Roche* are instances where the collectively dominant firms have a shared interest in achieving the anti-competitive outcome that the competition authorities identified, which is precisely the kind of risk that arises under settings of common ownership.

However, not every instance of common ownership will give rise to collective dominance of common shareholders. One must distinguish settings where common ownership is competitively neutral and settings where this is truly problematic.[49] We might be unconcerned if there are only two common owners each having but 1% of the shares of each firm, but be more worried if common shareholders have larger voting rights collectively.[50] Conversely, the distribution of the remaining shares also matters. If two common owners have 5% of the shares

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[45] Cases IV/34.621 and 35.059/F-3 *Irish Sugar plc* [1997] OJ L258/1, para 112.

[46] Ibid, para 113.

[47] Einer Elhauge, 'Horizontal Shareholding' (2016) 129 Harvard Law Review 1267, 1272.

[48] Case 6/72 *Europemballage Corporation and Continental Can Company Inc. v Commission*, EU:C:1973:22; Case C-376/20 P *Commission v CK Telecoms Investments*, EU:C:2023:561.

[49] See generally Eric A. Posner, Fiona M. Scott Morton and E. Glen Weyl, 'A Proposal to Limit the Anti-Competitive Power of Institutional Investors' (2017) 81(3) Antitrust Law Journal 669, where the authors discuss the modified Herfindhal-Hirshman Index (HHI) standard.

[50] Some argue that even with relatively low individual shareholdings, there may be a competition risk if one adds up all the shareholdings of the common owners, by which collectively

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of two rival firms but each rival firm is controlled by a powerful majority shareholder, then common ownership may not present competition concerns. In this scenario, whatever pressure the director feels to follow the interests of the minority shareholders will be cancelled out by the direction provided by the powerful majority shareholder. Generalizing from these two examples, the key consideration is that for there to be collective dominance, we not only need the common owners to hold shares in all firms in the relevant product market, but we also need to ensure that the common owners have sufficient economic power to influence the decision-making process of the directors: this requires that they have a sizeable aggregate number of shares and that there is no other shareholder that dominates the choices of the directors. In the language of the Court, these features are the economic links necessary to demonstrate that there is a collective position of dominance. This economic power is not to be equated with market power, but with the capacity of the common shareholders to either act to influence directors or to have such a presence that directors are affected by their shareholdings in their decisions. The identification of the degree of such power will be a question of fact, and courts or agencies can consider creating safe harbours of legality.

Finally, having established that the investors present themselves as a collectively dominant entity, the question of whether the market in which they hold shares should also be highly concentrated should be considered. The bulk of the economic studies have revealed that the anticompetitive effects manifest in concentrated product markets. Narrowing the application of Article 102 to follow this insight makes economic sense and also serves two additional purposes. First, it avoids false positives by limiting the power of competition authorities to intervene only in cases where the risk is highest. Second, it can provide a safe harbour for investors who will be better able to plan their activities knowing whether or not they are likely to be found to be collectively dominant.

Implementing these concepts will require further specification by competition authorities and courts: they would have to identify what shareholding threshold suffices to raise concerns as well as how to measure the countervailing power of other shareholders. These are questions of fact to be developed incrementally by decision-makers, but this remaining uncertainty is necessary when the law develops. Observe however that Courts will be wary of false positives and will likely construct concepts of collective dominance that do not capture all forms of common ownership that are predicted to yield anticompetitive effects.

4. ABUSE OF COLLECTIVE DOMINANCE

4.1 Conduct-Based Exploitation

Even if we find that some instances of common shareholding of horizontal competitors are such as to create a position of collective dominance among common shareholders, it is not clear how to identify an abuse. Consider this passage from Azar et al.

> … it is important to recognize that common owners of competitors need not explicitly communicate their anticompetitive incentives to management for the documented outcomes to materialize. For

they have the capacity and incentive to exercise some direction on the way the firm operates. See Tzanaki (n 12).

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> instance, not explicitly demanding or incentivizing tougher competition between portfolio firms may allow managers to enjoy the "quiet life" …, and thus lead to an equilibrium with reduced competition and sustained high margins.[51]

Basically, the authors are saying that a silent common shareholder can induce anticompetitive pricing. Later in the paper, they state that '*doing nothing* is sufficient for common ownership to lead to higher prices.'[52] Can there really be an antitrust offence in this constellation? Ex ante, there is a case for applying merger control when we can see that an institutional investor buying certain shares creates a scenario where it becomes plausible that directors will take this into account and act anticompetitively. Can we also say that the directors' individual choices not to act competitively constitute sufficient evidence that the firms abuse their collective dominance? In my view, we should observe specific conduct between shareholders and directors which leads to harmful effects. Otherwise, we risk over-enforcing competition law when parties are merely acting rationally in response to market stimuli. Just like we don't penalize pure oligopoly pricing when firms respond rationally to the signals of their rivals, we should not penalize rational reactions to shareholder presence in multiple markets. Therefore, in my view, antitrust can only bite when we have a bit more activism by the common shareholder(s). Azar et al. classify activism into three types: (i) voice: shareholders influence corporate strategy through public statements or private meetings; (ii) incentives: shareholders influence the design of director pay so that the directors take steps not to compete to gain more pay (e.g., pay depends on industry profitability); (iii) voting on which directors to hire and signaling a preference for directors whose strategy is not to compete aggressively.[53] These active steps give the competition authority something to bite on, but this is not wholly unproblematic. Here are two examples.

- Common shareholders play cartel ringmaster, e.g. blocking strategic choices by directors to compete. They align their strategies as shareholders by realizing that they would be better off if the all voted in a particular way, guiding directors to maximize the value of the portfolio rather than the value of the firm.
- There are multiple institutional investors all holding shares in a number of rivals (like in *Dow/du Pont*) and they encourage directors not to compete by setting a pay scale that encourages a collusive outcome. They all vote for a pay scale where rewards to directors are measured by industry performance, realizing that this creates incentives for directors to maximize the profits of common shareholders.

Both of these examples boil down to how you assess 'corporate channels of influence'[54] and what residual autonomy the firms who are influenced by horizontal shareholdings have. It is argued that an active institutional investor in the two examples acts as an undertaking, and it should be possible to challenge it for orchestrating an anticompetitive outcome. The first example looks like a variation on hub and spoke collusion, the second could be characterized as abuse of collective dominance among investors whose conduct facilitates coordinated effects in the product market.

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[51] Azar and others (n 10) 1518.
[52] Ibid, 1552.
[53] Ibid, 1554–1558.
[54] Thépot (n 22) 90.

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The case-law on abuse of collective dominance supports this approach even if the theories of harm that have been deployed to date are premised on the exclusion of rivals rather than exploitation. In *Irish Sugar*, one member of the collectively dominant duo took unilateral steps to sustain the collective dominant position, and this was found to be an abuse of collective dominance. The *Roche* case in France also provides a clear illustration. One of the firms provided the other two with data, which the others used to launch a campaign to denigrate a pharmaceutical product. This may not be sufficient information to establish collusion, but the two firms making the product announcements knew that using the information they received to discredit the rival pharmaceutical product would benefit both firms without the need to communicate. On the facts, it might well be that even if only one firm had undertaken the exclusionary steps, this would have had the capacity to harm competition. Thus, the conduct of the two firms was independently selected but pursued a common objective.

The approach discussed in this subsection could extend to certain actions of institutional shareholders, but it would not cover the entire range of effects examined in the economic literature. It would not apply to settings where the director responds to the mere presence and votes of common shareholders. Moreover, not all the actions of one or more common shareholders will be condemned: it has to be demonstrated that it was a factor that had a direct influence on the director's strategic choices.

4.2 Excessive Pricing

A more systematic approach is to target not the conduct of the common shareholders but the impact that their ownership has on the effects that result in the market. If, as noted, common shareholding creates a condition of collective dominance which leads to higher prices, then this may constitute an abuse of collective dominance. Two approaches might be considered: the first is to establish that the firms in the product market are collectively dominant because of their oligopolistic interdependence combined with the indirect incentives that directors have from the presence of common shareholding. The resulting higher prices are then attributed fully to the directors, with common shareholding serving as an additional factor to create the relevant glue to find collective dominance. A second approach is to continue, as in section 4.1, to target the common shareholders whose presence skews the incentives of directors and causes anticompetitively higher prices.

In the European Union, this approach would allow the competition authority to attack the higher prices that result. This is because, unlike US antitrust, excessive pricing constitutes an abuse of a dominant position. However, excessive pricing cases in the EU are rarely tried and rarely successful. There are a number of policy reasons why competition agencies are reluctant to address excessive prices: high prices encourage entry, so the long-term effects are pro-competitive; a remedy to prevent excessive pricing is hard to design as agencies are not regulators; and distinguishing between a fair and an unfairly high price is difficult, and one does not want to stifle innovation by prohibiting high prices that are necessary to recoup prior investment. The consequence is that few excessive pricing cases have been brought successfully by the Commission other than by securing a commitment decision.[55]

[55] Monti and Hancher (n 19). Case COMP/38.636 – Rambus (2009), Case COMP/39.592 – Standard & Poor's (2011), Case AT.39816 – Upstream Gas Supplies in Central and Eastern Europe (2018), and Case AT.40394 – Aspen (2021).

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More specifically, one must prove that prices are above cost and that these prices are unfair. In *AKKA/LAA*, it was suggested that the unfairness requirement refers to the persistence of the pricing practice.[56] This serves to prevent false positives by intervening too early. However, the benchmark for what pricing is excessive is very difficult to meet. For example, we have seen one competition authority lose a case when the price of a drug shot up by 500%.[57] On this basis, only egregiously high prices seem to be caught, and it is not clear that a cartel-like price increase is sufficient to warrant a finding of excessive pricing. Azar et al., for example found a 3–7% price increase in the US airline industry as a result of horizontal shareholding: this hardly seems high enough for a claim of excessive pricing.[58] Even if such cases can be brought successfully, it is clear that the cost and length of litigation make this an unattractive route to challenge a phenomenon like common ownership, which is said to be pervasive.

5. DEFENCES

The efficiency defence under Article 102 has been recognized for some time, and it was codified in the *Intel* judgment: 'the exclusionary effect arising from such a system, which is disadvantageous for competition, may be counterbalanced, or outweighed, by advantages in terms of efficiency which also benefit the consumer.'[59] In the context of common shareholders who are accused of facilitating excessive prices merely by their presence skewing the incentives of the directors, they might claim that horizontal shareholding yields certain efficiencies. For example, institutional investors are better able to control the company's management and can prevent poor decision-making, thereby avoid insolvencies by firms.[60] It can also stimulate more investment in industry and lead to a better-performing economy more generally. These are plausible claims, but successful pleading of this defence is demanding. One of the difficulties in operationalizing this defence is ensuring that the evidence of these efficiencies is verifiable. But even more challenging is that the efficiencies have to benefit the consumer, and it has to be shown that the conduct is indispensable to achieve those efficiencies. Applying these two standards, questions arise as to how easy it is to trace better industry performance to a consumer benefit: after all, if they pay 11% more for their airplane ticket, how do we work out whether this is compensated by better airline industry performance? And then how do we show that it is only common ownership that can yield those efficiencies? It is perhaps not

[56] Case C-177/16 *Autortiesību un komunicēšanās konsultāciju aģentūra/Latvijas Autoru apvienība v Konkurences padome*, EU:C:2017:689.

[57] Unfair pricing in respect of the supply of phenytoin sodium capsules in the UK, Case CE/9742-13 (7 December 2016), 83–86. After the decision was quashed by the Court of Appeal, the CMA has issued a second decision (Case 50908, Unfair pricing in respect of the supply of phenytoin sodium capsules in the UK (Competition and Markets Authority (CMA), 21 July 2022)). An appeal against this second decision is pending.

[58] Azar and others (n 10) 1517.

[59] Case C-413/14 P *Intel v Commission*, EU:C:2017:632, para 140.

[60] José Azar and Anna Tzanaki, 'Common Ownership and Merger Control Enforcement' in Ioannis Kokkoris and Claudia Lamus (eds), *Research Handbook on the Law and Economics of Competition Enforcement* (Edward Elgar Publishing 2022).

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surprising that no firm has ever managed to plead the efficiency defence successfully in any antitrust case.

If the abuse case is brought against the specific actions of one or more institutional investors, the efficiency defence may also apply. For example, if a case is brought because the institutional investor influenced the design of the director's remuneration package, which in turn led to the director raising prices, it is arguable that the pay package has countervailing efficiencies (e.g., the remuneration package stimulates the director to cut costs). This faces the same difficulties discussed above. However, in these kinds of cases, a plea of objective justification might also be made. Objective justification is a much more well-grounded defence in Article 102. It is not premised on efficiencies but on the dominant firm explaining that there are good reasons for its conduct.[61] In some jurisdictions, the policy is to encourage shareholder activism by institutional investors.[62] The view is taken that they have a comparative advantage in monitoring directors. So we have a tension between company law policies designed to ensure that shareholders control the directors and the antitrust approach, which fears this control in specific circumstances. Can a horizontal shareholder use the obligations it has as a justification for meddling in the work of directors? For example, what if the institutional investor has voted for a less aggressive director because it takes the view that this is preferable for the long-term survival of the firm? It may be invidious to challenge conduct which has had an anticompetitive effect when there may be justifiable reasons for supporting the presence of institutional investors. We return to this point in the next section.

6. REMEDIES

6.1 Attribution

The question of attribution has been discussed above already, but it is worth pushing the point. If we accuse the firms' directors of collectively choosing to price above marginal cost, it is clear that the firm is the unit against which antitrust liability attaches. In this context, a fine may be imposed, but we might query the deterrent effect when the reason prices are high is the existence of common ownership, not its exercise. In other words, when directors react to the presence of common shareholders and elect to act anticompetitively, a fine on the firm does not remove the incentive to accommodate the economic interests of common shareholdings, nor the incentives of the common shareholders to continue to try and influence directors, even if the corporate fine also hurts the shareholders. This is so for two reasons: first, the general deterrent effect of fines in cartel cases is already low and it is likely to be even lower if one applies abuse of collective dominance which, as discussed will only bite in a few instances. Second, and relatedly, many of the anticompetitive effects from horizontal shareholdings will fall under the radar and a fine for certain forms of conduct may not necessarily deter all sorts of actions that investors can take to influence directors. This requires a reflection of remedies, discussed in section 6.2.

[61] Ekaterina Rousseva, *Rethinking Exclusionary Abuses in EU Competition Law* (Hart Publishing 2010) chapter 7.

[62] See Paul L. Davies, *An Introduction to Company Law* (3rd edn, Oxford University Press 2020) chapter 2.

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What, however, if we challenge the conduct of the institutional shareholder directly, as in the scenarios depicted in section 4.1? In this context, it seems natural that a fine should be levelled against the shareholder, not the firm. After all, if a fine is to deter, then the conduct of the institutional shareholder should be targeted. However, this raises the puzzle of how to reconcile this intuition with the way the anticompetitive conduct manifests. One argument could be that the parties to blame are the directors: after all, they react to the signal sent by the shareholders; they are not required to follow that signal. How can we blame the common shareholders? Conversely, it may be said that even though the anticompetitive effects occur in the product market, the abuse occurs elsewhere. Consider, for example the case-law that imposes liability on firms that facilitate a cartel by offering consultancies to cartel members.[63] Here liability is imposed on an actor who is not present in the relevant market where the effects are felt. The Court justified extending liability to cartel facilitators in the name of effectiveness. To refuse to impose liability on cartel facilitators means that 'it would not be possible to put a stop to the active contribution of an undertaking to a restriction of competition simply because that contribution does not relate to an economic activity forming part of the relevant market on which that restriction comes about or is intended to come about.'[64] This policy consideration applies precisely to the conduct of an institutional shareholder when it steers directors to act in an anticompetitive way. It means that fines might serve an adequate deterrent effect if they are targeted at the institutional shareholders whose conduct causes the anticompetitive result, with the caveat that unless the probability of such conduct being prohibited and the fine are sufficiently high, then deterrent effects will not result.

This approach does not resolve difficulties of implementation: it may not be appropriate to impose liability on institutional investors in all cases. The standard adopted in the cartel case-law is to inquire whether the conduct of the firm was directly linked to the infringement. This is likely to require a case-by-case determination, and it may be that not all acts of investors will be sufficiently linked to warrant a penalty.

6.2 Remedy Design

While a fine may work to deter certain practices by institutional investors or firms, it is not clear if fines suffice. Matters are easy when we identify the conduct of one or more investors that directly contribute to the higher prices, but they are more complex when the abuse consists of simply excessive pricing. As Azar et al. put it:

> Because there are many plausible channels through which shareholder incentives can translate into firm behavior, we find it unlikely that a single mechanism is solely responsible. This insight is important, as it suggests that the common ownership problem is not likely to be solved by shutting down a particular channel. For example, managers are unlikely to be isolated from common owners' anticompetitive incentives if regulators prohibit communication about competition but permit conversations about pay structure or voting on board members. Moreover, given that "doing nothing" is a possible mechanism, finding conclusive evidence for a mechanism could prove elusive even if a robust causal relation exists.[65]

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[63] Case 194/14P *AC-Treuhand AG v Commission*, EU:C:2015:717.

[64] Ibid, para 36.

[65] Azar and others (n 10) 1558.

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It seems the most obvious remedy to a price abuse is for the investor to withdraw from some of its horizontal shareholdings and thereby reduce the risk of higher prices being facilitated by it. This is the suggestion found in Posner, Scott Morton and Weyl who suggest a reduction of horizontal shareholding below a threshold where the harm is eliminated.[66] Indeed, as Elhauge notes, when we use the abuse of collective dominance to horizontal shareholding, the abuse is easily avoidable: the definition of abuse creates its own remedy and also reveals to other firms what sort of horizontal shareholding is anticompetitive.[67] This remedy would only work if the abuse of collective dominance is committed by the common shareholders, however. If one were to penalize excessive pricing by targeting the firms, one would be unable to demand a divestiture by common shareholders because they are not the ones to whom the abuse is attributed: the directors choose the higher prices after all, and the firm is held liable. A firm may be required to sell some assets or behave in a particular way, but it is not clear if a competition authority can request the firm's other shareholders to buy the shares of one or more of the common shareholders to eliminate the risk of further anticompetitive effects.

There are additional challenges to imposing structural remedies on common shareholders. Proportionality is a key element that constrains the Commission's discretion when selecting remedies.[68] There may be a number of reasons why systematic divestitures may risk being disproportionate. First, the institutional investor may have a legitimate interest in developing its portfolio in a particular manner, and there may be a loss of efficiency or even a reduction in the promotion of ESG objectives among firms if divestitures are required. Second, there may also be other risks: for example, what if the buyer of these divested shares is a foreign power who has even less incentive to make sure the firms perform optimally? It may thus be necessary to monitor who the buyer of the divested shareholding is, which raises enforcement costs for the competition authority. Moreover, one would have to be certain that any systematic divestiture does not create greater competition risks than the status quo.[69] It follows that each divestiture order will have to be assessed individually, with several tradeoffs and safeguards necessary to avoid the cure being worse than the disease.

7. CONCLUSION

No competition law that I know of has a prohibition that states: any conduct that has anticompetitive effects is prohibited. This is because competition law is designed to be underinclusive. An antitrust offence exists if it fits within the four corners of a legal prohibition. The anticompetitive effects that result from common shareholding of horizontal competitors are an example of a setting which generally falls outside the current EU competition law framework. This may well be the result of rules that are not fit for a modern era where financialization is

[66] See n 49 above.

[67] Elhauge (n 9) 22.

[68] Regulation 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty [2003] OJ L1/1, Article 7.

[69] These points are discussed in Marco Corradi, 'Common Ownership by Investment Management Corporations and EU Policies: Please, Play Puzzles and not Mikado!' in Marco Corradi and Julian Nowag (eds), *The Intersections between Corporate and Competition Law* (Cambridge University Press 2023) 278–286.

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pervasive.[70] Or it may be an issue that is of limited relevance to the EU, since common ownership by institutional investors is less extensive than in the United States, where most of the evidence of these anticompetitive effects comes from.[71]

If there is an antitrust law gap in the EU, this chapter has shown that it is possible to apply the concept of abuse of collective dominance to capture certain practices that have been identified in the economic literature, but this does not allow an enforcer to challenge common ownership systematically. The claim that high prices are an abuse of collective dominance, which can be resolved by structural remedies, is one that is unlikely to be successful: establishing that prices are excessive is already very taxing when the price increase is significant – it becomes even less plausible to make a finding when prices are just 10% higher than the competitive price. Moreover, it seems difficult to justify structural remedies across the board given the risks this entails. Conversely, it has been shown that a more modest use of the concept of abuse of collective dominance is possible: such abuses arise when common shareholders take steps to influence the conduct of directors. This conduct can be identified and the shareholders can be penalized by the imposition of fines designed to deter repetition of that conduct. This approach is under-inclusive from an economic perspective because it will not encompass all instances of common shareholding, nor all anticompetitive manifestations, but it provides a workable way of triggering EU competition law to address certain anticompetitive effects in this policy space. By applying competition law to some such cases, authorities can obtain greater knowledge of this economic phenomenon and may be better placed to enforce competition law more systematically or to recommend more significant legislative reforms to address this issue.

[70] Ioannis Lianos, 'Value extraction and institutions in digital capitalism: Towards a law and political economy synthesis for competition law' (2022) 1 European Law Open 852.

[71] Corradi (n 69) 272–273, but see Tzanaki (n 12) 173–176.

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15. Interlocking Directorates in the United States

Yaron Nili

1. INTRODUCTION[1]

A company's board of directors is charged with several important governance roles and serves as the core organ of the modern corporation.[2] For example, although most operational decision-making can be, and is, delegated to management, the board must remain an active participant in crucial managerial business decisions, such as mergers, stock issues, and changes to company governance documents. Boards must also serve as a management resource, providing advice, insight, and networking benefits.[3]

The Board is also responsible for monitoring management.[4] Because of dispersed ownership and free-riding concerns, shareholders in the United States, at least historically, lack an incentive to oversee managers, effectively allowing managers to control the company.[5] To

[1] This chapter expands upon the concepts the author previously explored in 'Horizontal Directors' (2020) 114 NWU LR 1179, and 'Horizontal Directors Revisited' (2021) 18 J CL&E 5.

[2] Yaron Nili, 'Horizontal Directors' (2020) 114 NWU LR 1179; Jonathan R. Macey, *Corporate Governance: Promises Kept, Promises Broken* (Princeton UP 2008) 51 (citing the board as the "epicenter" of the modern corporation); Melvin Aron Eisenberg, 'Legal Models of Management Structure in the Modern Corporation: Officers, Directors, and Accountants' (1975) 63 CLR 375–76 (discussing the board of directors as the core of modern corporate decision-making); Business Roundtable, 'Principles of Corporate Governance' (*Harvard Law School Forum on Corporate Governance*) (8 September 2016) https://corpgov.law.harvard.edu/2016/09/08/principles-of-corporate-governance/ accessed 6 December 2023 (discussing the board of directors' vital role in overseeing the company's management and business strategies to achieve long-term value creation).

[3] Macey (n 2); Business Roundtable (n 2).

[4] See Stephen M. Bainbridge, *The New Corporate Governance in Theory and Practice* (OUP 2008) 155 (detailing the role of the board in monitoring management); Jill E. Fisch, 'Taking Boards Seriously' (1997) 19 Cardozo L Rev 265, 268–72.

[5] See Adolf A. Berle, Jr. & Gardiner C. Means, *The Modern Corporation and Private Property* (Transaction Publishers 1932) 6; Stephen J. Choi & Jill E. Fisch, 'How to Fix Wall Street: A Voucher Financing Proposal for Securities Intermediaries' (2003) 113 Yale LJ 269, 278 ("Any single shareholder who expends additional resources in monitoring management or coordinating with other shareholders to change management will typically bear the costs alone, while the profits generated by such action are shared by all shareholders, including those who do not contribute."); Emeka Duruigbo, 'Stimulating Long-Term Shareholding' (2012) 33 Cardozo L Rev 1733, 1765–69; Paul H. Edelman et al., 'Shareholder Voting in an Age of Intermediary Capitalism' (2014) 87 S Cal L Rev. 1359, 1407–08 (recognizing that collective-action and free-riding concerns make shareholders reluctant to initiate activism); Jeffrey N. Gordon, 'Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice' (1988) 76 CLR 22 (discussing the free-riding concern under a dual-class stock lens). The resulting costs are often referred to as "agency costs." Eugene F. Fama & Michael C. Jensen, 'Separation of Ownership and Control' (1983) 26 JL

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mitigate concerns that managers are not acting in the corporation's best interest, the board is tasked with supervising the management team to ensure they put the corporation first.[6]

Given the importance placed on the board of directors, it is not surprising that corporate governance focuses on issues of board composition and disclosure. One aspect of board composition is the presence of director interlocks—directors who serve on multiple boards at the same time. Directors that serve on multiple boards create these "interlocks," or connections, between the companies on which boards they serve.[7] Directors, and the interlocks they create, are an inevitable byproduct of corporate culture.[8] Corporations prefer director nominees to have operational and executive experience and prior board experience to increase investor and the board's confidence in their potential value.[9] Thus, it is not surprising that almost 40% of public company directors sit on multiple boards.[10]

One subset of interlocks is what I termed as horizontal directors. Horizontal directors are directors who serve on multiple boards *in the same industry*. This means they potentially serve on boards of competing companies. Despite potential conflicts, horizontal directors, and the interlocks they create, may contribute to better corporate governance. Horizontal directors' service on multiple boards arms them with more experience and more connections.[11] These directors also "develop more industry expertise at a rate that exponentially increases with the number of boards they serve."[12] Further, studies show that interlocking directors are

& Econ 301, 304 (defining agency costs as the "costs of structuring, monitoring, and bonding a set of contracts among agents with conflicting interests").

[6] See Arthur B. Laby, 'The Fiduciary Obligation as the Adoption of Ends' (2008) 56 Buff L Rev 99, 155–57 (describing directors' fiduciary duty to adopt shareholders' ends); see also Bainbridge (n 4) 160–63 (detailing the monitoring role of the board and its importance in the governance of the firm).

[7] Director "interlocks" refer to the connection between two companies that is facilitated by sharing a director. See, for example, Michal Barzuza & Quinn Curtis, 'Board Interlocks and Outside Directors' Protection' (2017) 46 JLS 129 (examining the relationship between interlocks and indemnification protection); Michal Barzuza & Quinn Curtis, 'Board Interlocks and Corporate Governance' (2015) 39 Del J Corp L 669, 669; Eliezer M. Fich & Lawrence J. White, 'CEO Compensation and Turnover: The Effects of Mutually Interlocked Boards' (2003) 38 Wake Forest L Rev 935 (empirical analysis finding that mutual interlocks increase CEO compensation and decrease CEO turnover).

[8] Yaron Nili, 'Horizontal Directors Revisited' (2021) 18 J CL&E 5.

[9] Yaron Nili, 'Beyond the Numbers: Substantive Gender Diversity in Boardrooms' (2019) 94 Ind LJ 145, 158. See Renée B. Adams et al., 'Director Skill Sets' (2017) 130 J Financial Economics 641, 646 https://papers.ssrn.com/a=2365748 accessed 6 December 2023 (finding that 13% of nominating committees specifically list outside board experience as a qualification for inclusion as a nominee).

[10] *See infra* Section 4.1, Table 15.2. Additionally, S&P 500 independent directors serve on an average of 2.1 public corporation boards. Spencer Stuart, 2019 U.S. Spencer Stuart Board Index 13 (2019) https://www.spencerstuart.com/-/media/2019/ssbi-2019/us_board_index_2019.pdf accessed 22 December 2023.

[11] Nili, 'Horizontal Directors Revisited' (n 8) 9.

[12] ibid.

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linked to more accurate financial reporting,[13] nominations of independent directors,[14] and separation of CEO and Chairperson of the board.[15] Interlocking directors have also been found to spread legal innovations.[16]

By contrast, horizontal directors also present significant corporate governance and antitrust concerns. There is a risk that horizontal directors share information between companies in the same industry, presenting unlawful collaboration or collusion concerns. In addition, horizontal directors may generally have reduced incentive to compete aggressively (the "unilateral" effect).[17] There is also a concern that horizontal directors may increase systematic governance risk.[18] Additionally, because horizontal directors serve on boards in the same industry, there is a further risk of compromising director independence and compensation practices.[19]

These governance and antitrust concerns are likely to be intensified for several reasons. First, the occurrence of horizontal directorships is not isolated. Indeed, data I collected on the service of directors in the S&P 1500 companies, reveals that a significant, and increasing, percentage of directors that serve on multiple boards are horizontal directors.[20] Second, the

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[13] Thomas C. Omer et al., 'Do Director Networks Matter for Financial Reporting Quality? Evidence from Audit Committee Connectedness and Restatements' (2019) Management Science 1, 1 https://pubsonline.informs.org/doi/10.1287/mnsc.2019.3331 accessed 6 December 2023 (finding that companies with more-connected directors are less likely to misstate their annual results).

[14] See Christa H. S. Bouwman, 'Corporate Governance Propagation Through Overlapping Directors' (2011) 24 Review of Financial Studies 2358, 2358–59, 2361 (finding that "[f]irms that are networked through overlapping directors tend to adopt similar governance practices," such as nominating independent directors).

[15] See ibid. The separation of the roles is indeed a good governance practice. See, e.g., Yaron Nili, 'Successor CEOs' (2019) 99 BU L Rev 787, 813 (explaining that separating the roles of CEO and chairman allows an independent chair with a fresh perspective to make positive changes).

[16] See Barzuza & Curtis, 'Board Interlocks and Corporate Governance' (n 7) 685–86; Barzuza & Curtis, 'Board Interlocks and Outside Directors' Protection' (n 7) 129–31.

[17] See, e.g., Scott A. Sher & Andrea Agathoklis Murino, 'Unilateral Effects in Technology Markets: *Oracle, H&R Block*, and What It All Means' (2012) 26 Antitrust 46, 46–47 https://www.wsgr.com/a/web/129/sher-summer-12.pdf accessed 6 December 2023; see also 'Competitive Effects', Federal Trade Commission https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/mergers/competitive-effects accessed 6 December 2023. See also Florence Thepot, 'Transatlantic Perspectives On Interlocking Directorates' (2023), CPI https://www.pymnts.com/cpi_posts/transatlantic-perspectives-on-interlocking-directorates/#_ftn17.

[18] The presence of horizontal directors may lead to the adoption of similar best practices across companies in which they serve and better overall governance practices. Yet, uniformity in governance procedures, through the adoption of similar governance arrangements, may form a "weak spot" in corporations' compliance or other best practices that could lead to a cascade of similar issues across corporations. See Veronica Root, 'The Compliance Process' (2019) 94 Ind LJ 203, 216.

[19] See Yaron Nili, 'Out of Sight, Out of Mind: The Case for Improving Director Independence Disclosure' (2017) 43 J Corp L 35, 60; Nili, 'Horizontal Directors' (n 2) 1232–33 ("The desire to secure more board positions, and to maintain the positions currently held, can lead directors to be less willing to confront management or to be perceived as 'difficult.'"). Horizontal directors may be more compliant with management because they do not want a negative reputation within the industry, as that could lead to a loss of other horizontal directorships. *Id*.

[20] See S IV Data on Horizontal Directors.

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rise in horizontal directors coincides with a period during which U.S. markets have become increasingly concentrated.[21] In more concentrated industries, the concern for anticompetitive behavior like collusion increases, since coordination is easier. Therefore, against the increased concentration of markets, the role of horizontal directors as conduits of coordination takes heightened importance. Third, it is becoming progressively more challenging to determine which companies are even competitors. As firms expand product lines, it becomes more difficult to decipher industry classifications and the subsequent potential for competition. For example, tech giants are pushing their way into healthcare, an industry traditionally distinct from the realm of the technology industry.[22] It is these blurred industry lines that heighten the antitrust and governance risks and benefits that directors who serve on these companies might pose.[23]

2. COMMON OWNERSHIP AND HORIZONTAL DIRECTORS

Horizontal directors cannot be analyzed without a recognition of broader concerns regarding the role of shareholders in contemporary antitrust discourse. In fact, antitrust has entered the spotlight in recent years, with increased attention on the significant and overlapping ownership stake that large institutional investors have in corporations that are horizontal competitors in a product market. This phenomenon is also known as horizontal shareholding.

The rise of horizontal shareholding has sparked debate about its potential effects on competition and antitrust policy. Scholars are concerned about the incentives to compete where institutional shareholders hold significant equity stake in all (or most) competitors.[24] It is not uncommon for some institutional investors to hold above 5% in some of their portfolio

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[21] Concentration, in this context, is used as a measure of (lack of) competition in the industry. A low concentration number indicates a high level of competition, while a high concentration level indicates a lower level of competition in the industry. See Sean P. Sullivan, 'What Structural Presumption?: Reuniting Evidence and Economics on the Role of Market Concentration in Horizontal Merger Analysis' (2016) 42 J Corp L 403, 408–10; Gustavo Grullon et al., 'Are U.S. Industries Becoming More Concentrated?' (2018) Swiss Finance Institute Research Paper No. 19-41, 2, 6–11 https://ssrn.com/a=2612047 accessed 6 December 2023 (finding that more than 75% of U.S. industries have experienced an increase in concentration levels over the last two decades).

[22] See Rob Copeland, 'Google's "Project Nightingale" Gathers Personal Health Data on Millions of Americans' *Wall Street Journal* (11 November 2019) https://www.wsj.com/articles/google-s-secret-project-nightingale-gathers-personal-health-data-on-millions-of-americans-11573496790 accessed 6 December 2023.

[23] See, e.g., Alexander Ljungqvist & Konrad Raff, 'Busy Directors: Strategic Interaction and Monitoring Synergies' (2017) Nat'l Bureau of Econ. Research, Working Paper No. 23889, 1 https://www.nber.org/papers/w23889.pdf accessed 6 December 2023.

[24] José Azar, Martin C. Schmalz, & Isabel Tecu, 'Anticompetitive Effects of Common Ownership' (2018) 18 J Fin 73(4); Anna Tzanaki, 'Varieties and Mechanisms of Common Ownership: A Calibration Exercise for Competition Policy' (2021) 18 J Comp L & Econ 1, 168–254; Daniel P. O'Brien & Steven C. Salop, 'Competitive effects of partial ownership: Financial interest and corporate control' (2000) Antitrust LJ 67, 559–614; Miguel Antón, Florian Ederer, Mireia Giné, & Martin Schmalz, 'Common Ownership, Competition, and Top Management Incentives' (2023) 131 J Pol Econ 5.

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companies which in the highly diffused U.S. markets is a significant position. Specifically, there is a debate regarding whether these equity positions promote anticompetitive behaviors in firms.[25] Firms maximize profits by competing only when the profits from capturing market share from other firms exceed the interest in maintaining high market-wide prices.[26] In a competitive market with no common owners, firms have an incentive to undercut prices because the profit from additional sales exceeds the price reduction.[27] When all firms have this same incentive, they continue undercutting prices until prices are at their lowest and most efficient level.[28] By contrast, when firms have common owners, the incentive to undercut competitor's prices is reduced because the common owner is losing profits on the sales taken from their competitors.[29] Instead, the common owner prefers that both firms they own do not undercut each other, keeping prices high.[30]

Included in this debate is the question of which channels common owners use to promote anticompetitive behavior. One way that common shareholders may promote anticompetitive behavior is through executive compensation. The argument is that horizontal shareholders actively discourage performance-sensitive compensation. Alternatively, they do not actively push for a particular compensation plan and support the status quo, allowing executives to "get away with high performance-insensitive pay."[31]

A second channel has been suggested to exist through a portfolio-value maximization strategy.[32] Horizontal shareholders direct management to promote the portfolio value even at the expense of firm value.[33] Specifically, a "common owner obtains leverage over management with its voting power and its ability to sell shares and decrease the market price of firm stock to promote its [portfolio-value maximization] strategy."[34] This channel is potentially less likely, as institutional investors rarely engage with companies in such explicit ways.

Finally, a third channel in which common shareholders may promote anticompetitive behavior is through the explicit or implicit appointment of horizontal directors. Horizontal directors might provide that governance channel for horizontal owners' influence, thereby creating anticompetitive effects on the market.[35] Indeed, according to my own research as

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[25] Manesh S. Patel, 'Common Ownership, Institutional Investors & Antitrust' (2018) 82 Antitrust LJ 279 (explaining that the extent to which common ownership results in anticompetitive harm depends on a number of market factors); Edward B. Rock & Daniel L. Rubinfeld, 'Antitrust for Institutional Investors' (2017) NYU L and Econ Research Paper No. 17–23 https://ssrn.com/abstrahttps://ssrn.com/abstract=2998296 accessed 6 December 2023; Scott Hemphill & Marcel Kahan, 'The Strategies of Anticompetitive Common Ownership' (2020) 129 Yale LJ 1392, 1420.

[26] Einer Elhauge, 'Horizontal Shareholding' (2016) Harvard LR 1267, 1268–69.

[27] ibid 1269.

[28] ibid.

[29] ibid.

[30] ibid.

[31] Antón, Ederer, Giné, & Schmalz (n 24).

[32] Nathan Shekita, 'Intervention by Common Owners' (2022) 18 J Comp L & Econ 99.

[33] Hemphill & Kahan, 'The Strategies of Anticompetitive Common Ownership' (n 25) 1420.

[34] Nili, 'Horizontal Directors Revisited' (n 8) 7.

[35] Hubert Buch-Hansen, 'Interlocking Directorates and Collusion: An Empirical Analysis' (2014) 29 International Sociology 249, 250–53 (describing research suggesting that interlocking directorates could facilitate collusion); James T. Halverson, 'Should Interlocking Director Relationships Be Subject to Regulation and, If So, What Kind?' (1976) 45 Antitrust LJ 341,

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well as a recent study by José Azar, pairs of firms with higher levels of common shareholders, are more likely to have interlocking directors.[36] This finding suggests that institutional investors, as horizontal shareholders, may exert influence on who sits on the board of directors of publicly traded U.S. companies.[37]

3. THE REGULATORY FRAMEWORK

Horizontal directorships are subject to regulatory and market restrictions. Although antitrust, corporate, and securities laws do not explicitly ban horizontal directorships, regulatory and market restrictions provide an outer limit on horizontal directors' service. Antitrust laws prohibit directors from serving on boards of competing companies. Fiduciary duties, shareholder advisory firms, stock exchange rules, institutional investors' voting policies, and companies' policies add an additional layer of potential restrictions to horizontal directorships. I briefly detail these restrictions next.

3.1 Antitrust: Section 8 of the Clayton Act and Section 5 of the FTC Act

Antitrust regulations are designed to promote healthy, fair, and robust competition among companies.[38] Horizontal directors might provide an avenue for companies to collude in violation of antitrust regulatory goals.[39] Section 8 of the Clayton Act mitigates possible antitrust concerns by prohibiting an individual or entity from serving on the board or as an officer of two competing companies.[40] The purpose behind Section 8 is to ensure that companies are not engaging in anticompetitive behavior through a common director or officer.[41]

347–49 ("While it seems unlikely, with counsel in attendance and recordation of minutes, that the boardroom serves today as a center of collusion, the potential for competitive abuses inherent in a horizontal interlocking relationship has not abated."); Maralynne Flehner, 'Section 8 of the Clayton Act Applicable to Corporations *(*SCM v. FTC)' (1979) 53 St. John's L Rev 234, 239.

[36] Ofer Eldar, Yaron Nili, & James Pennington, Common Ownership Directors (working paper) 2023; José Azar, 'Common Shareholders and Interlocking Directors: The Relation Between Two Corporate Networks' (2021) 18 J Comp L & Econ 75, 75.

[37] ibid 97.

[38] See also Keith N. Hylton, *Antitrust Law: Economic Theory and Common Law Evolution* (CUP 2003) 40; Daniel A. Crane*, Antitrust's Unconventional Politics* (2018) 104 Va L Rev Online 118, 123; David Wessel, 'Is Lack of Competition Strangling the U.S. Economy?' Harvard Business Review, Mar–Apr 2018, https://hbr.org/2018/03/is-lack-of-competition-strangling-the-u-s-economy accessed 9 December 2023 ("In remedying the harmful effects of industry consolidation and declining competition, an obvious place to start is antitrust regulation and enforcement.").

[39] Sher & Murino (n 17).

[40] See 15 U.S.C. § 19.

[41] Eric N. Fischer, 'Serving More Than One Master: A Social Network Analysis of Section 8 of the Clayton Act' (2015) 41 J Corp L 313, 316 (explaining that the policy reason behind Section 8's prohibition on interlocking directorates was to remove the opportunity to collude).

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The elements of a Section 8 violation are: (1) a simultaneous directorship[42] on at least two companies; (2) at least one company has "capital, surplus, and undivided profits" that meet a certain monetary threshold;[43] (3) companies must be engaged in part or in whole in commerce;[44] and (4) the companies must be competitors.[45] Horizontal directors that serve on boards of companies within the same industry risk violating Section 8. Therefore, to determine whether horizontal directorships violate antitrust law will depend on whether the two companies are considered "competitors." This is particularly important since antitrust definition and classification of "competitor" does not need to perfectly align with generic industry boundaries but is more outcome oriented.

Section 8's "competition" requirement is broad.[46] Companies are "competitors" in the traditional sense, that is, if they "produce the same line of products in the same region and compete for the same business."[47] Companies are also deemed "competitors" if they sell "reasonably interchangeable products within the same geographic area,"[48] or "vie for the business of the same prospective purchasers, even if the products they offer, unless modified, are sufficiently dissimilar to preclude a single purchaser from having a choice of a suitable product from each."[49] Courts, in their application of "competitor" have focused "not only on the degree of actual interchangeability of use between the products of alleged competitors, but also on evidence concerning (1) the extent to which the industry and its customers recognize the products as separate or competing; (2) the extent to which production techniques for the products are similar; and (3) the extent to which the products can be said to have distinctive customers."[50]

In addition to Section 8 of the Clayton Act, government can prohibit horizontal directors under Section 5 of the Federal Trade Commission Act (FTC Act) as an unfair practice or

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[42] 15 U.S.C. § 19(a)(1). The Act defines a "person" to include corporations, so corporations are subject to the prohibitions of Section 8. ibid. § 12(a). Therefore, a company, through its deputized agents, cannot serve as a director on the board of a competing business.

[43] ibid § 19(a)(1). Effective March 4, 2019, the threshold is $36,564,000, and the competitive sales of either corporation must be less than $3,656,400 or represent less than 2% of that firm's total sales, or the competitive sales of each firm are less than 4% of that firm's total sales. ibid § 19(a)(2); 84 Fed. Reg. 7369 (March 4, 2019).

[44] ibid § 19(a)(1)(A).

[45] ibid § 19(a)(1)(B). Proof of competition under the statute does not depend on a complex product market definition that may be required in a monopolization or merger case. See *In re* Borg-Warner Corp., 101 F.T.C. 863, 905 (1983), *rev'd on other grounds*, Borg-Warner Corp. v. FTC, 746 F.2d 108, 111–12 (2d Cir. 1984); see also 15 U.S.C. § 19(a)(1)(B).

[46] Antitrust law has seen a shift toward standards that are determined ex-post. Daniel A. Crane, 'Rules Versus Standards in Antitrust Adjudication' (2007) 64 Wash & Lee L Rev 49, 50 (detailing the shift and the normative implications).

[47] Dan A. Bailey, 'Interlocking Directorates: A Sleeping Bear Awakens?' https://baileycav.com/site/assets/files/1451/interlocking_directorates_-_a_sleeping_bear_awakens.pdf accessed 9 December 2023 (discussing Protectoseal Co. v. Barancik, 484 F.2d 585 (7th Cir. 1973)); *see also* United States v. Crocker Nat'l Corp., 422 F. Supp. 686, 703–04 (N.D. Cal. 1976) ("sales in the same *product* and *geographic* market").

[48] Earl W. Kintner et al., *Federal Antitrust Law* (Anderson Pub. Co. 2019) 5 § 42.11 (citing *Am. Bakeries Co. v Gourmet Bakers, Inc.*, 515 F. Supp. 977, 980 (D. Md. 1981)).

[49] *TRW, Inc. v F.T.C.*, 647 F.2d 942, 946 (9th Cir. 1981).

[50] ibid 947.

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method of competition.[51] Section 5 gives the FTC broad power to pursue *per se* violations and practices that violate the spirit of the Clayton Act.[52] The FTC views its grant of power as the ability to "[p]lug the loopholes in section 8."[53] The lack of a bright-line definition of "competition," however, may contribute to lower enforcement of Section 8 by the FTC, especially where the market in which a company is situated in is unclear.[54] Consider, for example, tech giants like Apple, Google, and Amazon, each continuously expanding into new markets.[55]

Antitrust law provides strong mechanisms to ensure enforcement of Section 8's prohibition on interlocking directorships between competing companies. For example, under Section 8, a director cannot claim as a defense a lack of consumer injury.[56] Similarly, no effect on price, output, or competition is required to establish Section 8 liability.[57] Governmental enforcement agencies, state attorneys general, private parties, and the corporation itself can bring a Section 8 claim.[58] Plaintiffs may also "obtain an injunction for a Section 8 violation" that includes a ban on future interlocks.[59] Private plaintiffs may also seek treble damages and attorneys' fees because Section 8 violations involve antitrust liability.[60]

3.2 Fiduciary Duty Law

Directors are agents of the corporation-principal, and therefore, owe fiduciary duties of care and loyalty to the corporation.[61] Interlocking directors who serve on two or more boards at the same time owe concurrent fiduciary duties to each company. Thus, there is a heightened risk that they may violate their fiduciary duties.[62] Said differently, if a director serves on the boards of Company A and Company B and as a director of Company A learns information that may

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[51] Federal Trade Commission Act, 15 U.S.C. § 45 (2012); *see, e.g.*, *In re Perpetual Fed. Sav. & Loan Ass'n*, 90 F.T.C. 608 (1977).

[52] See 15 U.S.C. § 45 (as generally applied to interlocks).

[53] 94 Cong. Rec. A112 (1948).

[54] Yaron Nili, 'Horizontal Directors' (2020) 114 NWUL Rev 1179, 1238.

[55] Iibid.

[56] Jennifer Coon, 'Interlocking Directorates' (*Thomson Reuters: Legal Solutions Blog*, April 21, 2017) http://blog.legalsolutions.thomsonreuters.com/large-law/interlocking-directorates/ accessed 9 December 2023; see also Flehner (n 35) 239 ("Section 8, which has been held to establish a *per se* rule of law, was intended to prevent [anticompetitive] effects by automatically proscribing certain interlocks, whether or not they actually are proved harmful to competition." (citations omitted)).

[57] Timothy Cornell, 'Don't Get Tangled Up With Interlocking Directorates' (January 2013) Clifford Chance 1, 3.

[58] Coon (n 56); see also *Protectoseal Co. v Barancik*, 484 F.2d 585, 588 (7th Cir. 1973). ("[A] corporation has standing to request a federal court to remove a director whose service on its board violates an Act of Congress").

[59] Coon (n 56) 127.

[60] Cornell (n 57) 2.

[61] See, e.g., *Guth v Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939).

[62] See John K. Wells, 'Multiple Directorships: The Fiduciary Duties and Conflicts of Interest that Arise When One Individual Serves More than One Corporation' (2000) 33 J Marshall L Rev 56.

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impact Company B, questions arise regarding whether that director can satisfy their fiduciary duties to both companies.[63]

The potential conflicting loyalties that horizontal directors face are not uncommon. Delaware has well-developed case law interpreting allegations of duty of loyalty violations.[64] Loyalty conflicts typically occur in the parent-subsidiary setting.[65] Delaware courts have held that dual-seated directors, that is, directors who serve on the parent and the subsidiary's board, are not *per se*, or automatically, conflicted.[66] However, the Delaware court has found dual-seated directors to be conflicted if they violate the duty of good faith and fair dealing and there is an "absence of any attempt to structure [the] transaction on an arm's length basis."[67] In that case, a former shareholder of UOP, Inc. challenged the elimination of UOP's minority shareholders by a cash-out merger between UOP and its majority owner, The Signal Companies, Inc., who owned 50.5% of UOP.[68] Two of UOP's directors were also Signal directors.[69] The court found that UOP and Signal withheld material information regarding their bargaining positions; thus, the merger failed the requisite fairness test.[70]

Additionally, the "corporate opportunity" doctrine has a direct impact on horizontal directors. This doctrine, which is part of the duty of loyalty, prohibits directors from taking for themselves "a new business opportunity that belongs to the corporation, unless they first present it to the corporation and receive authorization to pursue it personally."[71] Because horizontal directors serve on boards of companies that operate within the same industry and are exposed to intracompany information, there is a higher likelihood that horizontal directors usurp corporate opportunities.[72] Thus, these directors should limit their service on other

[63] ibid at 561–63; see also Arthur B. Laby, 'Resolving Conflicts of Duty in Fiduciary Relationships' (2004) 54 Am U L Rev 75 (outlining various situations in which knowledge gained through one fiduciary relationship could place the fiduciary in a situation to harm other fiduciary relationships).

[64] For a recent case explaining and applying this line of case law, see *Pers. Touch Holding Corp. v Glaubach*, No. 11199-CB, 2019 Del. Ch. LEXIS 66, at *34–49 (Feb. 25, 2019).

[65] Decisions made by directors are generally protected under the business judgment rule. However, in the parent-subsidiary setting, the boards of subsidiaries often have significant overlap with the boards of their parents, which may cause the overlapping subsidiary directors to be classified as "interested" in dealings with the parent. J. Haskell Murray, '"Latchkey Corporations": Fiduciary Duties in Wholly Owned, Financially Troubled Subsidiaries' (2011) 36 Del J Corp 577. This leaves subsidiaries open to possible breach of duty of loyalty claims by their creditors. ibid.

[66] *Weinberger v UOP, Inc.*, 457 A.2d 701 (Del. 1983).

[67] ibid 710–11.

[68] ibid 704.

[69] ibid.

[70] ibid 703.

[71] Gabriel Rauterberg & Eric Talley, 'Contracting Out of the Fiduciary Duty of Loyalty: An Empirical Analysis of Corporate Opportunity Waivers' (2017) 117 Colum L Rev 1075, 1086–87.

[72] See, e.g., Nicole Huberfeld, 'Tackling the "Evils" of Interlocking Directorates in Healthcare Nonprofits' (2007) 85 Neb L Rev 681 (discussing the increased potential for fiduciary duty breaches in the context of director interlocks in healthcare nonprofits); Wells (n 62) (analyzing the fiduciary duty conflicts arising out of holding multiple directorships).

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boards, or at the very least, limit their exposure through corporate opportunity waivers,[73] recusals, and nondisclosure agreements.[74]

3.3 Stock Market Limitations

The New York Stock Exchange (NYSE) and the NASDAQ Stock Market create additional restrictions for horizontal directors. The NYSE and NASDAQ require that a majority of a company's board are independent.[75] Director independence can depend on the director's or their family member's service in other companies. The NYSE standards, for instance, state that a director is not independent if the "director or an immediate family member, is, or has been with[in] the last three years, employed as an executive officer of another company where any of the listed company's present executive officers at the same time serves or served on that company's compensation committee."[76] Because of these broad standards, a horizontal director serving on multiple boards risks losing their independence.

Horizontal directors may also be affected by specific restrictions imposed by the NYSE relating to simultaneous service on audit committees. Specifically, Section 303A.07(a) of the NYSE Listed Company Manual requires that directors who simultaneously serve on more than three public company audit committees be disclosed and approved by the board.[77] The NASDAQ does not have a similar rule, but in recent years, there has been a steep decrease of directors who serve on more than three audit committees. As Table 15.1[78] shows, the percentage of directors serving on the audit committees of four or more boards has decreased significantly from 8.33 percent in 2010 to 0.51 percent in 2019.

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[73] Rauterberg & Talley (n 71) 1086.

[74] James E. Berchtold, 'Dual Directorship: The Perils of Serving Two Masters' (Martindale July 2003), https://www.martindale.com/business-law/article_Lewis-Roca-LLP_22410.htm accessed 9 December 2023; Charles M. Nathan, 'Maintaining Board Confidentiality' (*Harvard Law School Forum on Corporate Governance*, January 23, 2010) https://corpgov.law.harvard.edu/2010/01/23/maintaining-board-confidentiality/ (explaining the dearth of case law on confidentiality requirements of directors and the difficulties in ensuring director confidentiality).

[75] See Securities Exchange Act Release No. 34-48745 (November 4, 2003) (approving NYSE § 303A(1) & NASD Rule 4350(c)(1)); 'SEC Approves NYSE and NASDAQ Proposals Relating to Director Independence' (*FindLaw*, August 29, 2017) http://corporate.findlaw.com/finance/sec-approves-nyse-and-nasdaq-proposals-relating-to-director.html accessed 9 December 2023.

[76] N.Y.S.E. Listed Company Manual (CCH) § 303A.02(b)(iv).

[77] This disclosure can be made "either on or through the listed company's website or in its annual proxy statement or, if the listed company does not file an annual proxy statement, in its annual report on Form 10-K filed with the SEC. If this disclosure is made on or through the listed company's website, the listed company must disclose that fact in its annual proxy statement or annual report, as applicable, and provide the website address." N.Y.S.E. Listed Company Manual (CCH) § 303A.07(a).

[78] Data were obtained from the BoardEdge database. The BoardEdge data file contains various statistics on all public companies in the United States, including board committee service.

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Table 15.1 Audit committee participation by busy directors

Audit Participation	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
4+ Boards	8.33%	9.09%	6.06%	2.90%	2.33%	1.87%	1.80%	0.54%	0.54%	0.51%

Source: BoardEdge Database.

3.4 Proxy Advisory Firms

Glass Lewis and Institutional Shareholder Services, Inc. (ISS) exert tremendous influence over corporate governance practices and board policies.[79] Both proxy advisory firms have adopted policies requiring companies to comply with certain practices to obtain the advisory firm's support.[80] Glass Lewis and ISS have adopted polices limiting directors from serving on too many public company boards. Glass Lewis will "generally recommend voting against a director who serves as an executive officer of any public company while serving on a total of more than two public company boards and any other director who serves on a total of more than five public company boards."[81] ISS recommends voting against a director who "sit[s] on more than five public company boards" and CEOs who sit on more than two other public company boards.[82] Since securing support from Glass Lewis and ISS is crucial, boards tend to follow their guidelines.

These policies likely increase the pressure on firms to reduce the number of busy directors, including horizontal directors. Even though these policies only serve as an outer limit on extreme cases, they still have an impact. Data on horizontal directors demonstrate that the ratio of horizontal directors dramatically increases as they serve on more boards.[83] Thus, even a modest limitation on the number of boards a director can serve exerts significant influence on horizontal directorships.

3.5 Disclosure Rules

The SEC requires publicly traded companies to disclose information relating to their directors. Specifically, companies are required to disclose general information about their directors, including which directors are considered independent, each director's position on the

[79] See Timothy M. Doyle, 'New Report: Proxy Advisory Firms Operate with Unchecked Power' (*American Council for Capital Formation*, 1 May 2018) https://accf.org/2018/05/01/outsized-influence-minimal-oversight-new-accf-report-finds-that-proxy-advisory-firms-operate-with-unchecked-power/ accessed 9 December 2023.

[80] See Glass, Lewis & Co., '2017 U.S. Policy Guidelines' (2017) http://www.glasslewis.com/wp-content/uploads/2016/11/2017_Guideline_US.pdf accessed 9 December 2023; ISS, '2017 U.S. Summary Proxy Voting Guidelines' (2017) https://www.issgovernance.com/file/policy/2017-us-summary-voting-guidelines.pdf accessed 9 December 2023.

[81] Glass Lewis & Co. (n 80) 1, 7–8.

[82] ISS (n 80) 16.

[83] Nili, 'Horizontal Directors' (n 2) 1206.

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board, and any directorships held over the last five years.[84] The extent to which companies follow the SEC requirements may deter them from appointing horizontal directors, especially if they expect regulatory pressure or investor push-back.[85]

4. DATA ON HORIZONTAL DIRECTORS

4.1 The Prevalence of Horizontal Directors

Horizontal directors are nevertheless prevalent among U.S. public companies. According to Table 15.2, there were 1,888 directors that served on the board of more than one company within the same industry in 2019.[86] Table 15.3[87] takes a closer look at this data using Standard Industrial Classification (SIC) and North American Industry Classification System (NAICS) codes. Both are used to classify companies by industry; however, NAICS codes have more industry groupings and provide more detail on the type of business conducted than do SIC

Table 15.2 Number and percentage of interlocked directors sharing an industry within boards served

# of boards	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
2	952 (34%)	1002 (36%)	1056 (37%)	1077 (37%)	1094 (37%)	1075 (37%)	1051 (37%)	936 (38%)	960 (38%)	954 (38%)
3	676 (62%)	687 (63%)	724 (63%)	800 (66%)	769 (67%)	751 (67%)	767 (67%)	675 (65%)	674 (65%)	596 (65%)
4	258 (81%)	237 (81%)	237 (81%)	267 (80%)	289 (82%)	300 (83%)	282 (84%)	262 (84%)	281 (85%)	269 (86%)
5	80 (91%)	81 (91%)	89 (94%)	79 (92%)	93 (94%)	67 (91%)	62 (94%)	75 (95%)	73 (95%)	56 (90%)
6	33 (92%)	22 (96%)	16 (94%)	21 (100%)	22 (100%)	16 (100%)	13 (100%)	9 (100%)	12 (100%)	10 (100%)
7+	4 (100%)	3 (100%)	8 (100%)	9 (100%)	9 (100%)	9 (100%)	5 (100%)	2 (67%)	4 (80%)	3 (75%)
Total	-	- `	-	-	-	-	-	-	-	**1,888**

Source: Nili, Horizontal Directors: Revisited, J. Law & Econ. 5, 14 (2021).

[84] Corporate Governance, 17 C.F.R. § 229.407(a) (2012). Companies usually satisfy the Item 407 requirements by including the disclosures within their annual proxy statement or annual 10-K; 17 C.F.R. § 229.407(a); 17 C.F.R. § 229.401(e)(2).

[85] See Nili, 'Horizontal Directors Revisited' (n 8) 18 (finding that in a sample of large- and small-cap firms, 6 percent did not disclose past directorships and 53 percent disclosed directorships for the minimum required period of five years).

[86] Nili, 'Horizontal Directors Revisited' (n 8) 14.

[87] Nili, 'Horizontal Directors' (n 2) 1211.

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Table 15.3 Number and percentage of interlocked directors in the same SIC/ NAICs industry

# of boards	SIC/ NAICS	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	SIC
140 (5%)	149 (5%)	180 (6%)	183 (6%)	195 (7%)	208 (8%)	209 (8%)	170 (7%)	169 (7%)	184 (7%)		2	NAICS
104 (4%)	120 (4%)	144 (5%)	155 (5%)	165 (6%)	159 (5%)	147 (5%)	143 (6%)	151 (6%)	156 (6%)		3	SIC
101 (9%)	103 (9%)	123 (11%)	139 (12%)	129 (11%)	148 (13%)	150 (13%)	146 (14%)	154 (15%)	129 (14%)		3	NAICS
80 (7%)	81 (7%)	99 (9%)	118 (10%)	115 (10%)	129 (11%)	132 (12%)	121 (12%)	123 (12%)	107 (12%)		4	SIC
45 (14%)	43 (15%)	53 (18%)	70 (21%)	68 (19%)	85 (25%)	102 (29%)	73 (23%)	77 (23%)	67 (21%)		4	NAICS
36 (11%)	40 (14%)	41 (14%)	57 (17%)	65 (18%)	62 (17%)	56 (17%)	65 (21%)	65 (20%)	63 (20%)		5	SIC
21 (24%)	19 (21%)	28 (29%)	28 (33%)	31 (31%)	24 (32%)	26 (39%)	38 (48%)	29 (38%)	22 (35%)		5	NAICS
14 (16%)	14 (16%)	28 (29%)	23 (27%)	23 (23%)	19 (26%)	24 (36%)	35 (44%)	23 (30%)	14 (23%)		6	SIC
13 (36%)	8 (35%)	9 (53%)	8 (38%)	13 (59%)	9 (56%)	10 (77%)	7 (78%)	7 (58%)	9 (90%)		6	NAICS
13 (36%)	10 (43%)	7 (41%)	5 (24%)	11 (50%)	7 (44%)	8 (62%)	5 (56%)	6 (50%)	9 (90%)		7+	SIC
1 (25%)	0 (0%)	5 (62%)	7 (78%)	6 (67%)	4 (44%)	2 (40%)	2 (67%)	3 (60%)	1 (25%)		7+	NAICS
1 (25%)	0 (0%)	5 (62%)	6 (67%)	5 (56%)	3 (33%)	2 (40%)	2 (67%)	3 (60%)	1 (25%)		Total	SIC
321 (7.4%)	322 (7.5%)	398 (9.2%)	435 (9.5%)	442 (9.7%)	478 (10.5%)	499 (11.3%)	436 (11.1%)	449 (11.2%)	412 (10.8%)		NAICS	248 (5.7%)
265 (6.2%)	324 (7.5%)	364 (8%)	384 (8.4%)	379 (8.3%)	369 (8.4%)	371 (9.5%)	371 (9.2%)	350 (9.2%)				

Source: Yaron Nili, *Horizontal Directors* (2020) 114 NWU LR 1211.

codes.[88] On a more granular level, Table 15.3 shows that there were 412 directors (10.8% of directors serving on more than one board) who served on at least two companies in the same industry per four-digit SIC code. Similarly, there were 350 directors (9.2% of the directors serving on more than one board) that served on at least two companies' boards within the same NAICS code.

[88] *Industry Classification Overview*, U.S. Bureau Lab. Stats. (2023), https://www.bls.gov/ces/naics/#2.

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Table 15.4[89] further shows that the percentage of horizontal directors as a percent of busy and total directors has been trending upwards over time with merely a slight decline seen in the last two years. For example, in 2010, 7.4% of all horizontal directors that sat on at least two boards were within the same SIC classification. This number increased by 7% on average each year from 2010 to 2016 but decreased by 2% in both 2018 and 2019. A similar trend was observed under the NAICS classification with an average increase in that metric of 8% each year with a decline of 3% in the last two years of the sample.

Table 15.4 Time trend of Horizontal Directors

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
% of Industry-Horizontal Directors out of All Directors	16.9	17.1	17.6	18.2	18.2	17.8	17.3	19.7	19.5	18.8
% of Industry-Horizontal Directors out of Busy Directors	46.3	47.7	48.7	49.7	49.8	49.1	49.7	50.2	50.2	49.6
% of SIC-Horizontal Directors out of All Directors	2.7	2.7	3.3	3.5	3.5	3.8	3.9	4.4	4.3	4.2
% of SIC-Horizontal Directors out of Busy Directors	7.4	7.6	9.1	9.6	9.7	10.6	10.9	11.2	11	10.8
% of NAICS-Horizontal Directors out of All Directors	2.1	2.2	2.7	2.9	3.1	3	2.9	3.7	3.6	3.6
% of NAICS-Horizontal Directors out of Busy Directors	5.7	6.2	7.4	8	8.4	8.4	8.4	9.5	9.3	9.2

Source: Yaron Nili, *Horizontal Directors* (2020) 114 NWU LR 1211.

4.2 Related Studies

Horizontal directors have recently begun to attract significant academic attention. A team of Stanford researchers, spanning the fields of law and medicine, evaluated interlocking board memberships of 2,241 public life science companies since 2000.[90] The study revealed results consistent with this chapter's research. It highlighted a network of interlocked boards within the life science industry, finding that "at any given time, 10–20% of board members [of biotech companies] are interlocked," with tenures 50% longer than non-interlocked directors.[91] These interlocked boards are potentially illegal under antitrust law. The authors hypothesized that interlocked directors are especially prevalent in the life sciences industry because its officers and board members are required to have the rare domain expertise associated with the products in this market,[92] an argument that squares with the notion that director expertise

[89] Nili, 'Horizontal Directors' (n 2) 1212.

[90] Mark A. Lemley, Manjunath Anoop, Nathan Kahrobai, & Ishan Kumar, 'Analysis of Over 2,200 Life Science Companies Reveals a Network of Potentially Illegal Interlocked Boards' (19 October 2022) https://ssrn.com/abstract=4253144.

[91] ibid.

[92] ibid.

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matters. Yet, antitrust law is designed to prohibit this very behavior, as serving on the boards of two competitors is prohibited by Section 8 of the Clayton Act.[93]

There is also a line of research attempting to establish a causal relationship between common ownership and the probability of interlocking directors. Professor José Azar approached the issue of interlocking directors through a different lens.[94] Rather than leading with the concern about collusion through interlocking directors, he focused on the shareholders.[95] Professor Azar argued that, if shareholders' objectives affect firm objectives, they must at some point be accomplished through affecting boards.[96] In analyzing the relationship between measures of common ownership and interlocking directors, Professor Azar's research established a positive correlation between the level of common ownership for a pair of firms and the probability that the pair has interlocking directors, and a negative relationship between common ownership and distance in the network of directors.[97] Thus, having a common institutional shareholder has a positive and statistically significant impact on the probability that a pair of firms has interlocking directors.[98] Similarly, using data on overlapping directors and institutional shareholding from 2000 to 2019, a recent co-authored paper shows that common ownership across firms in the same industry is associated with a higher probability that they share a director. The results are particularly strong for institutions with lower portfolio turnover and longer investment horizons. However, we find little relationship using common ownership by the "Big Three" fund families (BlackRock, Vanguard, and State Street). Our results hold across various measures of common ownership, different definitions of competitors, and a variety of robustness checks.[99]

5. NEW DEVELOPMENTS

5.1 Department of Justice

The prevalence of these potentially illegal interlocking directors has not escaped the attention of the Department of Justice (DOJ).[100] Indeed, investigating horizontal directors has become an increased priority for government agencies. The current head of the DOJ Antitrust Division, Jonathan Kanter, stated in April 2022 that the Division is "ramping up efforts to identify violations across the broader economy [and will not] hesitate to bring Section 8 cases to break up interlocking directorates."[101] This announcement may have come as a surprise

[93] 15 U.S.C. § 19.

[94] Azar, 'Common Shareholders and Interlocking Directors' (n 36) 75.

[95] ibid.

[96] ibid.

[97] ibid.

[98] ibid.

[99] See Ofer Eldar, Yaron Nili, & James Pennington, 'Common Ownership Directors' (2023) (working paper).

[100] 'Directors Resign from the Boards of Five Companies in Response to Justice Department Concerns about Potentially Illegal Interlocking Directorates' (*Department of Justice*, 19 October 2022) www.Justice.Gov/Opa/Pr/Directors-Resign-Boards-Five-Companies-Response-Justice-Department-Concerns-About-Potentially accessed 22 December 2023.

[101] ibid.

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to some directors; historically, enforcement of Section 8 largely occurred in the context of merger reviews.[102] Now, the DOJ is actively pursuing potential Section 8 violations ex-post, even outside of a merger review.

The DOJ reiterated its position in October 2022 in a press release stating that "[c]ompanies, officers, and board members should expect that enforcement of Section 8 will continue to be a priority for the Antitrust Division."[103] These threats were not without action; thus far, the DOJ has conducted at least two major investigations resulting in directors' resignations.[104] The first of these investigations was in October 2022.[105] In response, seven directors from five companies' boards resigned from their corporate board positions.[106] One of the DOJ's investigations involved competitors Skillsoft Corp. and Udemy Inc., both of which provide online corporate education services.[107] Lawrence Illg, the CEO of Prosus, a technology investment group, simultaneously served on the boards of both companies.[108] After the Antitrust Division raised concerns about this horizontal directorship, Mr. Illg resigned from Udemy's board.[109] The second major investigation occurred in March 2023 and resulted in five directors stepping down from the boards of three companies.[110] Kanter also announced that the DOJ has launched multiple active investigations into possible overlapping directors.[111]

The Justice Department is also investigating potential Section 8 violations among private equity firms, including Blackstone Inc., Apollo Global Management Inc., and KKR & Co.[112] Antitrust enforcers are concerned that horizontal directors may encourage competing companies to maximize total gains, rather than competing aggressively to provide the highest quality or lowest price to customers. Many private equity firms maintain that they do not

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[102] Scott A. Sher et al., 'DOJ Launches Enforcement Initiative Against "Interlocking Directorates"' (*Wilson Sonsini*. 22 September 2022) https://www.wsgr.com/en/insights/doj-launches-enforcement-initiative-against-interlocking-directorates.html#:~:text=An%20%E2%80%9Cinterlocking%20directorate%E2%80%9D%20occurs%20when,board%20of%20two%20competing%20companies accessed 22 December 2023.

[103] Department of Justice (n 100).

[104] ibid; 'Justice Department's Ongoing Section 8 Enforcement Prevents More Potentially Illegal Interlocking Directorates' (*Department of Justice*, 9 March 2023) www.justice.gov/opa/pr/justice-department-s-ongoing-section-8-enforcement-prevents-more-potentially-illegal accessed 22 December 2023.

[105] Department of Justice (n 100).

[106] ibid.

[107] ibid.

[108] Dhawal Shah, 'Udemy Board Member Resigns Due to Antitrust Concerns by Justice Department' (*The Report*, 26 October 2022) www.classcentral.com/report/udemy-larry-illg-resignation/ accessed 22 December 2023.

[109] ibid.

[110] Department of Justice (n 100).

[111] Jonathan Kanter, Assistant Attorney General, Dept. of Just. Antitrust Division, 'Remarks at the Keystone Conference on Antitrust, Regulation & the Political Economy' (2 March 2023), www.justice.gov/opa/speech/assistant-attorney-general-jonathan-kanter-antitrust-division-delivers-remarks-keystone accessed 22 December 2023.

[112] Leah Nylen & Dawn Lim, 'Private Equity Firms Probed by US on Overlapping Board Seats' *Bloomberg* (28 October 2022) www.bloomberg.com/news/articles/2022-10-28/blackstone-among-pe-firms-under-doj-antitrust-probe-into-overlapping-board-seats accessed 22 December 2023.

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micromanage companies or influence prices; instead, their role is to oversee management.[113] Despite this stance, the DOJ has made its position clear, perhaps fueled by pressure from other stakeholders to eliminate horizontal directors. In early March 2023, a worker advocacy group formally requested that the Justice Department investigate BC Partners Holding Ltd., specifically regarding its relationship with PetSmart LLC and Chewy, Inc. The advocacy group expressed concerns that the presence of overlapping directors among these pet supply retailers constituted a violation of U.S. antitrust law.[114] Despite the two companies' split in early 2021,[115] PetSmart and Chewy shared three directors from BC Partners: Raymond Svider, Michael Chang, and Fahim Ahmed. Svider served as chairman of Chewy's board, as director on PetSmart's board, and chairman of BC Partners. Chang and Ahmed, also partners at BC Partners, concurrently served on Chewy's board and PetSmart's board. Importantly, BC Partners wholly owns PetSmart and 98% of Chewy's voting control.[116]

5.2 Federal Trade Commission

The DOJ is not alone in its rigorous antitrust enforcement against horizontal directors. The FTC has reinterpreted Section 5 of the FTC Act to grant it broad authority over interlocking directorates that do not fall within the "literal language of [Section 8 of] the Clayton Act."[117] Section 5 prohibits "unfair methods of competition."[118] From 2015 to 2021, the FTC interpreted Section 5 to include conduct that violates the spirit of the Clayton Act and harmed consumers under the "rule of reason."[119] The FTC rescinded the rule-of-reason requirement in July 2021. In November 2022, it issued a new interpretation of Section 5, which gives the agency broad authority to decide when conduct "threatens fair competition," regardless of whether it falls within the scope of the Sherman and Clayton Acts.[120] Now, the FTC can determine independently whether conduct is anticompetitive or whether conduct negatively

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[113] ibid.

[114] Leah Nylen, 'PetSmart, Chewy Overlapping Directors Focus of DOJ Complaint' *Bloomberg News* (9 March 2023), www.bloomberglaw.com/bloomberglawnews/antitrust/XF8C2PPO000000?bna_news_filter=antitrust#jcite accessed 22 December 2023.

[115] ibid; Lucinda Shen, 'PetSmart and Chewy Are Splitting Three Years After Their Tie-Up' (*Fortune*, 23 October 2020) www.fortune.com/2020/10/23/petsmart-and-chewy-are-splitting-three-years-after-their-tie-up/ accessed 22 December 2023.

[116] ibid; Chewy, Inc., Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 (Schedule 14A) (May 26, 2022).

[117] 'Comm'n File No. P221202, Policy Statement Regarding the Scope of Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act' (*Federal Trade Commission,* 2022) www.ftc.gov/system/files/ftc_gov/pdf/P221202Section5PolicyStatement.pdf accessed 22 December 2023.

[118] 15 U.S.C. § 45(a)(1).

[119] 'Statement of Enforcement Principles Regarding "Unfair Methods of Competition" Under Section 5 of the FTC Act' (*Federal Trade Commission*, 2015) www.ftc.gov/system/files/documents/public_statements/735201/150813section5enforcement.pdf accessed 22 December 2023.

[120] Scott A. Sher, et. al., 'FTC Reinterprets FTC Act to Include Broad Powers Related to "Interlocking Directorates"' (*Wilson Sonsini*, 14 November 2022) https://www.wsgr.com/en/insights/ftc-reinterprets-ftc-act-to-include-broad-powers-related-to-interlocking-directorates.html#3 accessed 22 December 2023.

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affects competition. Therefore, to take enforcement action against interlocking directors, the FTC needs only to find that the conduct constitutes an "unfair method of competition" under Section 5.[121]

The FTC's policy will likely curb the prevalence of horizontal directorships. The FTC's policy statement specifically lists "interlocking directors and officers of competing firms not covered by the literal language of the Clayton Act" as one example of a Section 5 violation. This new interpretation likely includes interlocks involving board observers. A board observer is an individual who is not a director but has the right to observe the board. That is, they may attend and participate in the board meetings, receive all sensitive information presented to the board, but are not permitted to vote on any voting matters. This new interpretation likely means a Section 5 violation could occur in a situation where an individual is a board observer for two competing companies or where an individual is a director for a company and a board observer at a competing company.[122]

Section 8 of the Clayton Act's safe harbor exemptions may also be at risk under the FTC's new interpretation. Generally, parties are strictly liable for Section 8 violations. However, there are several safe harbors that, if applicable, will prevent a party from liability. Corporations with less than $45,257,000 in total capital, surplus, and undivided profits will not be liable for Section 8 violations.[123] Section 8 also does not apply if competitive sales of either corporation are less than $4,525,700; competitive sales of either corporation are less than two percent of the corporation's total sales; or competitive sales of each corporation are less than four percent of the corporation's total sales.[124] These safe harbors may no longer be safe under the FTC's new interpretation.

The FTC also expressed concern regarding the lack of and overall decline in Section 8 enforcement over the past century, "worry[ing] that this has over time led to under-deterrence and that corporate actors are not sufficiently appreciative of Section 8's prohibitions."[125]

In August 2023, the Commission announced its commitment to "reactivate Section 8 and effectively put market participants back on notice."[126] This announcement accompanied the Commission's action to unravel a $5.2 billion cash-and-stock deal between the nation's largest natural gas producer, EQT Corporation ("EQT"), and private equity firm Quantum Energy Partners, LP ("Quantum"), which holds a host of investments across the oil and gas industry.[127] Both EQT and Quantum's investments are involved in the production of gas in the

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[121] ibid.

[122] ibid.

[123] The monetary thresholds under the Clayton Act are adjusted by the FTC in January of each year based on changes in gross national product. The monetary thresholds included here are for the calendar year 2023.

[124] The term "*competitive sales*" means the gross revenues for all products and services sold by one corporation in competition with another, determined on the basis of annual gross revenues for such products and services in that corporation's last completed fiscal year.

[125] 'Statement of Chair Lina M. Khan Joined by Commissioner Rebecca Kelly Slaughter and Commissioner Alvaro Bedoya In re EQT Corporation Commission File No. 221-0212' (*Federal Trade Commission,* 16 August 2023) https://www.ftc.gov/system/files/ftc_gov/pdf/2210212eqtqepkhanstatement.pdf accessed 22 December 2023.

[126] ibid.

[127] ibid.

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Appalachian basin, and therefore, were considered "head-to-head" competitors by the FTC.[128] The two companies had also agreed that EQT would "'take all necessary action to facilitate' the appointment of Quantum CEO Wil VanLoh (or another Quantum designee) 'to be included in a slate of director nominees recommended by the [EQT] Board' for election as an EQT director."[129] In its complaint, the FTC noted that—since half of the purchase price would provide Quantum with 55 million shares of EQT stock—Quantum would become one of EQT's largest shareholders.[130] In addition to "deepen[ing] the already cozy relationship that exists between these competitors," "[t]his appointment would create a board interlock among competitors in violation of Section 8 of the Clayton Act."[131]

The FTC thereby approved a consent order (1) prohibiting Quantum from occupying an EQT board seat, (2) requiring Quantum to divest the EQT shares, and (3) requiring EQT and Quantum to unwind their existing joint venture and any noncompete provisions. According to the Commission, this would "structurally eliminate key mechanisms for undue influence and information exchange," and limit "current and future entanglements between the firms and reduces opportunities for exchanging confidential and competitively significant information between the firms."[132] This action marks the FTC's first formal Section 8 enforcement action since 1984,[133] affirming the Commission's renewed commitment to enforcing Section 8 violations. Further, companies are heeding the FTC's concerns. In response to the FTC's complaint and the approved consent order, two directors have resigned from the board of Nextdoor Holdings Inc.[134]

6. A ZERO-SUM PROPOSITION?

The prevalence of horizontal directors indicates that while other governance mechanisms—including state law, exchange rules, and shareholders' guidelines—may limit some instances of horizontal directorships beyond the scope of Section 8, they are far from effective constraints on the pervasiveness of horizontal directors.

The policy implications that stem from the prominence of horizontal directors within public firms are twofold. First, legislative and regulatory reforms to Section 8 could help address the anticompetitive ramifications of horizontal directors. Second, to address horizontal directorships that do not fall within Section 8's terms but may still present corporate governance concerns, I argue that an improved disclosure regime may be warranted.

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[128] ibid.

[129] ibid.

[130] *In re QEP Partners/EQT Corporation* (16 August 2023) www.ftc.gov/system/files/ftc_gov/pdf/2220212eqtquantumcomplaint.pdf accessed 22 December 2023.

[131] ibid.

[132] 'Press Release, FTC Acts to Prevent Interlocking Directorate Arrangement, Anticompetitive Information Exchange in EQT, Quantum Energy Deal' Federal Trade Commission (16 August 2023) https://www.ftc.gov/news-events/news/press-releases/2023/08/ftc-acts-prevent-interlocking-directorate-arrangement-anticompetitive-information-exchange-eqt (accessed 22 December 2023).

[133] ibid.

[134] Leah Nylen, 'Pinterest Directors Quit Nextdoor Board on DOJ Concerns' *Bloomberg* (16 August 2023) www.bloomberg.com/news/articles/2023-08-16/pinterest-directors-quit-nextdoor-board-on-doj-concerns-for-overlap-by-rivals accessed 22 December 2023.

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If directors serve competitor companies, even under a broader definition of competition, they may facilitate coordination to the detriment of consumers. Indeed, the intent of Section 8 was to "nip in the bud incipient violations of the antitrust laws."[135] Yet, the current regulatory framework is both over- and under-inclusive. On the one hand, the Clayton Act prohibits horizontal directors among competitors, even when the antitrust concern is low and the benefits to corporate governance are high. On the other, it does not provide any regulation of horizontal directors of noncompetitors, even when the antitrust risk may be high but the corporate governance benefits are low.[136] In addition, the enforcement and interpretation of Section 8's competition requirement are not uniform, as Section 8 lacks a bright-line rule for determining "competitors" and the reliance on private discussions for enforcing Section 8 leaves room for inconsistency and raises concerns about transparency in protecting competition.

Legislative and regulatory reforms must not only address the issues raised by the current formulation of the Clayton Act but should also address the greater governance ecosystem of horizontal directors. As previously mentioned, horizontal directors tread the line between antitrust and corporate governance.

Indeed, some level of collaboration between companies within the same industry can be beneficial to consumers; therefore, antitrust laws only target efforts that lead to anticompetitive outcomes or collusion. Horizontal directors may provide value to the company and investors, such as contributing to the diffusion of beneficial corporate governance practices, networking, expertise, and innovation. By sitting on boards of multiple companies in the same industry, horizontal directors gain intimate knowledge that can be a valuable asset to a director's ability to advise and monitor the management team. However, the presence of horizontal directors also presents concerns, such as an increased risk of anticompetitive collaboration, increased risk of systemic governance risk, and decreased director independence. Furthermore, horizontal directors may facilitate anticompetitive practices like price-fixing or agreements not to engage in certain M&A transactions that could further insulate management from market pressures, which may lead to a loss of shareholder value in the long term.[137]

Importantly, horizontal directors are not necessarily a zero-sum proposition. Companies can still tap the valuable aspects of horizontal directors while at the same time minimizing the concerns that they may present.

First, legislation that targets higher-risk companies will be more effective at mitigating antitrust risks and will be easier (in terms of resources) to enforce uniformly, which will mitigate some of the current Section 8 under-enforcement concerns. Some industries are more likely to have horizontal directors, and some of these horizontal-director-saturated industries also exhibit strong levels of industry concentration. Focusing the prohibition of horizontal

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[135] *U.S. v Sears, Roebuck & Co.*, 111 F. Supp. 614, 616 (S.D.N.Y. 1953).

[136] See, e.g., Benjamin M. Gerber, 'Enabling Interlock Benefits While Preventing Anticompetitive Harm: Toward an Optimal Definition of Competitors Under Section 8 of the Clayton Act' (2007) 24 Yale J on Reg 107, 118–24 (examining the unclear and inconsistent findings of the courts regarding Section 7's relation to Section 8); John T. Murray, 'The Definition of Competitors Under Section 8 of the Clayton Act: The Emergence of Supply Side Competition Analysis' (1984) 41 Wash & Lee L Rev 135, 137–38 (arguing that the courts have been inconsistent in selecting a standard that determines whether two corporations are competitors).

[137] See Federal Trade Commission, 'Anticompetitive Practices' https://www.ftc.gov/enforcement/anticompetitive-practices accessed 17 January 2024.

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directors on concentrated industries might strike a desired balance, allowing companies to enjoy the benefits these directors provide while prohibiting their presence in cases where the costs to competition are more likely to outweigh these benefits. For instance, Section 8 could be revised to exempt from the prohibition industries with an Herfindahl-Hirschman Index (HHI) that is below a certain threshold. Aggressively enforcing Section 8 for that subset of public companies would reduce significant antitrust risk.

Second, regulators could consider an ex-ante design to Section 8 of the Clayton Act that would allow directors to apply for a waiver before accepting a horizontal directorship. By obtaining an ex-ante "no action" waiver, companies would be more certain about nominating potential directors. The "no action" waiver automatically excludes any ex-post enforcement and resembles the no-action process employed by the SEC in the exclusion of shareholder proposals.[138] Furthermore, companies would be able to justify the nomination of directors that would technically violate the Act. Giving the FTC a veto right ex-ante would also reduce the need for costly ex-post enforcement and may lead to more consistent enforcement.

In fact, a similar arrangement is already employed in the context of interlocking bank directorships. The Federal Reserve's (the Fed) Regulation L is similar to the Clayton Act in that it prohibits an officer or director from serving more than one of any bank's holding companies with over $10 billion in assets from serving as an officer or director. However, Regulation L allows the Fed to grant waivers when it determines that an interlock would not substantially lessen competition.

Third, and as previously mentioned, horizontal directors tread the line between antitrust and corporate governance, and a comprehensive reform should highlight the benefits of these directors as well as address the corporate governance risks. Many companies currently keep disclosures to the bare minimum required. Thus, it is often difficult to even identify the industry of the other boards on which horizontal directors serve. Regardless of whether shareholders see horizontal directors as positively or negatively impacting the company, improved transparency via more comprehensive disclosures would enable shareholders to more effectively participate in corporate governance by making more informed director nominations and board recommendations.

Finally, state law and fiduciary law can also evolve[139] to increase restrictions to mitigate the concerns that arise from the prominence of horizontal directors. Additionally, tightening judicial review of noncompete agreements, corporate opportunity waivers, and board fiduciary duties may position common law jurisprudence to more effectively address potential governance issues that stem from the presence of horizontal directors. For example, courts may examine corporate opportunity waivers more skeptically where a horizontal director is involved and where the opportunity is given to a horizontal company. The common law route can provide the flexibility and adaptability that regulatory intervention often lacks.

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[138] See Note, 'Proxy Rule 14a-8: Omission of Shareholder Proposals' (1971) 84 Harv L Rev 700, 717; Scott Lesmes, 'Frequently Asked Questions About Shareholder Proposals And Proxy Access' (2017) 1–3 https://seventhgenerationinterfaith.files.wordpress.com/2018/12/faq-shareholder-proposals-and-proxy-access.pdf accessed 17 January 2024.

[139] See Nili, 'Horizontal Directors Revisited' (n 8) 1250–51.

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7. CONCLUSION

In many ways, horizontal directors epitomize the push and pull of our corporate governance system. We rely on directors to fulfill a diverse array of roles for both investors and companies. Directors are expected to monitor management, to provide expertise and networking, and to make the corporation's most important decisions. Yet, we lean on outsiders to serve as directors, and we allow, and even encourage, their service on other boards.

It remains unclear how we should view horizontal directorships against the backdrop of increased industry concentration and vivid discourse regarding horizontal mergers and horizontal shareholdings. These questions are especially pertinent given the overwhelming number of directors who serve on boards within the same industry. With the rise in importance of the board as an institution, and with the emergence of contemporary antitrust discourse regarding horizontal ties between companies through common shareholders, future research into horizontal directorships is still needed. Regulators and legislators should also reevaluate the current regulatory framework governing horizontal directors in light of recent findings. Investors, too, should direct their attention to the issue of horizontal directorships. Understanding that not all companies are created equal, investors may be better situated than regulators to account for the rise in horizontal directorships and offer market-based solutions to the inherent tension that these directors present.

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16. Interlocking Directorships: Evidence from a Natural Experiment by Israeli Competition Law

Moran Ofir and Anat Alon-Beck

1. INTRODUCTION

At the turn of the twentieth century, the interlocking directorate practice was deemed the "root of many evils".[1] Brandeis, along with other scholars of his era, expressed apprehension about the possibility of collusion that could result in a decline in competition. These concerns played a role in the enactment of the Clayton Act.[2] Fast forward, in contemporary times, there are numerous instances where the same directors serve on the boards of multiple companies within the same industry.[3]

It seems like there is a need to differentiate between two conflicting theories here. On the one hand, the interlocking directorate practice might raise antitrust concerns, such as collusion and coordination of companies within the same industry. On the other hand, this practice might serve some goals of corporate governance theory, specifically, maximizing shareholder value. It is conceivable that coordination between directors may benefit the shareholders of companies in the same industries as it can facilitate increasing profits. There is a need for further discussion and research on this distinctive intersection between corporate governance, competition and antitrust law. Exploring recent changes to Israeli law, involving both corporate governance and competition regulations, could serve as a valuable starting point for this inquiry.

This chapter empirically examines the market's reaction to increased corporate governance regulatory provisions that were applied to pyramid-structured corporations. Specifically, it examines the influence of legal provisions addressing the composition of boards of directors on the intensity of board connectivity. For this purpose, two databases have been especially constructed. One reflects the situation prior to the entry of the regulatory changes into force, and the other reflects the situation afterwards. These databases have been analyzed using social network analysis methodologies. The findings demonstrate that following the entry into force of these legal provisions, the average number of directors per board dropped, as did the average number of board seats held by each director. In addition, the level of connectivity of the board interlocks within Israel's large public corporations dropped. The intensity of the decline was lower than what could be expected under complete adherence to the minimal standard required in primary and secondary legislation. The purpose of this chapter is not to

[1] Louis Brandeis, *Other People's Money And How the Bankers Use It* (Frederick A. Stokes Company 1914).

[2] See infra.

[3] See Yaron Nili, 'Horizontal Directors' (2020) 114 Nw UL Rev 1179.

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theoretically define threats of collusion or determine whether these practices are illegal but instead to empirically examine the phenomenon of interlocking directorships in Israel in light of corporate governance practices and firm performance.

2. LEGAL AND POLICY BACKGROUND

2.1 Board Interlocks Literature Review

The merits and effects of interlocking directorates have been the subject of great debate, policy initiatives, and legislation for over 100 years. When held among competitors, they may be viewed, as Justice Brandeis noted in his 1914 essay on the subject, as "the root of many evils."[4] Although this view is not universally held, significant debate has arisen as to whether this is a problem needing addressing at all and the preferred methodology of doing so. As equity ownership, particularly in publicly traded companies, increasingly shifts toward institutional ownership, the chances of these interlocks occurring increase as well.[5] Furthermore, as large companies move to expand into an increased number of areas, there may be a greater chance of running afoul of existing regulatory structures, requiring proactive action.[6]

For those who hold a different opinion and do not share Justice Brandeis's concerns, interlocking directorates represent part of the basis for electing a member to a board. Those with "a broad network" tend to be more highly valued as a result of their social and professional connections and the connections' ability to bring support, influence, and information into a board's discussion.[7] Although there is some concession that these connections may lead to the impairment of economic value and to reduced governance quality and may also stretch existing directors too thin, there is the potential for benefits stemming from the sharing of market information, management practices, and increased market efficiency.[8] However, such benefits also come with increased scrutiny by antitrust laws, as sharing information may also be viewed as collusive activity.[9] For those who do view interlocks as problematic, there are considerable differences as to how and to what extent to address the problem. Some of this variance can simply be attributed to the varying empirical extent of interlocks in any particular jurisdiction.

An extensive literature review shows that the level of connectivity in board interlocks has significant consequences for the performance and corporate governance practices of various

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[4] Brandeis (n 1).

[5] See Ronald J Gilson and Jeffrey N Gordon, 'Board 3.0 – An Introduction' (2019) 74 Bus L 351, 352.

[6] See Laura A Wilkinson, 'Interlocking Directorates' (2017) Practical L the J 56, 56.

[7] David F Larcker and Brian Tayan, 'Director Networks: Good for the Director, Good for Shareholders' (2010) Rock Center for Corporate Governance at Stanford University Closer Look Series: Topics, Issues and Controversies 1 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1678065 accessed 17 May 2024.

[8] ibid 1–2.

[9] ibid 1.

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firms.[10] The connections between firms via directors were found to be a pathway for transferring information and propagating either positive or negative practices across various firms in the market.

In general, it was found that firms tend to have corporate governance practices similar to other firms with which they share directors.[11] Specifically, characteristics affected by interlocked directors are board size, board independence, whether the CEO is also chairperson of the board, and CEO and director compensation. In fact, two coexisting tendencies are noted: firms tend to (1) elect their directors from among those who sit on boards of firms similar in the aforementioned characteristics[12] and (2) show stronger similarities with regard to these characteristics after electing an interlocked director or after their acting directors join other boards.[13]

In regard to *negative practices*, high levels of connectivity were found to increase the probability of option backdating.[14] Additionally, firms in which most independent directors hold three or more director positions in other firms are more commonly associated with poor corporate governance, produce a lower market-to-book ratio, have lower profitability, and show less sensitivity to the correlation between CEO replacement and firm performance.[15]

In addition, the removal of interlocked directors produces abnormal positive returns, and in contrast, the election of an acting director to the board of an additional firm creates abnormal low return.[16] Another study shows that poison pill practices are adopted by American firms via their spread across firms through interlocked directors. Specifically, a firm's connection through an interlocked director to a company that has adopted poison pill practices increases the probability of adoption by more than 50%.[17]

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[10] John Bizjak, Michael Lemmon and Ryan Whitby, 'Option Backdating and Board Interlocks' (2009) 22 Rev Fin Stud 4821; Peng-Chia Chiu, Siew Hong Teoh and Feng Tian, 'Board Interlocks and Earnings Management Contagion' (2013) 88 Acct Rev 915; Christa HS Bouwman, 'Corporate Governance Propagation through Overlapping Directors' (2011) 24 Rev Fin Stud 2358; Robert Schonlau and Param Vir Singh, 'Board Networks and Merger Performance' (2009) Working Paper, Tepper School of Business; Marielle C Non and Philip Hans Franses, 'Interlocking Boards and Firm Performance: Evidence from a New Panel Database' (2009) Discussion Paper, Tinbergen Institute; Thomas C Omer, Marjorie K Shelley and Frances M Tice, 'Do Director Networks Matter for Financial Reporting Quality? Evidence from Audit Committee Connectedness and Restatements' (2016) https://ssrn.com/abstract=2379151 accessed 17 May 2024; Stephen P Ferris, Murali Jagannathan and AC Pritchard, 'Too Busy to Mind the Business? Monitoring by Directors with Multiple Board Appointments' (2003) 58 J Fin Stud 1087; Eliezer M Fich and Anil Shivdasani, 'Are Busy Boards Effective Monitors?' (2006) 61 J Fin Stud 689; Eliezer M Fich and Anil Shivdasani, 'Financial Fraud, Director Reputation, and Shareholder Wealth' (2007) 86 J Fin Econ 306; David F Larcker, Eric C So and Charles CY Wang, 'Boardroom Centrality and Firm Performance' (2013) 55 J Fin Econ Acct 225.

[11] Bouwman (n 10).

[12] Ibid.

[13] Ibid.

[14] Bizjak, Lemmon and Whitby (n 10).

[15] Fich and Shivdasani, 'Financial Fraud, Director Reputation, and Shareholder Wealth' (n 10).

[16] Fich and Shivdasan, 'Are Busy Boards Effective Monitors?' (n 10).

[17] Gerald F Davis and Henrich R Greve, 'Corporate Elite Networks and Governance Changes in the 1980s' (1997) 103 American J of Sociology 1.

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In regard to *positive practices*, the post-merger financial performance of acquiring firms with interlocked boards is higher by approximately 7% to 12% than that of acquiring firms with boards characterized by lower levels of connectivity.[18] Furthermore, firms with boards that are more interlocked obtain higher profits.[19]

2.2 The Israeli Capital Market and Regulatory Framework

The Israeli market is characterized by a concentrated ownership structure.[20] Most publicly traded firms in the Tel Aviv Stock Exchange (TASE) have a controlling block, and a small number of business groups control many public firms. This means that traditionally, in Israel, there are dominant shareholders who hold, alone or with a group, a majority of the stock, that is, more than 50% of the voting power in the public company. Accordingly, Israel adopted corporate governance rules for its public companies that have focused on protecting the minority public shareholders from the dominant controlling shareholders.

Approximately one-quarter of the publicly traded firms in Israel belong to 25 business groups, and their total weight in the market value of all public firms is estimated at 69%.[21] These business groups are characterized by large diversification across industries, high leverage, combinations of real and financial assets, and, most importantly for our purposes, a shared network of directors.

The Israeli network of directors is also characterized by high concentration and connectivity. Many directors sit on several boards simultaneously, and the boards of many firms are composed of several interlocked directors who sit on other boards as well. Much like the business groups in Israel, the network of directors is characterized by inter-branch connectivity and by connections between real and financially oriented firms, whereas a significant portion of directors who sit on the boards of financial firms in Israel also serve as directors in real firms.[22]

In light of the empirical literature findings as well as the unique characteristics of the Israeli capital market and the general level of concentration in the economy, the Promotion of Competition and Reduction of Concentration Law of 2013 (Concentration Law) was enacted.

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[18] Robert Schonlau and Param Vir Singh, 'Board Networks and Merger Performance' (2009) Working Paper, Tepper School of Business.

[19] Larcker, So and Wang (n 10).

[20] For more analysis on the dominant role of pyramidal structures in the Israeli economy and the elaborate and multi-leveled structure of some of these pyramids, see Lucian A Bebchuck, 'Constraining Corporate Groups' Working Paper.

[21] The Committee on Increasing Competitiveness in the Economy (Israel Ministry of Finance), *Final Recommendations and Supplement to the Interim Report* (2012) 9. Israel's ten largest business groups represent about half the overall off-bank credit. Ibid. About half of the Israeli financial firms belong to business groups. Tamir Agmon and Ami Tzadik, 'Business Groups in Israel – Description, Analysis and Recommendations' (Knesset Research and Information Center, Jerusalem 2010).

[22] The Committee on Increasing Competitiveness in the Economy (Israel Ministry of Finance) (n 21) 25. The network of directors in Israel was found to be a "small world" and that it was possible to get from every director to every other director within only 5–6 steps. Eyal Solgenik, Yitzhak Suary and Liron Constantine, 'Directors of Public Companies Network in Israel' (2009) 11 L & Bus 251–98.

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The law is designed to reduce concentration and enhance the market's competitive structure, improve its efficiency and stability, and increase public welfare.[23] To achieve these goals, it lays down an array of provisions relating to three primary fields: regulation of control through pyramid-structured holdings (Chapter III Concentration Law), regulation of real and financial holdings (Chapter IV Concentration Law), and conditions for the allocation of public assets (Chapter II Concentration Law).

In the Concentration Law, the section addressing the regulation of pyramid-structured holdings, notably their "dismantling," contains an outline for the transition of the market to a holdings structure of no more than two tiers. It should be noted that pyramid-structured holdings refer to a business structure where a firm is controlled through a chain of ownership relations. This ownership structure displays a top-to-bottom chain of control. Different firms that belong to this business structure are placed in different layers in the pyramid to serve a specific purpose. Specifically, there is a parent company that controls several levels of subsidiaries. Each of the controlled subsidiaries controls its own separate subsidiaries. These structures can consist of several levels and were often used up to seven levels. This meant that a small minority of individuals in Israel controlled, through these pyramid structures, many companies with low capital investment. The pyramid mechanisms separate cash flow rights and voting rights, thereby enabling a party to control corporate assets while contributing only a small minority share of the equity capital to fund these assets.

Because the structural changes required by the regulation are fundamental, the law provides a period of four to six years for the dismantling of existing pyramids.[24] For the duration of this period, the law lays down strict corporate governance provisions for firms found in the third or further tiers of the pyramids.[25] Essentially, these require that a majority of board members be independent directors.[26]

Since the legislation entered into force, regulations providing for an easement of the requirements regarding the number of independent directors were enacted.[27] The regulations enable firms in the third tier and above to reduce the number of independant directors in two instances: 1) when directors are appointed according to a nomination by a shareholder who is not the controlling shareholder or his relative, and 2) when directors are appointed according to a nomination by a representative workers union.[28] In both cases, the required number of independent directors will be reduced by the number of directors appointed in said manner, while maintaining a minimum of one-third of total board members.

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[23] The Committee on Increasing Competitiveness in the Economy (Israel Ministry of Finance) (n 21), 4.

[24] Law to Promote Competition and Reduce Concentration, 5774-2013, SH No. 2420 (Isr.) Art. 25 (Concentration Law).

[25] Referred to in the Concentration Law as "other tier firms".

[26] An independent director, as defined in Art. 1 of the Israeli Company Law, 5759-1999, SH 1711 p. 189 (Isr.), is a director eligible for appointment as an independent director and who has not sat on the firm's board for more than nine consecutive years; Art. 25(d)(1) Concentration Law (Art. 25(d)(2) Concentration Law).

[27] Promotion of Competition and Reduction of Concentration Regulations (Easements Regarding Number of Independent Directors), 5774-2014, KT 7382 p. 1188 (Isr.).

[28] Easements Regarding Number Independent Directors (n 27), s 1.

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The primary legislation governing competition and antitrust issues in Israel is the Israeli Economic Competition Law of 1988. Its aim is to prevent harm and address three key trade practices: restrictive arrangements, mergers, and monopolies.[29] The Israeli Concentration Law stands out as a distinctive regulation in the global international context. Enacted as an extension to the Israeli Economic Competition Law, it acknowledges that the competition law alone may not effectively diminish concentration and improve the competitive framework of the market. This recognition stems from the distinctive pyramidal business group structure prevalent among many Israeli firms. This structure is characterized by tiered arrangements, where a top-tier firm exercises control over multiple subsidiaries in lower tiers.[30]

A significant aspect of the Concentration Law is its mandate for firms to disassemble pyramid multi-tiered corporate holding structures within a stipulated period of two to four years. This requirement establishes a global precedent. Israeli companies with pyramid structures were obligated to dismantle them, with a restriction that no firm could possess more than two tiers of publicly listed companies, regardless of whether they issued stocks or bonds. This law brought about a substantial disruption to the structural ownership of the Israeli public market.[31]

During the transitional period from the introduction of the law to the full compliance deadline, pyramid firms were compelled to implement and integrate advanced corporate governance mechanisms and requirements.[32] Notably, this involved a transformation in the composition of their board of directors, necessitating a majority of independent, disinterested directors on the board. Our study is centered on these novel corporate governance requirements, aiming to analyze how they impact the networks of boards of directors in Israel.

It is crucial to differentiate between the U.S. public market, marked by the separation of ownership and control, and the Israeli market, which exhibits a concentration of ownership. In the Israeli context, it is frequent for public companies to have controlling shareholders who wield significant influence, not only at the apex of the pyramid but also in the lower-tier companies within the pyramid structure. This holds true even when these controlling shareholders own only a small fraction of the total equity in certain cases.[33]

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[29] See Tal Eyal-Boger and others, 'Israel: Updated Competition Policy Affects Merger Control and Enhances ICA Enforcement Against Anticompetitive Conduct' (*Global Competition Review*, 30 June 2023) https://globalcompetitionreview.com/review/the-european-middle-east-and-african-antitrust-review/2024/article/israel-updated-competition-policy-affects-merger-control-and-enhances-ica-enforcement-against-anticompetitive-conduct accessed 17 May 2024.

[30] See Tal Eyal-Boger, Ziv Schwartz and Shani Brown, 'Israel: Competition Law Regime' (*Global Competition Review*, 14 July 2021) https://globalcompetitionreview.com/review/the-european-middle-east-and-african-antitrust-review/2022/article/israel-competition-law-regime accessed 17 May 2024.

[31] Ido Baum, Zvi Zrahiya and Ora Coren, 'What Is Israel's New Business Concentration Law and Why Should We Care?' *Haaretz* (29 December 2013) https://www.haaretz.com/israel-news/business/2013-12-29/ty-article/q-a-on-business-concentration-law/0000017f-db5f-d3ff-a7ff-fbff50b00000 accessed 18 May 2024.

[32] ibid.

[33] Nitzan Shilon, 'Markets versus Regulation: Investor Protection in the United States Compared to Israel' in Arthur B Laby (ed), *The Cambridge Handbook of Investor Protection* (Cambridge University Press 2022).

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Due to these considerations, the Concentration Law, in conjunction with the Economic Competition Law, stands out as exceptionally unique. Its primary purpose was to address the issue of concentrated ownership prevalent in the Israeli public markets. In conclusion, the implementation of these laws proved successful in reducing the levels of concentration within the market.

Based on this background, the chapter empirically examines the market's reaction to these corporate governance provisions and, specifically, their effect on the intensity of board connectivity in Israel. Two databases were especially constructed for this purpose, with detailed information on the boards of the 50 largest publicly traded firms in Israel. One database reflects the situation six months prior to the entry of the Concentration Law into force, and the other reflects the situation six months afterwards.[34] These datasets were processed and analyzed using social network analysis methodology to examine the changes that have occurred in various connectivity indices as a result of the legislation.

Underlying all of these differing forms of interlocking directorates and methods of addressing them is the changing structure of equity ownership.[35] As corporate ownership becomes concentrated by institutional investors, there is a very real concern that indirect and direct interlocks will become unavoidable for competing owners of the equity, not just the directors themselves. Courts and antitrust enforcement agencies have repeatedly held that the definition of "person" includes corporate owners and their agents under agency and deputization theory.[36]

Some have advocated for simply embracing this new reality and shifting the predominant theory of board structures. Under this approach, independent and non-interlocked directors would serve in the traditional oversight and compliance roles, with significantly interlocked directors taking a more active role in the company.[37] This would include serving as the ultimate guidance for the strategic direction of the company.[38] Advocates for this method argue this would solve concerns of interlocking by forcing these directors to take large financial stakes to gain this position and would result in a reduction of activist challenges seeking increased information disclosure.[39]

3. METHODOLOGY: SOCIAL NETWORK ANALYSIS

Social network analysis is a methodology used for the discovery and analysis of social networks and relationship patterns between individuals composing the network.[40] This analysis

[34] The provisions dealing with board composition in other-tier firms entered into force on 11 June 2014.

[35] For more on the potential anticompetitive risks raised by interlocking directorates between competitors, such as facilitating collusion and reducing the intensity of competition, see Florence Thépot, 'Transatlantic Perspectives on Interlocking Directorates' (2023) 3(1) CPI Antitrust Chron 8.

[36] See Wilkinson (n 6) 58.

[37] See Gilson and Gordon (n 5) 352.

[38] See ibid.

[39] See ibid 354, 361.

[40] John Scott, *Social Network Analysis* (4th edn, Sage Publications Ltd 2017).

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reflects the connection patterns between the individuals within the network using a mathematical analysis of the relations between them. It helps produce both quantitative findings on relationship intensity and also visual findings that enable the nonprofessional observer to be impressed with the intensity of connections and the patterns of relations. The indices produced by the analysis provide insights into the role of individuals and different groups within the wider social network and help reveal informal roles of entities in the social network. For the presentation and analysis of our results, basic terms of social network analysis are defined below:

Vertex is the set of entities that form a connection among themselves within the network. Entities in this chapter include both directors and firms, together comprising the whole sample.

Edge is the manner in which entities within the network are connected. In this chapter, the manner in which entities are connected entails sitting together on the same board.

Graph Density indicates the number of existing edges in the network, out of all possible edges. The graph will reflect a higher level of density as the number of edges in the network increases relative to the maximal possible number of edges in that same network.

Degree of Connectivity indicates the number of direct connections an entity within the network has with others. The degree of connectivity reflects the direct communication channels a director has within the network, through which information and practices may spread.

Closeness Centrality indexes an entity's proximity to all other entities within the network. Practically, the index reflects the speed at which information is transferred and practices are diffused throughout the network. The value of this index is high when connections between entities are close, that is, when the number of steps required to move from one node to another is low. Practices spread faster as the number of steps is lower.

Betweenness Centrality indexes information flow within the network by examining, per entity, the number of times it is positioned in the shortest route between every pair of entities within the network. In practice, the index measures the role of each entity in transferring information and spreading practices across firms. A high value in this index indicates that the entity it represents is a significant factor in the communications between other entities included in the sample.

Several possibilities exist for modeling the relationship between directors using social network analysis. One is to examine the network of directors in a model that has two vertex populations: vertices that represent directors and vertices that represent the firms on whose boards the directors sit. In this model, edges connect the two populations but do not connect vertices from the same population. That is to say, an edge connects a director and a firm if the director sits on that firm's board.

Another possibility is to model the network in a manner that refers to only one population of vertices – directors. An edge connecting two vertices will exist when both directors sit on at least one shared board. Therefore, each vertex is a director connected with all other directors sitting on the same board. A director sitting on several boards is represented in the network by a single vertex but is connected with every director who sits on the same boards as they do.

This chapter reports analyses based on these two different models to produce a rich and varied view of board interlocks in Israel. Furthermore, analyzing the network using two distinct models enables us to assess the robustness of the findings and phenomena observed by each model. If the outcomes of both models reflect the same tendency, the validity of its existence worldwide will be enhanced, regardless of which specific model is used.

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4. THE DATA

For the purpose of this research, data on the 50 largest publicly traded firms in Israel were gathered. The datasets are based on the firms included in TASE's TA-100 index. The data were gathered from TASE's data website. Data missing from the website were recovered from the Dun & Bradstreet Directors website and the Bizportal website. The data were gathered for two points in time: January 2014 and January 2015, approximately six months before and after the entry into force of the additional corporate governance provisions regarding pyramid-structured corporations. Firms removed from the TA-100 index during the examined period were removed from the samples examined so the comparison of samples could be based on an identical number of firms.[41]

The data gathered include the list of all directors sitting on the boards of the aforementioned firms. For each director, we examined whether they were the board chairperson or vice chairperson, an independent director, a director with accounting and financial expertise,[42] or a member of the firm's audit committee. Additionally, for each firm, we examined its position within a pyramid-structured business group and, specifically, its tier location.

5. RESULTS

5.1 Descriptive Statistics

As Table 16.1 shows, the enactment of the Concentration Law was followed by an increase in the number of directors in the network. However, both the number of directors per board and the number of boards an individual director sits on dropped. The combination of an increase in the total number of directors for the same sample and the drop in the number of boards an individual director sits on indicates a greater variety of directors in the network along with a smaller number of interlocked directors.

5.2 Analysis of Director Networks in Israel

The data gathered on Israeli director networks before and after the enactment of the Concentration Law were analyzed using two software packages to assess the law's impact on the network's connectivity indices.[43] In addition to calculating the various indices, the

[41] During the 1-year period examined, six firms were removed from TA-100: Avner Oil & Gas Ltd., Alrov Properties Ltd., Given Imaging Ltd., Delek Drilling – Limited Partnership, Koor (merged into Discount Investment Group Ltd.), and Clal Insurance Ltd.

[42] The definition of a director with accounting and financial expertise is found in Art. 1 of Company Regulations (Conditions and Tests for Directors with Accounting and Financial Expertise and for Professionally Competent Directors), 5766-2005, KT 6445 p. 198 (Isr.). Essentially, the director is required to have education, experience, and skills that afford expertise and understanding in business and accounting issues.

[43] The packages are NodeXL and Pajek. Most of the analyses were conducted using NodeXL, which was also used to produce the graphic displays. Pajek was used to shift from a database that

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Table 16.1 Descriptive statistics of board of directors before and after the regulatory change

Year	No. of directors in network	Mean No. of directors on board	Median No. of directors on board	SD No. of directors on board	Mean No. of boards each director sits on	Median No. of boards each director sits on	SD No. of boards each director sits on
2014	365	9.75	10	4	1.1753	1	0.4704
2015	378	9.56	9	2.97	1.1111	1	0.3538

Source: Authors' data collection

software packages provide a graphic display of the network's structure and array of connections in the examined periods.

To compare the change reflected in the real data with the change expected to occur under complete adherence to the legislation, a simulation displaying the expected changes was conducted. In the simulation, one-third of the board members of all firms on the third tier or above were randomly swapped. According to the easing of requirements the regulations provided, one-third is the minimal number of independent directors that must be appointed in such firms, whereas the majority of firms are, in fact, required to appoint even more. Therefore, the simulation reflects the minimal measure of change that was expected to occur following the application of these additional corporate governance provisions.

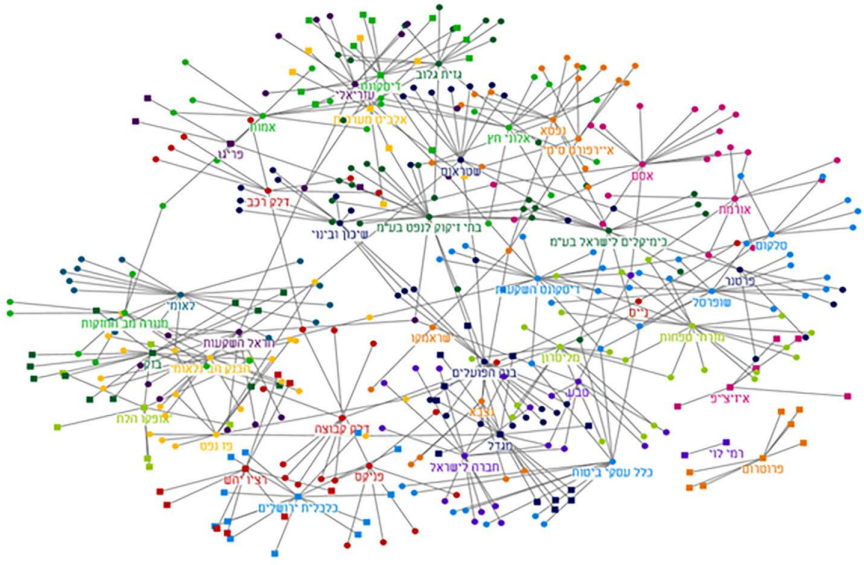
5.2.1 Board interlocks *before* the concentration law

The following graph shows the connections between directors and firms in the Israeli market prior to the entry of the Concentration Law into force. Each firm is mentioned by name next to its representing vertex. The additional vertices are the directors. Directors sitting on numerous boards are represented by a single vertex and are connected by several edges to the vertices representing the firms.

As seen in Figure 16.1, the network is complex and contains many edges between many firms via shared directors. The number of vertices is 409, the number of edges is 429, and the graph density is 0.0051. The mean degree of connectivity is 2.098 (min = 1, max = 19). The closeness centrality index is 0.02, and the betweenness centrality is 480.489.

includes firms and the directors sitting on their boards to a database that includes only the directors but delineates connections between directors sitting on the boards of the same firms.

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Source: Authors' data collection.

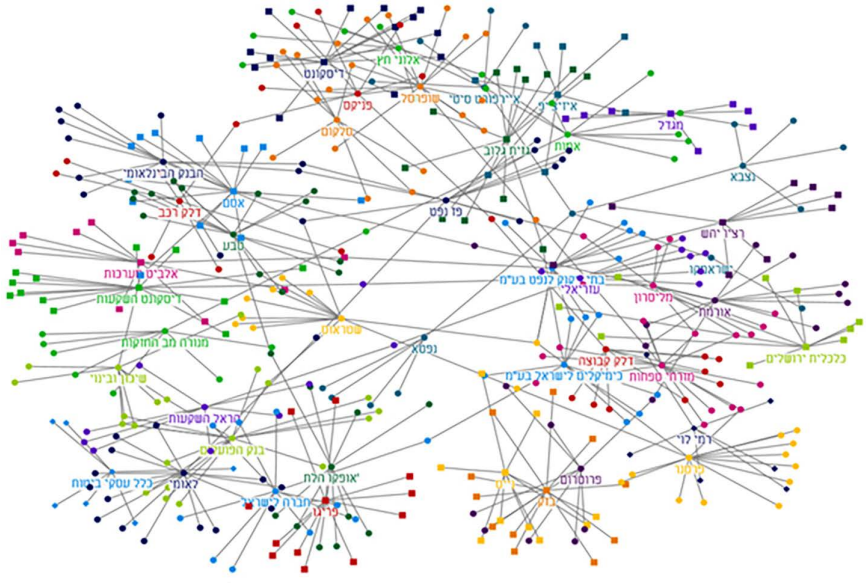
Figure 16.1 The network of directors in January 2014

5.2.2 Board interlocks *after* the concentration law

Figure 16.2 shows the connections between directors and firms in the Israeli market after the entry into force of the Concentration Law. Here, too, firms are mentioned by name next to their representing vertices. The edges that connect a firm on the one end and an unnamed vertex on the other end represent the connections between a firm and the directors sitting on its board. Directors sitting on numerous boards appear in the graph as a single vertex, connected to each of the different firms on whose boards they sit.

As shown in Figure 16.2, the number of vertices in the network is 422, and there is a clear increase in the number of directors in the network. This indicates a drop in the total number of shared directors. In addition, the number of edges dropped to 419. Graph density also declined slightly, to 0.0047. The mean degree of connectivity is 1.991 (min = 1, max = 15). Additionally, the closeness centrality index dropped to 0.019, and the betweenness centrality index dropped to 397.815. Therefore, it appears that following the legislation's enactment, there was a decline in the various network connectivity indices. To examine the decline in these indices relative to that which was expected, these results must be compared to those of the simulation conducted.

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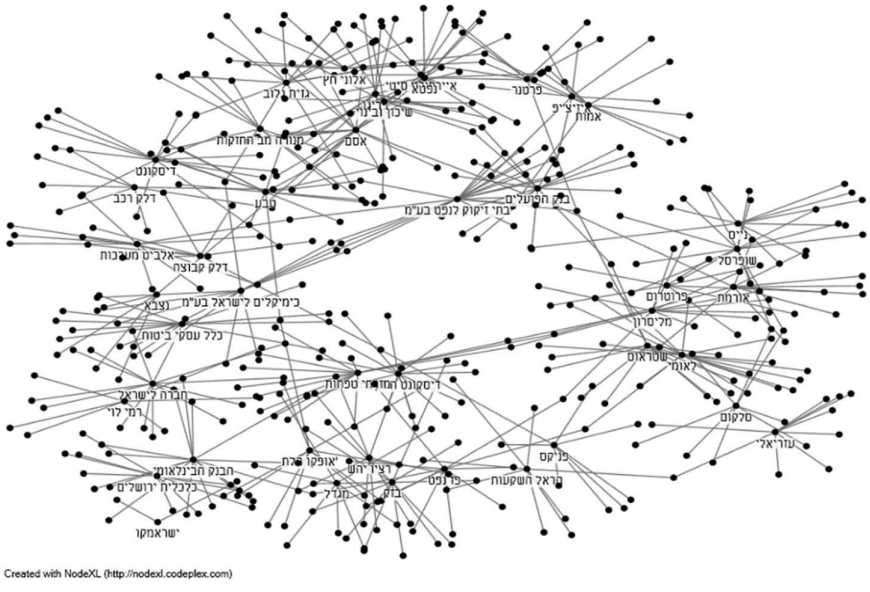
Figure 16.2 The network of directors in January 2015

5.3 Expected Board Interlocks: Simulation Results

As mentioned, the simulation seeks to examine the expected appearance of the network under complete adherence to the additional corporate governance provisions within the Concentration Law. In the simulation, one-third of board members were randomly swapped in the boards of all third- or further-tier firms in business groups with a pyramidal structure. The selection of one-third of the board, instead of half, is stricter in relation to the model, representing the minimal swap required in those firms. For most firms, the requirement remains half of the board, but as mentioned, for the purpose of simulating complete adherence to the minimal standard required by the law, the stricter requirement was selected.

The results of the simulation indicate that the decline in connectivity indices that occurred in reality was lower than expected. The number of vertices in this network is 463, meaning an even higher number of different directors within the network, compared with what existed in reality, could be expected. The expected number of edges is 449, which is also higher than the number observed in reality. Graph density is lower and is set at 0.0041. The expected mean degree of connectivity is 1.94, and is also lower than that observed in actuality, meaning we would expect every entity to have a smaller number of edges than the number observed in reality. The closeness centrality and betweenness centrality indices in the expected network are 0.028 and 381.963, respectively, lower than their equivalents in the actual network observed after the law entered into force.

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Source: Authors' data collection.

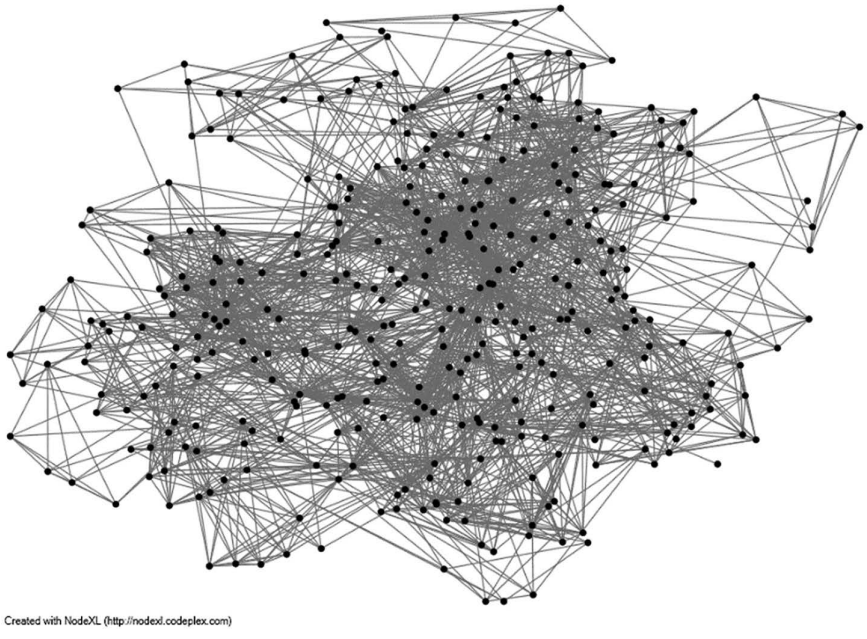
Figure 16.3 The expected network of directors under complete minimal compliance

It can be readily observed (see Figure 16.3) that in the expected network, there exists a "gap" at the center of the network, which does not exist in the actual network. That "gap" represents the removal of connections between directors and firms, which was required by law but not fully performed. From this, we can deduce that the network of directors that exists today is more connected and denser than the one expected under complete adherence to the minimal legal standard.

5.4 Analysis of Connections between Directors

Another analysis examines the direct connections between directors themselves, whereas firms are not treated as vertices in the network. In this analysis, every two directors who sit on the same board are connected to each other directly rather than via firms as in the previous analysis. Although the previous analysis also depicts inter-firm edges via shared directors, this analysis depicts inter-director edges only and serves as another means to examine the robustness of the results.

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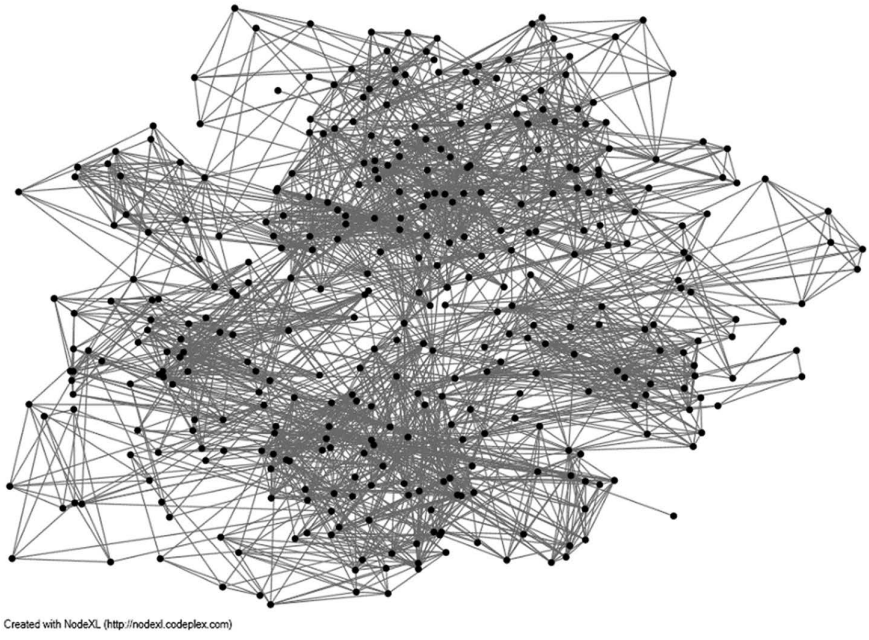
Source: Authors' data collection.

Figure 16.4 Inter-director connectivity in January 2014

The network in Figure 16.4 depicts inter-director edges prior to the entry of the Concentration Law into force. It contains 362 vertices and 2,178 edges. Graph density is 0.0333, and the mean degree of connectivity is 12.033 (min = 1, max = 38). It is evident that when examining the direct connections between directors, without accounting for firms as an intermediary element, a more complex and connected network is revealed. To examine the effects of the Concentration Law on this complex network, these findings must be compared with the network's characteristics after the legislation entered into force.

The network in Figure 16.5 depicts inter-director edges after the entry of the Concentration Law into force. This network contains 373 vertices, which reflects the increase in the number of different directors, stemming from adherence to the requirements set in the law. The network contains 1,945 edges, indicating a decline in the number of inter-director connections. Graph density also declined to 0.028. The mean degree of connectivity follows the general trend by falling to 10.429 (min = 1, max = 37). The minuscule difference in the maximal degree of connectivity characterizing an entity in the network indicates that even after the application of the Concentration Law, there still are some directors with an abundance of connections with other directors.

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Source: Authors' data collection.

Figure 16.5 Inter-director connectivity in January 2015

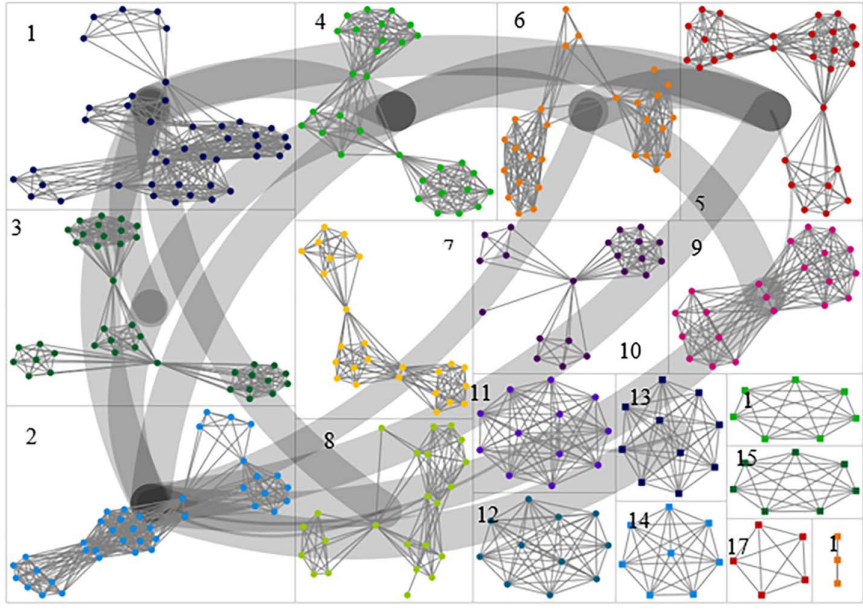
5.5 Dividing the Network into Groups of Firms

In this analysis, we divided the network into groups of firms based on the level of connections, reflected by the number of shared directors. The division process was conducted under the Clauset-Newman-Moore algorithm,[44] which helps characterize the structure of large networks. We divided the firms into several groups according to each group's level of connectivity with one another. The value of this analysis lies in its ability to examine the impact of the Concentration Law on the number of groups of firms found in the market and their composition, along with its ability to examine the transferring of various practices through interlocked directors, seeing if there is a higher probability for such transfers within the groups provided by the algorithm

.Group numbers are indicated in Figure 16.6. Table A16.2: Appendix A specifies, for each group, the firms whose directors are most commonly connected in that group. A group does not always contain all of a firm's directors, and hence there may be firms that are connected to a group but not listed as part of it. These firms are characterized by a small number of directors within that group and are not listed because their connection to the group is weak.

[44] Aaron Clauset, MEJ Newman and Cristopher Moore, 'Finding Community Structure in Very Large Networks' (2004) 70(6) Physical Review E 066111 https://arxiv.org/pdf/cond-mat/0408187.pdf accessed 18 May 2024.

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Source: Authors' data collection.

Figure 16.6 The network of directors divided into groups, January 2014

The connections in the background represent the connections between the various groups in the network.

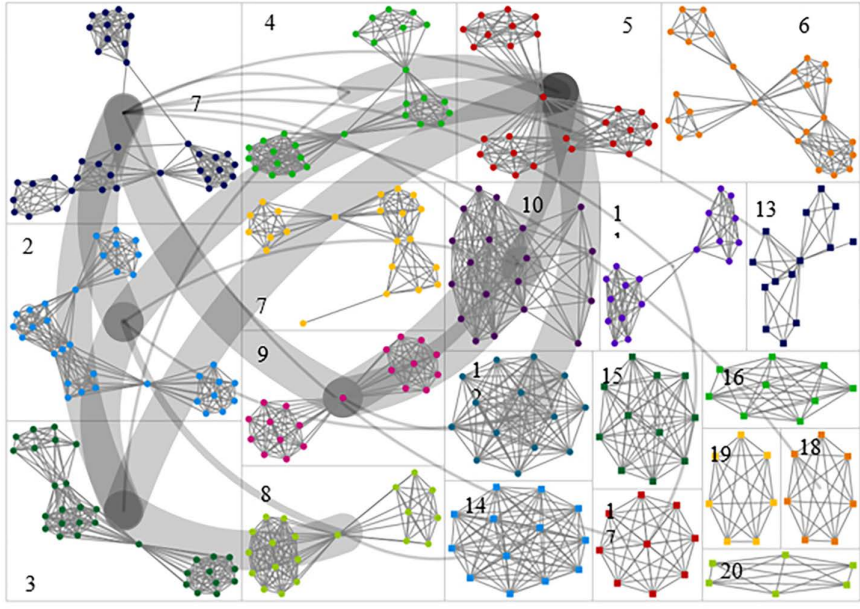
In January 2014, the network of firms comprised 18 groups. Groups 1–10 were composed of numerous firms, and the remaining eight (11–18) had a single firm each. Group 2 was the most connected; it connected to seven other groups in the network.

Following the changes that occurred in boards of directors due to the enactment of the Concentration Law, the network's structure in 2015 was divided by the algorithm into 20 groups, more than in the previous year. The changes are shown in Figure 16.7. Twelve groups (groups 1–11, 13) were composed of numerous firms, and eight had only one firm per group. The most significant change observed was the decline in connections between groups in 2015. The most connected group was Group 5, connected to six other groups. Table A16.3: Appendix B specifies the firms included in each group, by group numbers.

6. DISCUSSION

This chapter examined market reactions to Israeli regulations that applied additional corporate governance provisions to third- or further-tier firms within pyramid-structured business groups using social network analysis tools and methodology. The results of the analysis include both quantitative results regarding various connectivity indices of the director

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Source: Authors' data collection

Figure 16.7 The network of directors divided into groups, January 2015

network in Israel and also visual results in the form of graphs that delineate the network and its connections.

The results of the empirical analysis show that following the entry of these provisions into force, the average number of directors per board declined, as did the average number of interlocked directors, i.e., the number of directors who serve on multiple boards has decreased.[45] In addition, there was a drop in the level of connectivity of the board interlocks within the large publicly traded corporations in Israel. This decline was lower than what could be expected under complete adherence to the minimal standard required in primary and secondary legislation. The connections between directors themselves were complex and dense, but there was also a decline in their own level of connectivity following the aforementioned regulatory changes. Finally, when dividing the market into groups, there was an evident increase in the number of different groups within the same sample of firms and a decrease in the number of connections between groups.

In addition to these findings, social network analysis tools enable us to observe qualitative characteristics of board interlocks in Israel. These include the division of the network into groups, a division that reveals firms that are connected more intensely via shared directors,

[45] The concept of director "overboarding" refers to a director who sits on a large number of boards. Sean O'Neill, 'What is Overboarding?' (*Corporate Governance Institute*, 12 January 2023) https://www.thecorporategovernanceinstitute.com/insights/lexicon/what-is-overboarding/ accessed 18 May 2024.

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and the connections between different groups. Thus, it becomes possible to single out groups of firms and certain firms that are more intensely connected in the network and, therefore, are a decisive element in the transfer of various practices to other firms in the network. The literature shows that directors who sit on the boards of multiple firms bring with them diverse corporate governance practices from other firms and drive the firm on which they sit in their own direction in such a manner that the effect of said connections is a convergence of corporate governance practices.[46] The analysis conducted here, which reveals firms that function as decisive elements in the network, can predict a tendency for convergence to the corporate governance practices of said firms.

The present research serves as a test case illustrative of the interaction between legislative change and the market. Legislative requirements that are applied to the market in a short time and that require immediate execution of their provisions enable the examination of this interaction in a relatively short period, thus avoiding other possible influences that might explain the market's reaction. Firms in which a structural change has occurred, such as a merger or a change in the form of incorporation (for example, transition from a publicly traded to a limited partnership firm), were excluded from the sample because these changes might provide an alternative explanation for changes in the firms' board composition.

In general, it is evident that firms in the market reacted in accordance with the legal requirements, causing a drop in the level of board interlock connectivity, although not entirely. The means by which connectivity levels were reduced were varied, including downsizing boards; merging second- and third-tier firms such that the newly merged firm became a second-tier firm, to which the legislation did not apply; and swapping inside directors with independent ones. All these measures reduced connectivity and promoted the law's aim and are thus equally appropriate from a functional perspective.

The question of whether reducing board interlock connectivity is appropriate and wise remains controversial in economic and financial literature.[47] A full answer requires a separate, in-depth discussion, taking the unique characteristics of the Israeli market into account. Given the current market structure, characterized by the existence of multiple firms with a controlling block and of business groups that represent the main market share of publicly traded firms, there may be reasons to assume that reducing board interlocking connectivity would be beneficial. The appointment of directors is one of the means to control a firm. When a director has attachments to a specific person or firm, a concern arises that this director would act in a manner favorable to the person or firm to whom they are attached. Hence, a network of connections between directors might function as a substitute for the need to possess corporate control. When a gap exists between actual control and the investment in control measures, an agency problem exists, which entails agency costs that reduce market efficiency.

Finally, this chapter examines the impact of legislative change on short-term market behavior. Examination of the long-term impact of the decline in director connectivity levels on corporate governance in Israeli publicly traded firms is also important and necessary. The findings of this research may serve as a basis for examining long-term impacts, first, on the diffusion of different practices, whether positive or negative, from one firm to another; second,

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[46] Bouwman (n 10).

[47] Michal Barzuza and Quinn Curtis, 'Board Interlocks and Corporate Governance' (2014) 39 Del J Corp L 669.

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on the connections between financial and real corporations in the Israeli capital market; and third, on the market's own level of concentration.

To conclude, this chapter has examined the complex legal and corporate governance issues surrounding board interlocks using a natural experiment from Israeli competition law. Board interlocks, where directors serve on multiple corporate boards simultaneously, have long been a subject of debate in corporate law and governance circles. Board interlocks can have both positive and negative effects on corporate governance. They facilitate the spread of best practices and provide valuable external perspectives. However, they also risk groupthink, conflicts of interest, and the entrenchment of a small elite network of directors. They are so deeply rooted in the corporations that the regulatory intervention tested empirically didn't achieve its entire goal. By discovering that, this chapter aims to contribute to the ongoing dialogue on how best to balance the potential benefits of board interlocks with the need to protect shareholder interests and maintain competitive markets.

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APPENDIX 16

Table A16.1 Details of the firms included in each group, January 2014

Group Number	Firms in Group
1	Cellcom, Clal Insurance Holdings Ltd., Shufersal, Discount Investment Group, Elbit Systems.
2	Bazan (Oil Refineries Ltd.), Migdal Insurance, ICL (Israel Chemicals Ltd.), Partner, Strauss Group.
3	Leumi, Harel Investments, Azrieli Group, Discount Bank Ltd.
4	FIBI Bank, Paz Oil, Rami Levi.
5	Melisron, Mizrahi Tefahot, Ormat Technologies.
6	Israel Corp, Teva, Osem.
7	Menora Miv. Holdings, Amot, Alony Hetz.
8	Delek Automotive, Delek Group, Nice, Phoenix.
9	Shikun & Binui, Poalim Bank.
10	Nitzba, Naphtha, Airport City, Isramco.
11	Bezeq.
12	Jerusalem Econ.
13	Gazit Globe.
14	Ratio Oil Exploration.
15	Opko Health.
16	Frutarom.
17	EZchip.
18	Perrigo.

Source: Authors' data collection.

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Table A16.2 Details of the firms included in each group, January 2015

Group Number	Firms in Group
1	Gazit Globe, Osem, Ormat Technologies, Frutarom.
2	Elbit Systems, Bazan (Oil Refineries Ltd.), Israel Corp, ICL (Israel Chemicals Ltd.).
3	Melisron, Mizrahi Tefahot, Partner.
4	Harel Investments, Azrieli Group, Discount Investment Group.
5	Strauss Group, Paz Oil, FIBI Bank.
6	Clal Insurance Holdings Ltd., Delek Automotive, Delek Group, Phoenix.
7	Menora Miv. Holdings, Amot, Alony Hetz.
8	Shufersal, Cellcom.
9	Teva, Opko Health.
10	Poalim Bank, Shikun & Binui.
11	Bezeq, Ratio Oil Exploration.
12	Leumi.
13	Naphtha, Airport City, Nitzba, Isramco.
14	Discount Bank Ltd.
15	Perrigo.
16	Jerusalem Econ.
17	Nice.
18	Migdal Insurance.
19	EZchip.
20	Rami Levi.

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17. "Killer Acquisitions" or "Killing Innovation": Antitrust Implications of the New Wave of Tech Acquisitions and the New European and Italian Regimes for Below-Threshold Mergers

Valeria Falce and Nicola M. F. Faraone

1. INTRODUCTION[1]

Start-ups or nascent firms play a crucial role in the dynamics of competitive markets. They can represent an input for dissolving concentrated markets, marginalizing less efficient incumbents and forcing their exit, if necessary, without hindering innovation. Traditionally, however, they rarely attracted the attention of competition authorities and raised little competitive concern, at least until they had the chance to become successful businesses. Their relevance to merger control has thus been limited to a new entrant's model for signalling that dominant incumbents' market power has been eroded rather than as merging parties. Despite their role in boosting innovation, this is essentially due to their low turnover.

That was true until 2018, when a seminal research paper focusing on the pharmaceutical industry and published by Colleen Cunningham, Florian Ederer and Song Ma warned against potentially problematic acquisitions of start-ups by incumbent undertakings. The authors defined this type of transaction as "killer acquisitions" insofar as dominant firms, threatened by the potential launch of a competitive product or service that would undermine their own product or service, may acquire start-ups with a view to shutting them down.[2] Although the research was originally limited to the pharmaceutical sector, this phenomenon later spread throughout the digital environment.[3]

At the same time, many recent economic papers and policy reports have expressed concerns about competition and innovation advanced in the context of the acquisitions of start-ups or scale-ups by digital gatekeepers.[4]

[1] Although this paper is the result of a joint discussion and mutual reflections of the Authors, paras 6 and 7 are attributable to Professor Valeria Falce while paras 2, 3, 4 and 5 are attributable to Dr. Nicola M.F. Faraone. Paras 1 and 8 are attributable to both the Authors.

[2] C. Cunningham, F. Ederer and S. Ma, 'Killer Acquisitions' (2021) 129(3) Journal of Political Economy 649.

[3] OECD, Start-ups, Killer Acquisitions and Merger Control – Background Note; materials for the Meeting of the Competition Committee on 10–12 June 2020.

[4] See, among others, J. Crémer, Y.A. de Montjoye and H. Schweitzer (2019), Competition Policy for the Digital Era, Final Report for the EU Commission (hereinafter, the 'Crémer Report'); J. Furman et al. (2019), Unlocking digital competition, Report of the Digital Competition Expert Panel (hereinafter, the 'Furman Report'); George J. Stigler Center for the Study of the Economy and the State (2019), Report of Committee for the Study of Digital Platforms, Market Structure and

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One catalyst for the ongoing debate, which gives us the opportunity to explore the topic anew, is the recent approval in Italy of Article 32 of Law No. 118/2022 (the "2021 Annual Law for the Market and Competition"), which entrusted the Italian Competition Authority (hereinafter, the "AGCM") with the power to request undertakings to mandatorily notify a merger or concentration that falls below the previously existing turnover thresholds (including if the transaction is already completed) as set out in Article 16 of Law No. 287/1990 (the "Italian Competition Act").

Also, at European level, the revisitation of Article 22 of EU Merger Regulation No. 139/2004 (the "EUMR")[5] is likely to evoke a renewed reflection on the killer acquisitions framework.

Obviously, these amendments are cases in point for addressing the issue of "killer acquisitions" and other "gap cases" that would have fallen outside of the scope of the European Commission (hereinafter, the "Commission") and AGCM's powers to scrutinize, block or impose conditions or remedies to preserve effective competition.

Therefore, an undertaking with a low turnover does not meet the thresholds and escapes merger control review. In addition, in the long run, the increased scrutiny into these potentially concerning acquisitions needs to be reconciled with the new Digital Markets Act ("DMA"), which contains a specific provision – Article 14 – clashing with the autonomous significance of killer acquisitions as a separate field of investigation.[6]

In the present contribution, the two subsequent sections will firstly define the features of digital markets and boundaries and the scope of the notion of "killer acquisitions", further exploring the meaning of two controversial definitions (potential competition and nascent competitors). Then, the analysis will concentrate on the referral mechanism under Article 22 of the EUMR and the shift in the EU Commission's approach, now encouraging referrals from Member States even where the national filing thresholds are not met. The most immediate repercussion of this change in policy is exemplified by the *Illumina/Grail* case, which will be examined in an appropriate level of detail. Lastly, before coming to some tentative conclusions, the most recent case law will be discussed, both at European and Italian levels.

Antitrust Subcommittee, The University of Chicago Booth School of Business (hereinafter, the 'Stigler Report'). There have also been reports from Australia (ACCC, Digital Platforms Inquiry – Final Report, July 2019) (hereinafter, the 'ACCC Report'); Benelux (Joint Memorandum of the Belgian, Dutch and Luxembourg Competition Authorities on Challenges Faced by Competition Authorities in a Digital World, 2019); BRICS (BRICS in the Digital Economy: Competition Policy in Practice, 2019); France (G. Longuet et al., Report at the French Senate on Digital Sovereignty, 2019); Germany (M. Schallbruch, H. Schweitzer and A. Wambach, A New Competition Framework for the Digital Economy: Report by the Commission 'Competition Law 4.0', 2019); Italy (AGCM, AGCOM, AGPDP, Big Data Joint Survey, 2019); Japan (FTC, Report Regarding Trade Practices on Digital Platforms, 2019); Netherlands (Ministry of Economic Affairs and Climate Policy, Future-proofing of Competition Policy in Regard to Online Platforms, 2019); Portugal (Autoridade da Concorrência, Digital Ecosystems, Big Data and Algorithms, 2019); UNCTAD (Competition Issues in the Digital Economy, 2019).

[5] Council Regulation (EC) No. 139/2004 of 20 January 2004 on the control of concentrations between undertakings, OJ L024/ 0001–0022.

[6] Regulation (EU) 2022/1925 of the European Parliament and of the Council of 14 September 2022 on contestable and fair markets in the digital sector and amending Directives (EU) 2019/1937 and (EU) 2020/1828 (Digital Markets Act).

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Starting from the assumption that incentives for innovation for start-ups are key to ensuring that markets remain open, the new legislation at both the EU and Italian levels and the consequent case law will be analysed. The ultimate objective of this chapter is to contribute to the debate, identifying the expected consequences and envisaging some limits deriving from the renewed role "played" by merger control in the broader context of digital ecosystems.

2. CHARACTERISTICS OF DIGITAL BUSINESS MODELS AND MARKETS

The functioning of digital markets is essential preliminary information for approaching the "killer acquisitions" framework.

Digital business models have a number of peculiar features.[7] First, they are often identified with large economies of scale. Providing the services to an additional user, for example, is usually associated with only minimal marginal costs for a digital company. In addition to economies of scale, economies of scope also play a crucial role in many digital markets and exist to implement diversification strategies if offering various products within a single company can be realized at lower costs than offering these products by different companies.

Moreover, many digital business models and markets are characterized by direct and indirect network effects.[8] Direct network effects exist where a service's benefits to a user increase (positive network effects) or decrease (negative network effects) as the number of overall users grows. Positive network effects can make a service more attractive to new users, make switching to other services unattractive, and tie users to the service in the sense of a "lock-in effect".[9]

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[7] M. Bourreau and A. de Streel, 'Digital Conglomerates and EU Competition Policy', Working Paper, 26 February 2019, 5; M. Bourreau and A. de Streel, 'Big Tech Acquisitions: Competition & Innovation Effects and EU Merger Control', Centre on Regulation in Europe (CERRE) Issue Paper, February 2020; OECD, Roundtable on Conglomerate Effects of Mergers, 2020, 23; M. Motta and M. Peitz, 'Big Tech Mergers' (2021) 54 Information Economics and Policy, 100868; A. Gautier and G. Lamesch, 'Mergers in the Digital Economy' (2021) 54 Information Economics and Policy, 100890; M.L. Katz, 'Big Tech mergers: Innovation, competition for the market, and the acquisition of emerging competitors' (2021) 54 Information Economics and Policy 100883; E. Calvano and M. Polo, 'Market power, competition and innovation in digital markets: A survey' (2021) 54 Information Economics and Policy 100853; OECD, 'OECD Handbook on Competition Policy in the Digital Age' (2022), available at https://www.oecd.org/daf/competition-policy-in-the-digital-age; G. Parker, G. Petropolous, and M. Van Alstyne, 'Platform mergers and antitrust' (2021) 30 Industrial & Corporate Change 1307, 1311; E. Argentesi, P. Buccirossi, E. Calvano, T. Duso, A. Marrazzo and S. Nava, 'Merger Policy in Digital Markets: An Ex Post Assessment' (2021) 17(1) Journal of Competition Law & Economics 95–140. This article is part of a wider report commissioned by the CMA on the evaluation of past merger decisions in UK digital markets. See Lear - Economic Consultancy, 'Ex-post Assessment of Merger Control Decisions in Digital Markets – Final report', 9 May 2019.

[8] Crémer Report (n 4) 20.

[9] E. Argentesi et al. (n 7) 4; Crémer Report (n 4) 22, according to which "[t]he benefits, for an incumbent platform, of network externalities are due to the difficulty for users to coordinate migration to a new platform. Indeed, even if the users would all be better off if they migrated en masse

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Indirect network effects are characteristic of so-called multi-sided markets or platforms.[10] Indirect network effects exist, for example, where an increase in user numbers on one market side increases the service's value on the other market side (positive network effects) or where an increase in user numbers on one market side decreases the service's value on the other market side (negative network effects). Positive network effects may lead to market "tipping" so that the scope of action enjoyed by the incumbent is no longer controlled by competition in the market but (only) by competition for the market. Moreover, one characteristic feature of digital multi-sided markets is that the offers are frequently provided to one market side at no monetary cost and financed through the offer provided to the other market side – such as offering advertisers opportunities for their adverts to be seen by their target audience.

In the digital sector, economies of scale and network effects are often accompanied by other advantages of scale. The reason for this is that a service's increased popularity may involve, for example, an increased ability to better access data relevant to competition compared to other market players. The quality improvements made possible by way of data can then, in the sense of a feedback loop, lead to the service's popularity further increasing, thus making it possible to collect even more data.[11]

In their entirety, these features of digital business models can also facilitate strategies allowing a company to create, strengthen or secure a so-called ecosystem. Such an ecosystem can be reflected in the technical connection between various products and services offered by a company. This may result in complementarities or synergies; an example of this on the supply side is the use of one input factor for various products. Data in particular can constitute such an input factor. The technical connection between various products or services can also facilitate strategies which increase the switching costs for users. If products or services offered by a company can only be used together, or if it is at least better to use them together, with other products or services in the ecosystem, the use of individual products or services can already result in (another) lock-in effect, which at least influences a user's future decisions in the sense of path dependency.

Lastly, innovations play a prominent role in digital business models and digital markets and contribute considerably to the welfare-enhancing effects of the digital economy.

3. CHALLENGES OF MERGER CONTROL IN DIGITAL MARKETS

Over the past fifteen years, the number of acquisitions by large digital corporations has rocketed.[12] Indeed, in the period 2009–2019, more than 400 acquisitions are attributable to the so-called "GAFAM" (Google, Apple, Facebook, Amazon and Microsoft).[13] In fact, most of those

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to a new platform, they would not necessarily have an individual incentive to move to the new platform – whether or not they chose to do so depends on their expectation that others will follow."

[10] E. Argentesi et al. (n 7) 5.

[11] OECD, Roundtable on Conglomerate Effects of Mergers (n 7) 24.

[12] M. Motta and M. Peitz (n 7) point out that Alphabet is reported to have made 48 acquisitions, Amazon 42, Apple 33, Facebook 21 and Microsoft 53; A. Gautier and G. Lamesch (n 7) count 175 acquisitions made by Alphabet, Amazon, Apple, Facebook and Microsoft during 2015–2017.

[13] According to the Furman Report (n 4), "[o]ver the last 10 years the 5 largest firms have made over 400 acquisitions globally. None has been blocked and very few have had conditions attached

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acquisitions have not been reviewed by the competition agencies. Among the few acquisitions that were reviewed, most of them were authorized without conditions, and very few of them previously assessed have often been authorized without conditions.[14]

The emblematic exemplification of that and the smoking gun evidence of this growing realization of anticompetitiveness is the $19 billion acquisition of WhatsApp by Facebook back in 2014, which did not reach EU turnover thresholds and was thus reviewed by the Commission only following a referral-up from Member States. The same goes for Facebook's acquisition of Instagram, which at that time was a small, differentiated and growing social network alternative to Facebook. Possible additional examples include Google's acquisition of YouTube, Android and Waze; Amazon's acquisition of Goodreads; and pharmaceutical companies acquiring rival drugs still in the start-up phase. The Furman Report, among others, reinforced the conclusion of a consistent underenforcement of digital mergers, even at a global level, finding that there have been no false positives in mergers involving major digital actors for the simple reason that all of them have been permitted.[15]

In addition, the Furman Report argued that, over the last decade, GAFAM companies combined have made over 400 acquisitions globally (peaking with the exceptionally high-value acquisition of LinkedIn by Microsoft amounting to $26.2 billion). With another 250 acquisitions completed in the five years prior to the publication, this is actually a growing trend. Even more clearly, the Furman Report concluded that none of these mergers were notified voluntarily to the Competition and Markets Authority (CMA) (but this is an argument likely to be applied throughout all the National Competition Authorities (NCAs)), and none were called in for investigation. This means that none during this period have been blocked, or even approved subject to conditions set by the CMA. Before the investigation conducted into the proposed acquisition of Giphy by Meta, the last time the CMA investigated a merger by one of these large digital companies was in 2013, when the proposed acquisition of Waze by Google (Motorola Mobility) was cleared following a Phase 1 investigation.[16] In the same vein, Lear's assessment recognized that Google, Amazon and Facebook made a combined total of

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to approval, in the UK or elsewhere, or even been scrutinised by competition authorities." It is also noteworthy that the large number of acquisitions is not matched by a large number of divestitures; we have seen very few of the latter by big digital companies (one of the few instances is the spin-off of PayPal by eBay). The same Furman Report added that "[t]he largest digital companies have made extensive use of mergers, as their market shares have grown. Acquisitions have included buying businesses that could have become competitors to the acquiring company (for example Facebook's acquisition of Instagram), businesses that have given a platform a strong position in a related market (for example Google's acquisition of DoubleClick, the advertising technology business), and data-driven businesses in related markets which may cement the acquirer's strong position in both markets (Google/YouTube, Facebook/WhatsApp)."

[14] The vast majority of notified mergers are permitted with only a brief review due to the lack of significant overlap between the merging parties in terms of their products and the territories they serve. Of the 9,059 merger transactions notified to the Commission between 1990 and 30 November 2023, only 53 were blocked following a Phase II assessment. This represents less than 0.7% of notified cases. See EU Commission, 'Statistics on Mergers cases', available at: https://competition-policy.ec.europa.eu/system/files/2023-12/Merger_cases_statistics.pdf.

[15] See Furman Report (n 4) 91.

[16] See Office of Fair Trading, 'Completed acquisition by Motorola Mobility Holding (Google, Inc.) of Waze Mobile Limited', ME/6167/13, decision published on 17 December 2013.

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299 acquisitions between 2008 and 2018, with very few of them receiving a Phase 1 review by the CMA, and even fewer of them being looked at in detail.[17]

Given the above, a complete U-turn would not have been too long in coming. On 30 November 2021, the CMA, paving the way for novelties again, blocked its first tech-related acquisition in the Meta/Giphy case.[18] The CMA concluded that Facebook's acquisition of Giphy would reduce competition between social media platforms and that the deal had already removed Giphy as a potential challenger in the display advertising market.[19] Thus, after consulting with interested businesses and organizations – and assessing alternative solutions (known as "remedies") put forward by Facebook – the CMA concluded that its competition concerns could only be addressed by Facebook selling Giphy in its entirety to an approved buyer.[20] Subsequently, Meta launched an appeal against the CMA's decision before the UK's Competition Appeal Tribunal ("CAT") and the CAT's judgment was delivered on 14 June 2022.[21]

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[17] E. Argentesi et al. (n 7) 5.

[18] See CMA, Completed acquisition by Facebook, Inc (now Meta Platforms, Inc) of Giphy, Inc. – Final report, 30 November 2021. See T. Smith and S. Erciyas, 'The Competition and Markets Authority blocks the Meta/Giphy merger: you can't say they didn't warn us' (2022) 21(1) Competition Law Journal 25–31.

[19] According to the CMA, Facebook's platforms (Facebook, WhatsApp, Instagram) account for 73% of user time spent on social media in the UK, and Giphy is the world's leading provider of free GIFs and GIF stickers. The two parties operate mostly at different levels of the supply chain, with Giphy's services being an input for social media platforms. The CMA ultimately found a substantial lessening of competition ("SLC") on two bases: (i) horizontal effects resulting from the loss of potential competition in display advertising; and (ii) vertical effects on competition in the supply of social media arising from input foreclosure. Facebook terminated Giphy's advertising services at the time of the merger, removing an important source of potential competition. The CMA considers this particularly concerning given that Facebook controls nearly half of the £7 billion display advertising market in the UK. See the CMA's Press Release, dated 30 November 2021, 'CMA directs Facebook to sell Giphy'.

[20] The CMA's Facebook/Giphy investigation traces its roots back to the 2,000-page market study report published in July 2020, which showed Facebook to have substantial market power and a strategic position as a gatekeeper in the UK economy (CMA, 'Online platforms and digital advertising Market study - Final Report', 1 July 2020). In this context, the CMA's Digital Markets Taskforce also recommended an enhanced merger control regime for Big Tech acquisitions (CMA, 'A new pro-competition regime for digital markets - Advice of the Digital Markets Taskforce', December 2020), whose assumptions have been eventually encompassed into the UK Government's White Paper in July 2021 (CMA, 'A new pro-competition regime for digital markets', July 2021).

[21] Competition Appeal Tribunal, *Meta Platforms, Inc. v Competition and Markets Authority and Application Developers Alliance, the Computer & Communications Industry Association, Privacy International*, Case No: 1429/4/12/21. The most controversial element of the investigation has been the CMA's theory of "dynamic competition", which was illustrated in the CMA's revised Merger Assessment Guidelines (CMA, Merger Assessment Guidelines, 18 March 2021). Regarding the dynamic competition notion, this amounts to the concern that the merger would remove a business that had the potential to compete with Facebook in display advertising. In this regard, the CMA stated in para 5.3, that "[…] existing firms and potential competitors can interact in an ongoing dynamic competitive process, and a merger could lead to a loss of dynamic competition.

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The above suggests that a gap in merger control needs to be closed, since EUMR establishes a mandatory notification system for mergers, based on turnover thresholds.[22]

4. DEFINING THE PROBLEM: THE NOTION OF KILLER ACQUISITIONS AND THE DISPUTE AROUND NASCENT VS POTENTIAL COMPETITORS

The intense level of acquisition activity by current leading technology firms – a group that includes both GAFAM and non-GAFAM entities – which escaped merger scrutiny, may be observed in light of the growing label of "killer acquisitions".

As previously recalled, the notion of "killer acquisitions" was coined by Cunningham, Ederer and Ma for particular pharma-related acquisitions in the context of their influential paper in late 2018, alluding to the risk that an originator (branded pharmaceutical company) acquires a start-up company with a pipeline product with the intention to shut the pipeline product down.[23] According to the reasoning presented by Cunningham, Ederer and Ma, the acquiring (and, in our assumption, hypothetically dominant) firm might in some circumstances find it more profitable to buy and terminate a nascent firm's product (and so could have no incentive to develop this innovation), rather than experiencing the loss in revenue to be potentially suffered when a nascent firm's business grows, or acquiring and continuing to develop the undertaking at the cost of eventually affecting its own sales. Thus, the acquisition has two anticompetitive effects: competition is reduced and innovation harmed. As a result, the authors inferred that the purpose of shutting down such innovation is to preempt future competition from a nascent competitor.[24]

Firms that are making efforts or investments that may eventually lead to their entry or expansion will do so based on the opportunity to win new sales and profits, which may in part be 'stolen' from the other merger firm. Incumbent firms that are making efforts to improve their own competitive offering may do so to mitigate the risk of losing future profits to potential entrants. In this sense, potential entrants can be thought of as dynamic competitors, even before they effectively enter and begin supplying customers. A merger may reduce the incentives of dynamic competitors to continue with efforts to enter or expand, or the incentive of incumbent firms to mitigate the threat of future rival entry or expansion. The impact of such a reduction in efforts would affect customers in the present, rather than solely from the future point in time when entry or expansion has occurred." The concept of dynamic competition is essentially the CMA's response to a potential increase, if not propagation, of "killer acquisitions" and other shopping campaigns of competitive rivals by incumbent firms. The definitive change in policy is that the CAT has now fully endorsed these criteria, reinforcing its position with "no hesitation in concluding that the decision made by the CMA was one that it was entitled to make" (CAT Judgment, para 126).

[22] J. Faull, 'The Politics of Merger Control in the European Union' in I. Kokkoris & N. Levy (eds), *Research Handbook on Global Merger Control* 267 (Edward Elgar Publishing, 2023); M. Cini, 'The European Merger Regime: Accounting for the Distinctiveness of the EU Model' (2002) 30 Policy Studies Journal 240; L.H. Roller and M. de la Mano, 'The Impact of the New Substantive Test in European Merger Control' (2006) 2(1) European Competition Journal 9.

[23] C. Cunningham et al. (n 2).

[24] Competition law scrutinizes killer acquisitions as "a particular variation on the more general loss of potential competition through the acquisition of a nascent firm theory of harm". These

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Originally, the authors undertook an empirical study of acquisitions in the pharmaceutical industry, and estimated that more than 6% of new entrants' acquisitions undertaken by incumbent drug companies amount to acquisitions aimed at "killing" ongoing promising development projects.[25] More specifically, using data on 35,000 drug projects conducted by more than 6,700 pharmaceutical companies over the previous 25 years, they found evidence that acquiring firms terminate projects that overlap with their existing products. When this is the case, a project is 39.6% less likely to be continued after the acquisition compared to drugs that are not acquired, controlling for various factors that can also influence the decision to continue the project. Overall, as a result, they estimate that 6.4% of acquisitions are killer acquisitions.

Since Cunningham et al.'s paper, the debate has attracted enormous academic and policy-related interest. The growing body of literature on killer acquisitions is a demonstration of that.

It has been argued that killer acquisitions have the potential to harm consumer welfare due to anticompetitive data consolidation, increased prices and reduced opportunities for entrants.[26] Other scholars recognize that adverse effects on competition arise from the venture capital funding model that dominates the tech industry and from the focus on exit strategies and the ways to cash out the founders' initial investments. According to these commentators, most successful companies, particularly when they are venture-funded, are likely to exit the market by merging with an existing firm.[27]

Other studies have reached mixed conclusions regarding killer acquisitions. On the one hand, start-up acquisitions can be defined as anticompetitive and thus "killer" if the target would have kept pursuing innovative investments without the acquisition.[28] On the other hand, start-up acquisitions are considered pro-competitive if they mitigate financial, technical, and managerial restrictions faced by the target.[29] In this regard, some authors underline that a central element to approach the discussion is "evaluating how costly it is for the entrant to catch up with the incumbent in terms of competitiveness".[30]

As a result, killer acquisitions are clearly different from traditional acquisitions, in which an innovative new entrant is acquired by an incumbent who then integrates the acquired technology into its own range of products. While traditional acquisitions also remove real or potential competitors from the market, they usually preserve competing innovations. However, the

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acquisitions cause a loss of competition, and the product or technology itself, which threatens the efficiency of innovative sectors, thus descending consumer welfare. See OECD Directorate for Financial and Enterprise Affairs, Competition Committee, Start-ups, Killer Acquisitions and Merger Control Background Note by the Secretariat DAF/ COMP(2020)5 June 2020 2.

[25] This would amount to approximately 50 killer acquisitions every year. More specifically, among the mergers reviewed in the paper, those whose value was 5% below the US FTC's turnover threshold were 11.3% more likely to be killer acquisitions than those that were 5% above the threshold (see Cunningham et al. (n 2) 58).

[26] M. Motta and M. Peitz (n 7).

[27] M.A. Lemley and A. McCreary, 'Exit Strategy' (2021) 101 Boston University Law Review 1.

[28] P. Affeldt and R. Kesler, 'Big Tech Acquisitions – Towards Empirical Evidence' (2021) 12(6) Journal of European Competition Law & Practice 471.

[29] C. Fumagalli, M. Motta and E. Tarantino, 'Shelving or Developing? The Acquisition of Potential Competitors Under Financial Constraints' (2020) CEPR Discussion Paper No. DP15113.

[30] Z. Brutti and L.E. Rojas, 'M&A and Early Investment Decisions by Digital Platforms' (2022) 49 Journal of Industrial and Business Economics 509.

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maintenance of these beneficial synergies resulting from traditional acquisitions, such as consequent specialization and innovation, is excluded when firms simultaneously seek to shut down competitors and competing technologies.

But identifying a killer acquisition *ex ante* or *ex post* is not an easy task, and we cannot imply that acquiring start-ups can necessarily be conducive to those detrimental effects and be labelled as "killer acquisitions". Undertakings routinely choose to discontinue product lines and development projects; therefore, this can be a rational business decision, potentially likely to take place when there is room for product overlap between the acquirer and the target, and the substitute product will cannibalize some of their existing profits.

The term "killer acquisitions", drawn from the Cunningham's paper, has become a key academic reference in the debate on tech acquisitions due to the lack of quantitative evidence on the effect of mergers in digital markets. Therefore, the next consequential question to be addressed here is whether the "killer" label may also apply to acquisitions of innovative tech firms by GAFAM companies or tech giants.[31]

Albeit there could be room for dominant firms in the digital environment to acquire innovative targets and later dismantle the relevant innovation, all the contributions gathered in the above-mentioned reports on the digital economy emphasized that this is, however, not the typical scenario in digital markets.

Consequently, some commentators distinguished between innovative dynamics in the digital and pharmaceutical sector.[32] Patents density is higher in pharmaceuticals, drug development is slow, innovation is cumulative, and generic entry is real.[33] These dynamics often lead pharmaceutical firms to engage in horizontal acquisitions to speed up innovation processes and are more prone to product overlaps and discontinuation of research and development efforts. As a result, pharmaceutical companies may acquire nascent rivals to terminate innovation that threatens to challenge established drugs. Instead, digital platforms often acquire innovative start-ups to expand and integrate the acquired product or service[34] and thus the acquiring start-up is often integrated into the "ecosystem" of the acquirer or into one of their existing products.[35] Thus, innovation in digital markets relies on product differentiation,

[31] There is a direct relationship between venture capital and killer acquisitions. In fact, venture capitalists do not aim at the long-term progressive growth of businesses in which they have invested, because this would not allow an adequate return on all the capital invested. They need timely and substantive results, assuming that this will only be the case for one out of many of the start-ups in which they invested. They, therefore, have a great interest in obtaining high bids, and these can only come from large companies already established in the market. The latter, in turn, may have an interest either in incorporating the new product into their wider offerings or in stifling innovation because it is incompatible with their own development programs.

[32] Sokol develops an analysis of nascent competitor acquisitions in the biotech sector. See D. Sokol, 'Merger Law for Biotech and Killer Acquisitions' (2021) 72 Florida Law Review Forum 1.

[33] Arti K. Rai, 'Fostering Cumulative Innovation in the Biopharmaceutical Industry: The Role of Patents and Antitrust' (2001) 16(2) Berkeley Technology Law Journal 813.

[34] L. Levy, H. Mostyn and B. Buzatu, 'Reforming EU merger control to capture "killer acquisitions" – the case for caution' (2020) 19(2) Communications Law 51.

[35] As the Crémer Report clearly stated (n 4) 125, "[i]n the pharmaceutical and the agro-chemical industry, the concept of 'innovation competition' allows restrictions of competition to be captured at an early point of time, i.e. before an effect on a relevant product market can be predicted with a sufficient degree of certainty, because R&D in these sectors typically takes the form of a

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complementarity, and ecosystem building, and non-horizontal acquisitions play a larger role in these industries.[36] As a result, the general conclusion is that these are not typically killer acquisitions as depicted in Cunningham's paper and, differently from pharmaceuticals, in digital markets, the business expectation will be developing the services of start-up firms, rather than shutting them down.[37]

Nevertheless, killer acquisitions statistically remain a rare phenomenon[38] and this suggests alternative business explanations for the majority of start-up acquisitions. For example, some commentators have entirely dismissed the concern surrounding killer acquisitions[39] and it has been claimed that acquisitions may reflect a legitimate expectation to harvest beneficial complementarity effects by combining the assets of the target with those of the acquirer.[40] Others argue that acquisitions may be explained by the desire to diversify product portfolios[41] or combine R&D activities.[42] These positions support the assumption that acquisitions are generally procompetitive and promote innovation rather than hinder it.

The above-mentioned distinction between acquisitions in the pharmaceutical and digital sectors reveals the potentiality of the label "killer" to be applied indistinctly not only to acquisitions whereby the acquiring undertaking acquires the target company to shut it down completely and discontinue its product or activity (defined as elimination of future competition) but also to less straightforward cases whereby the target company's potential, albeit not "killed", is not entirely exploited compared to the pre-acquisition scenario.[43]

The killer acquisition scenario is also spreading new narratives on industry structure and business conduct. For example, the notion also includes "reverse killer acquisitions", where the

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distinct, well-structured process preceding product market competition. The situation in digital markets is frequently different. The research driving digital innovation is often closer to the market and therefore closer to the product competition itself. Where clearly identifiable research poles are absent, the concept of innovation competition cannot help to reduce the uncertainties related to the future developments of product markets."

[36] K.R. Sarangee and R. Echambadi, 'Firm-Specific Determinants of Product Line Technology Strategies in High Technology Markets' (2014) 8(2) Strategic Entrepreneurship Journal 149.

[37] According to this scenario, since product development is less structured and the pace and success of innovation are more problematic in digital markets, assessing the theory of harm will be more complex. In this regard, Bourreau and de Streel advocated for a new innovation-based theory of harm in merger control, essentially exploring whether the merger brings about a risk of a "cannibalisation effect". See M. Bourreau and A. de Streel (n 7) 33.

[38] As outlined above, in pharmaceuticals, C. Cunningham et al. (n 2) find a likelihood of 5.3% to 7.4% for a killer acquisition and, in their contribution, A. Gautier and G. Lamesch (n 7) consider that only one in 175 transactions qualifies as a killer acquisition.

[39] K. Limarzi and H.S. Phillips, '"Killer Acquisitions," Big Tech, and Section 2: A Solution in Search of a Problem', Competition Policy International (CPI), 26 May 2022.

[40] L. Cabral, 'Merger Policy in Digital Industries' (2021) 54 Information Economics and Policy 100866.

[41] G. Manne, S. Bowman and D. Auer, 'Technology Mergers and the Market for Corporate Control' (2022) 86(4) Missouri Law Review 1047.

[42] B. Lundqvist, 'Killer Acquisitions and Other Forms of Anticompetitive Collaborations in Time of Corona' (2022) BRICS Competition Law and Policy Series Working Paper No. 22/2022/01.

[43] In general, for a contribution seeking to explain these notions, see J.M. Yun, 'Are We Dropping the Crystal Ball? Understanding Nascent & Potential Competition in Antitrust' (2021) 104(3) Marquette Law Review 613.

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acquisition is effectively designed to extinguish and discontinue the buyer's effort to expand in a particular space because the target undertaking immediately replaces these functionalities.[44]

In addition, killer acquisitions have been labelled "acquisitions for sleep", according to which the target firm's patents or other valuable assets are "put to sleep" after the transaction is consummated.[45] Other contributions have developed the concept of "kill zones", dealing with less appealing business fields with difficulties in financing due to widespread acquisitions by large tech undertakings.[46] As a result, start-ups operating in or around the kill zone may be discouraged from pursuing business innovations that would be capable of substituting the incumbent's product, opting for complementary investments instead.[47]

Furthermore, the literature tends to use the terms nascent competitor, potential competition, and killer acquisitions interchangeably and vaguely, despite the fact that each term has different connotations.

It is worth appreciating that the "killer acquisitions" label can be considered a subcategory of the broader group of acquisitions involving nascent competitors.[48]

Generally speaking, potential competition may involve a product that does not yet compete within a specific relevant market but is predicted to compete or could compete very quickly; thus, the potential competition theory is really a forecast about pending entry or the threat of entry. On the contrary, nascent competition describes rivalry or potential rivalry with a product or technology – particularly one associated with a great degree of innovation – that exists but has not yet matured into a significant competitor, whether within or outside the same relevant market. Like potential competition, nascent competition can be a forecast of entry, but it involves a number of other aspects. In particular, it also involves a forecast of future differentiation or development of a product or technology and its level of market success.[49]

5. REFORM OPTIONS IN MERGER CONTROL: THE NEW ARTICLE 22 EUMR AND THE ILLUMINA/GRAIL CASE

The low probability of the killer acquisition phenomenon does not imply minimal intervention in terms of legitimate merger scrutiny.

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[44] C. Caffarra, G. Crawford and T. Valletti, '"How Tech Rolls": Potential Competition and "Reverse" Killer Acquisitions' CPI Antitrust Chronicle, May 2020; O. Latham, I. Tecu and N. Bagaria, 'Beyond Killer Acquisitions: Are There More Common Potential Competition Issues in Tech Deals and How Can These Be Assessed?' CPI Antitrust Chronicle, May 2020.

[45] P.J. Norback, C. Olofsson and L. Persson, 'Acquisitions for Sleep' (2020) CESifo Working Paper No. 8095.

[46] K. Kamepalli, R. Rajan and Z. Zingales, 'Kill Zone' (2020) NBER Working Paper No. 27146.

[47] K.A. Bryan and E. Hovenkamp, 'Antitrust Limits on Startup Acquisitions' (2020) 56 Review of Industrial Organization 615.

[48] See D. Melamed, 'Mergers involving nascent competition' (17 January 2022) Stanford Law & Economics Olin Working Paper No. 566. For a broader overview, see C.S. Hemphill and T. Wu, 'Nascent Competitors' (2020) 168 University of Pennsylvania Law Review 1879. The authors mentioned "prospective innovation" as a central attribute of nascent competitors.

[49] J.M. Yun, 'Potential Competition, Nascent Competitors, and Killer Acquisitions' (2020) 18 The Global Antitrust Institute Report On The Digital Economy 653, 656.

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Jurisdiction under the EUMR is traditionally based on turnover thresholds,[50] which do not appear to be a reliable indicator for innovative firms in the digital environment of the competition-related repercussions of transactions characterized by target firms with small turnover but promising business potential. Therefore, such acquisitions escape any form of jurisdiction under the EUMR.[51]

The thresholds prescribed for the determination of the Commission's jurisdiction under the EUMR were designed to establish "precise and objective criteria" capable of relatively straightforward application in order to reflect "the requirements of legal certainty and speed"[52] and to "make a clear allocation between the interventions to be made by the national and by the Community authorities".[53] The thresholds are intended to capture "major concentrations"[54] that are deemed to be of "EU dimension".[55]

In contrast to systems of merger control that incorporate jurisdictional thresholds based on asset values or market shares, competence under the EUMR is established by reference to global, European Economic Area (EEA), and Member States' revenues. The thresholds require that both parties to a concentration generate EEA revenues that meet the applicable tests.

The EUMR is based on "a clear division of powers" between the EU and the Member States.[56] Accordingly, the EUMR seeks to avoid concurrent EU and Member State jurisdiction over the same transactions: the Commission has exclusive competence over concentrations of an EU dimension (the "one-stop-shop" principle),[57] and Member State competition agencies

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[50] See Article 1 EUMR for the relevant turnover thresholds.

[51] According to Article 22(1) EUMR, one or more Member States may request the Commission to examine any concentration with no Community dimension within the meaning of Article 1 EUMR when it affects trade between Member States and threatens to significantly affect competition within the territory of the Member State or States making the request.

[52] Case T-417/05 *Endesa* [2006] EU:T:2006:219, para 209 ("the requirements of legal certainty and speed which apply in the context of control of concentrations mean that both undertakings and competition authorities can in principle rely on a foreseeable criterion and immediate access").

[53] Case C-202/06 *Cementbouw* [2007] EU:C:2007:814 ("Cementbouw CJ"), paras 37–38.

[54] Recitals 8 and 20 EUMR.

[55] Concentrations are deemed to have an EU dimension where: (i) the combined worldwide turnover exceeds €5 billion, at least two of the parties have EU-wide turnover exceeding €250 million, and the parties do not achieve more than two-thirds of their EU turnover in one Member State, or (ii) the combined worldwide turnover exceeds €2.5 billion, the EU-wide turnover of at least two of the parties exceeds €100 million, in each of the three Member States, the combined turnover of all parties exceeds €100 million, in each of those Member States, the turnover of at least two of the parties exceeds €25 million, and the parties do not achieve more than two-thirds of their individual EU-wide turnover in one Member State: Art 1(2) and 1(3) EUMR.

[56] Case C-170/02 *Schlüsselverlag J. S. Moser GmbH, J. Wimmer Medien GmbH & Co. KG, Styria Medien AG, Zeitungs- und Verlags-Gesellschaft mbH, Eugen Ruß Vorarlberger Zeitungsverlag und Druckerei GmbH, 'Die Presse' Verlags-Gesellschaft mbH, and 'Salzburger Nachrichten' Verlags-Gesellschaft mbH & Co. KG v Commission* EU:C:2003:501 ('Schlüsselverlag'), para 32. See also Cementbouw CJ, para 37 (ECJ confirmed that the EU legislature had "intended to make a clear allocation between the interventions to be made by the national and by the Community Authorities").

[57] Recital 8 EUMR.

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("NCAs") may not apply national merger control rules to such operations.[58] Correspondingly, the EU Commission has no competence to review concentrations that lack an EU dimension; such concentrations are instead subject to review by NCAs if they meet national jurisdictional thresholds.

The division of powers between the Commission and the Member States "follows from the principle of subsidiarity".[59]

To sum up, if a merger meets one of the thresholds of the EUMR and therefore has a "community dimension", it is reviewed by the Commission. Otherwise, it may be examined in one or more Member States. The turnover thresholds are therefore "designed to govern jurisdiction and not to assess the market position of the parties to the concentration nor the impact of the operation".[60]

These principles, based on turnover thresholds and clear division of powers between the EU Commission and Member States, are subject to three exceptions.

First, the EU Commission does not have jurisdiction over transactions that are considered to principally affect one Member State because the undertakings concerned each achieve two-thirds of their EEA revenues in the same Member State.[61]

Second, concentrations that are reportable under the EUMR may be referred in whole or in part to one or more NCAs. Such referrals may be made either at the request of one or more NCAs under Article 9 of the EUMR, or, since 1 May 2004, following an application by the merging parties under Article 4(5) of the EUMR in situations where a concentration would "threaten significantly to affect competition in a market within [a] Member State presenting all the characteristics of a distinct market".[62]

Third, NCAs may refer to the EU Commission transactions that do not have an EU dimension. Such referrals may be made either at the instigation of an NCA under Article 22 of the EUMR, or, since 1 May 2004, following an application by the merging parties under Article 4(5) of the EUMR in situations where a concentration would be reportable to three or more national agencies and may therefore be expected to "affect competition beyond the territory of one Member State".[63] Under Article 22, a Member State may ask the EU Commission to

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[58] Article 21(3) EUMR.

[59] Communication from the Commission to the Council, Report on the Functioning of Regulation No. 139/2004, Brussels, 18 June 2009, COM(2009) 281 final, para 2 ("The concept that the Commission should have sole competence to deal with mergers with a Community dimension follows from the principle of subsidiarity").

[60] Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings [2008] OJ C95/1, para 127.

[61] Article 1(2) and 1(3) EUMR.

[62] Recital 15 EUMR. See also Recital 16 EUMR, according to which "[u]pon request by the undertakings concerned, the Commission should be able to refer to a Member State a concentration with a Community dimension which may significantly affect competition in a market within that Member State presenting all the characteristics of a distinct market; the undertakings concerned should not, however, be required to demonstrate that the effects of the concentration would be detrimental to competition."

[63] According to EUMR, Recital 16, "[b]efore notification to national authorities, the undertakings concerned should also be able to request that a concentration without a Community dimension which is capable of being reviewed under the national competition laws of at least three Member States be referred to the Commission. Such requests for pre-notification referrals to the

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examine a concentration that "deserve[s] close scrutiny" because it "affects trade between Member States" and "threatens to significantly affect competition" within that Member State's territory. To meet the first criterion, a Member State requesting referral must show that the transaction "is liable to have some discernible influence on the pattern of trade between Member States." The second condition is fulfilled where, "based on a preliminary analysis, there is a real risk that the transaction may have a significant adverse impact on competition, and thus that it deserves close scrutiny".[64]

Therefore, for the sake of argument, changing the jurisdictional thresholds would be the first path to follow to target those kinds of acquisitions. The UK opted for this opportunity, as the CMA's jurisdiction to review transactions relies not only on turnover thresholds but also on the firms' "share of supply".[65] The Facebook/Instagram[66] and Google/Waze[67] mergers were clear cases in point.

A second potential suggestion for reform was the introduction of a jurisdictional test based on the transaction value. Over the past few years, Austria and Germany – which have traditionally adopted turnover thresholds – have broadened the scope of their merger control regimes by presenting transaction value-based notification thresholds.[68] The underlying assumption was to fill the perceived gap in cases where the purchase price is a large multiple of the present turnover of the target, thus demonstrating a high market potential of an innovative target in the future.

In addition, some have argued for a "more aggressive antitrust" policy by changing the merger guidelines for digital platforms[69] and the OECD has advocated for a reversal of the burden of proof for certain mergers.[70]

However, the EU Commission chose not to amend jurisdictional thresholds. The fundamental reason was clearly explained by Commissioner Vestager, according to whom the existing notification thresholds have proved to "work well", even if she could not help but recognize the existence of a handful of cases escaping merger control under the current regime that do not

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Commission would be particularly pertinent in situations where the concentration would affect competition beyond the territory of one Member State".

[64] EU Commission Notice on Case Referral in respect of concentrations [2005] OJ C56/02, paras 43–44.

[65] See section 23 of the Enterprise Act 2002. According to the "share of supply test", the enterprises which cease to be distinct supply or acquire goods or services of any description and, after the merger, together supply or acquire at least 25% of all those particular goods or services of that kind supplied in the UK or in a substantial part of it. The merger must also result in an increment to the share of supply or acquisition.

[66] The OFT examined this merger on the basis that the parties overlap in the supply of social networking services. See Office of Fair Trading, Anticipated acquisition by Facebook Inc. of Instagram Inc., ME/5525/12. Full text of decision published on 22 August 2012.

[67] See Office of Fair Trading, Completed acquisition by Motorola Mobility Holding (Google, Inc.) of Waze Mobile Limited, ME/6167/13. Full text of decision published on 17 December 2013.

[68] See Sec. 35(1a) GWB (Germany) and Sec. 9(4) KartG (Austria). On both, see Bundeskartellamt/Bundeswettbewerbsbehörde, Guidance on Transaction Value Thresholds for Mandatory Premerger Notification (Section 35 (1a) GWB and Section 9 (4) KartG, July 2018).

[69] See Stigler Report (n 4).

[70] OECD, 'Start-ups, Killer Acquisitions, and Merger Control' (n 3).

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meet turnover thresholds but can seriously affect competition.[71] As a consequence, start-ups' turnover might not reflect their competitive potential, which "runs counter to the assumption underlying the jurisdictional test of the EUMR that the 'Community dimension' of a merger, i.e. its potential competitive significance for the internal market, is roughly related to the turnover of both the acquirer and the target".[72] For instance, the Commission did not review the acquisition by Facebook of Instagram, since at the time Instagram did not generate any revenue. When WhatsApp was acquired by Facebook in 2014 for $19 billion, it had over 600 million users worldwide and up to 150 million users in the EEA. The acquisition did not reach the EU turnover thresholds either and could only be reviewed by the Commission by means of a referral.[73]

Thus, Commissioner Vestager advanced solutions she labelled as "hiding in plain sight" and which can be summarized as follows: revitalizing referrals from NCAs under Article 22 EUMR.[74]

The referral mechanism is an alternative way in which the Commission can gain jurisdiction to review a merger. Under Article 4(5), if a concentration does not have a community

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[71] On 11 September 2020, Commissioner Vestager, during a conference hosted by the International Bar Association 24th Annual Competition Conference for the 30th anniversary of the EUMR, outlined her vision on merger control policy for the upcoming years with a speech titled "The future of EU Merger Control". During the speech, Commissioner Vestager cautiously addressed another very sensitive debate, which is the softening of standards for so-called "European champions". After prohibiting the merger between Siemens and Alstom in 2019 (see Case COMP/M.8677), the EU Commission faced calls to review merger control rules to allow for the creation of "industrial champions". France, Germany and Poland in particular advocated for a stronger consideration of potential competition at the international level, and for a reinforced role for the Council regarding merger control policy and decision-making. Commissioner Vestager systematically rejected such suggestions, refusing to build industrial champions at the expense of competition in European markets. See also Margrethe Vestager, Speech of European Commissioner for Competition 'Refining the EU Merger Control System' (10 March 2016): "A merger that involves this sort of [small, innovative] company [that could have considerable potential and play a significant role in the market] could clearly affect competition, even though the company's turnover might not be high enough to meet our thresholds. So by looking only at turnover, we might be missing some important deals that we ought to review. But before we think about changing our rules, we need to be sure we fully understand what's at stake. We need to know which important mergers we think we might be missing. And we have to see how we could pick out the transactions that matter, without also covering a lot of mergers without much effect on competition in Europe". The Commission's concerns were mainly about non-reportable but potential killer acquisitions in the digital and pharmaceutical industries. Following a public consultation initiated in 2016, they eventually decided after balancing several factors not to proceed with reform of the EUMR's purely turnover-based thresholds.

[72] See Crémer Report (n 4) 111.

[73] Case M.7217 – Facebook/WhatsApp, Commission decision of 3 October 2014.

[74] In a speech delivered on 2 March 2020, Commissioner Vestager already rejected the suggestion that amending the EUMR's jurisdictional thresholds would provide an immediate solution, instead confirming that the Commission was considering whether to make greater use of referral mechanisms to review important below-threshold mergers. See M. Vestager, 'Keeping the EU Competitive in a Green and Digital World' (Speech at the College of Europe, Bruges, 2 March 2020).

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dimension, the Commission is able to review it, at the request of the parties,[75] if the acquisition is notifiable under the national competition law of at least three Member States. The existence of the referral mechanism provides a level of flexibility that, to some extent, compensates for the rigid turnover thresholds.[76]

In addition to Article 4(5), Article 22 entitles Member States to request the referral of concentrations to the Commission that do not meet the EU thresholds but which affect trade between EU Member States and threaten to significantly affect competition within the territory of the requesting Member State.[77]

Article 22 referral is commonly known as the Dutch clause because a number of Member States (including the Netherlands, which led to the provision being known as above) had no merger control regime at the time of the EUMR's adoption and wanted to be able to ask the EU Commission to review deals that might harm competition on its territory.[78] Therefore, at that time, Member States required the EU Commission's assistance for reviewing (presumably local) transactions.

Accordingly, the EUMR does not specify that an NCA may make a referral only in respect of transactions over which it has jurisdiction under its national merger control rules. On the contrary, the original intention was to allow NCAs to refer concentrations to the EU Commission where they lacked the power to review themselves, but believed should be subject to merger review. Article 22 was amended in 1998 to allow two or more Member States to make a joint request for referral to the EC in circumstances where they believed the EC would be better placed to review a transaction (e.g., because the markets in question were wider than national).[79]

As all Member States other than Luxembourg had by then adopted merger control rules,[80] this became the primary purpose of Article 22, diluting the original rationale for the provi-

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[75] The Member States competent to review the merger have the power to veto the referral request (Article 4(5) EUMR).

[76] J.U. Franck, M. Monti and A. de Streel, 'Options to Strengthen the Control of Acquisitions by Digital Gatekeepers in EU Law', TILEC Discussion Paper DP 2021-016, October 11, 2021, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3966244 20; K.J. Cseres, 'Re-Prioritising Referrals under Article 22 EUMR: Consequences for Third Parties and Mutual Trust between Competition Authorities' (2023) 14(7) Journal of European Competition Law & Practice 410–422.

[77] EUMR, Article 22 provides: "One or more Member States may request the Commission to examine any concentration as defined in Article 3 that does not have a Community dimension within the meaning of Article 1 but affects trade between Member States and threatens to significantly affect competition within the territory of the Member State or States making the request."

[78] C.S. Rusu, 'The Dutch Clause Revisited: New Commission Guidelines on Case Referrals Based on Article 22 of the EU Merger Control Regulation' (*Radboud Economic Law Blog*, 5 April 2021) available at: https://www.ru.nl/law/research/radboud-economic-law-conference/radboud-economic-law-blog/2021/dutch-clause-revisited-new-commission-guidelines/.

[79] Council Regulation (EC) 1310/97 of 30 June 1997 amending Regulation (EEC) No. 4064/89 on the control of concentrations between undertakings [1997] OJ L180/1, Amendment 12(b). In addition, in January 2004, the Article 22 procedure was elaborated to provide a specific procedural timetable, information requirements placed on the Commission, and – under Article 22(5) EUMR – an explicit stipulation that the Commission may invite Member States to make a referral request.

[80] Actually, this is about to change, as Luxembourg is preparing to incorporate an *ex ante* merger control regime into its domestic legislation. The Luxembourg Ministry of the Economy

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sion.[81] Although these changes extended the scope of Article 22, the Commission, by exercising discretion in its interpretation and application, developed a practice of discouraging NCAs from referring transactions to the EC that fell below national merger control thresholds on the ground that such transactions were of a limited size and were generally not likely to have a significant impact in the internal market.[82]

The EU Commission's competence under Article 22 is limited to assessing a referred concentration's effect in the territories of the referring Member States, and Member States that do not join a referral request may review that concentration under their respective national rules.[83]

In response to a scenario leading to a gap to be filled in merger control, the EU Commission confirmed its intention to abandon its policy of discouraging below-threshold referrals and published new guidance on the pre-existing Article 22 EUMR referral mechanism ("Article 22 referral Guidance" or the "referral Guidance"),[84] which increases the number of acquisitions it is entitled to scrutinize and allows it to review deals that meet neither EU nor national thresholds.[85] The Commission concluded that its previous approach of discouraging referrals under Article 22 EUMR where the concentration falls outside the national merger control thresholds limited the effectiveness of referrals as a corrective mechanism to the turnover-based thresholds.[86] Accepting and encouraging a referral of relevant transactions would give flexibility to the Member States and the Commission to target concentrations that merit review at the EU level, without imposing the notification of transactions that do not. More specifically, the referral Guidance Paper refers to Article 22's two legal requirements for referral; namely, that the concentration must: (i) affect trade between Member States,[87] and (ii) threaten to sig-

released Draft Bill No. 8296, which shall establish a merger control regime in Luxembourg, on 23 August 2023.

[81] According to L. Levy, H. Mostyn and B. Buzatu (n 34) 366, the amendment in 1998 effectively changed the 'primary purpose' of Article 22.

[82] Commission Notice on Case Referral in respect of concentrations [2005] C56/02, especially para 45 and page 23. In general, the wording of the Notice implies that, for a merger to be eligible for any of the referral processes under the EUMR, it should usually be in possession of an 'original jurisdiction' (i.e., must meet either Member State or EU jurisdictional thresholds).

[83] Article 22(3) EUMR.

[84] Commission Guidance on the application of the referral mechanism set out in Article 22 of the Merger Regulation to certain categories of cases (published 26.03.2021, C(2021), 1959 final). The Guidance is accompanied by the Commission Staff Working Document, Evaluation of procedural and jurisdictional aspects of EU merger control, Brussels, 26.3.2021 SWD(2021) 66 final.

[85] According to Article 22 referral Guidance, para 10, "[…] while these thresholds, complemented by the referral mechanisms set out in the Merger Regulation, have generally been effective in capturing transactions with a significant impact on competition in the EU internal market, a number of cross-border transactions which could potentially also have such an impact have escaped review by both the Commission and the Member States."

[86] S. Cisnal de Ugarte, M. Perez and I. Pico, 'A New Era for European Merger Control: An Increasingly Fragmented and Uncertain Regulatory Landscape' (2022) 6 Eur Competition & Reg L Rev 17, 20; A. Looijestijn-Clearie and C.S. Rusu and M.J.M. Veenbrink, 'In search of the Holy Grail? The EU Commission's new approach to Article 22 of the EU Merger Regulation' (2022) 29(5) Maastricht Journal of European and Comparative Law 560.

[87] Article 22 referral Guidance (n 84), para 13. Further explanation of this criterion is provided in para 14.

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nificantly affect competition within the territory of the Member State(s) making the request. It offers further insight into this second criterion, confirming that the burden is placed on the referring Member State to demonstrate the existence of such a threat "based on a preliminary analysis […] without prejudice to the outcome of a full investigation".[88] Now the Article 22 referral Guidance states that transactions will be appropriate for an Article 22 referral where the turnover of at least one of the parties "does not reflect its actual or future competitive potential".[89] In its assessment, the EU Commission may take into account whether the value of the consideration received by the seller is particularly high compared to the current turnover of the target. According to the illustrative list provided in the Article 22 Guidance, cases suitable for referral include transactions where the target: (i) is a start-up or recent entrant with significant competitive potential; (ii) is an important innovator or is conducting potentially important research; (iii) is an actual or potential competitive force; (iv) has access to competitively significant assets (raw materials, infrastructure, data or intellectual property rights) and/or provides products or services that are key inputs/components for other industries.[90]

Despite the long-standing policy of the Commission not accepting referrals of transactions that did not trigger national merger control rules, the EU Commission has now reversed course and solicited referral requests,[91] providing procedural guidance as well. More particu-

[88] Ibid, para 15. Explicit mention is afforded to four particular considerations, which indicate that the Commission and Member State NCAs should consider whether the merger: (i) creates or strengthens a dominant position of one of the parties; (ii) results in the elimination of an important competitive force, including the elimination of a recent or future entrant, or where the merger is between two important innovators; (iii) reduces competitors' ability and/or incentive to compete, including by making their entry or expansion more difficult or by hampering their access to supplies or markets; or (iv) enhances the ability and incentive of the parties to leverage a strong market position from one market to another by means of tying or bundling or other exclusionary practices.

[89] Article 22 referral Guidance (n 84) para 19.

[90] Ibid, para 19.

[91] Prior to its recent Guidance, the adoption of Article 22 of the EUMR in Case M.9744 *Mastercard/Nets*, Commission decision of 2 April 2020, and Case M.8788 *Apple/Shazam*, Commission decision of 6 February 2018, already showed the potential of this tool. In those cases, a national competition authority, which had jurisdiction to assess a notified concentration, requested the EU Commission to assess the case at the EU level in view of its possible cross-border effects. In both cases, several other competition authorities supported the requests by the Danish and Austrian authorities, and the Commission indeed assessed both acquisitions as if they had an EU dimension. The Apple/Shazam merger, for instance, which had first been notified in Austria, was referred to the EU Commission after an Article 22 request by several Member States. According to the Commission Staff Working Document, the EU Commission's research showed that referrals have resulted in the Commission acquiring jurisdiction over significant concentrations; more precisely, "between 2004 and 2020, the EU Commission received a total of 384 requests on the basis of Article 4(5) and 34 requests on the basis of Article 22. Among those cases, there were around 30 particularly significant transactions in the digital and pharmaceutical sectors." Other notable transactions referred to the EU Commission included, in the digital area, the following cases: Case M.9424 *Nvidia/Mellanox* (2019), Case M.8994 *Microsoft/GitHub* (2018), Case M.7217 *Facebook/WhatsApp* (2014), Case M.4731 *Google/DoubleClick* (2008), Case M.4854 *TomTom/Tele Atlas* (2008) and Case M.4942 *Nokia/Navteq* (2008). In the pharmaceutical sector, examples include Case M.5555 *Novartis/EBEWE Pharma* (2009) and CaseM.5530 *GSK/Stiefel* (2009). The transaction value in all of these cases exceeded EUR 1 billion.

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larly, the Article 22 referral Guidance noted that the Commission could examine a transaction under Article 22 EUMR even if it has already been closed, although the EU Commission will generally not proceed more than six months after closing (or when "material facts" about the concentration have been made public within the EU).[92] The EU Commission also indicated that third parties may inform them of candidate transactions for referral, whereas previously the mechanism operated bilaterally between the EU Commission and national competition authorities only.[93] Not only does this add complexity to merger control scrutiny, it also extends a new distortive instrument to unsatisfied customers, suppliers or competitors.[94]

In this regard, the Illumina/Grail saga provides the first illustrative example of the EU Commission's new approach to "catch" transactions using the referral mechanism in Article 22 EUMR for a concentration that was not notifiable in the Member State making the request.[95]

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[92] Article 22 referral Guidance, para 21. Under Article 22 EUMR, Member States making a referral request must proceed within 15 working days of the date on which the transaction is notified or otherwise "made known" to the Member State concerned. The Article 22 referral Guidance states that the "notion of 'made known' should be interpreted as implying sufficient information to make a preliminary assessment as to the existence of the criteria relevant for the assessment of the referral." Since it is not recognizable in advance what kind of information will be required, the triggering event for an Article 22 EUMR referral timeline will often be unclear. Once a referral request has been advanced, the EU Commission will immediately inform Member State authorities and the parties involved. Other Member States may join the initial request within 15 working days. The EU Commission will have an additional 10 working days to decide whether to accept the referral, for a total of 40 working days (plus potentially several more days between the date the EU Commission receives the first referral request and the date on which it notifies other Member States). If the EU Commission does not adopt a decision within this period, it is deemed to have accepted the referral request. Once the EU Commission informs the parties that a referral request has been proposed, the EUMR obligation to suspend implementation becomes effective (unless and until the EU Commission decides not to accept the request).

[93] According to Article 22 referral Guidance, para 23, "[t]he Commission will cooperate closely with the competent authorities of the Member States to identify concentrations that may constitute potential candidates for a referral under Article 22 of the Merger Regulation but do not meet the jurisdictional criteria relevant under the respective national laws." In addition, according to paras 24–25, merging parties may voluntarily notify their transactions, and the Commission may give them an early indication that it does not consider their concentration to be a good candidate for a referral under Article 22, or third parties may inform competition authorities of such cases.

[94] According to Article 22 referral Guidance, para 3, both Member States and the Commission have discretion in deciding to refer or accept such a merger case, and Member States' decisions to refer are not appealable before national courts. Pursuant to paras 27 and 31, once the Commission decides to accept a referral by a Member State, this decision may be challenged before European Courts as it "activates" the "standstill obligation" under Article 7 EUMR (that applies since the parties are informed that the referral request is made), meaning that the parties cannot implement the transaction before the Commission issues its final decision on the case. According to A. Kontosakou, 'European Antitrust Enforcement in the Digital Era: How It Started, How It's Going, and the Risks Lying Ahead' (2022) 67 The Antitrust Bulletin 522, 529, "[t]he French Council of State found that […] the decision to refer did not constitute in and of itself an appealable act and as such only the EU Courts had jurisdiction".

[95] See A.S. D'Amico, 'Closing the tech acquisitions enforcement gap: from article 22 to article 102' (2023) European Competition Journal 1–25; J. Mulder and W. Sauter, 'A new regime for

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On September 2020, Illumina (a supplier of next-generation sequencing (NGS) systems for genetic and genomic analysis) entered into an agreement and plan of merger to acquire sole control of Grail (a customer developing tests for the early detection of cancer using the NGS systems). The $7.1 billion transaction did not meet the review thresholds of the EUMR or any national merger control rules, since Grail accounts for no sales in the EU at all. On December 2020, after receiving a complaint, the EU Commission reached a preliminary conclusion that the transaction could be the subject of a referral under Article 22 EUMR and invited NCAs to request a referral of the Illumina/Grail transaction. The French NCA made a referral request in March 2021, which was joined by Belgium, Greece, Iceland, the Netherlands and Norway later that month, and the EU Commission accepted the referral. In April 2021, Illumina challenged before the EU's General Court (supported by Grail) the EU Commission's decision to accept jurisdiction to review the transaction pursuant to Article 22(3) EUMR, and sought its annulment under an expedited procedure. Illumina also filed legal proceedings in France and the Netherlands to try to stop the NCAs in those countries from requesting a referral, but these proceedings failed in both jurisdictions.[96] More recently, on 13 July 2022, the General Court upheld the decisions of the EU Commission confirming its competence to examine concentrations which did not have a European dimension or fall within the scope of the national merger control rules and thus accepting referral requests proposed from France and other Member States.[97] It confirmed that under Article 22 EUMR, NCAs may request a referral to the Commission "regardless of the existence or scope of national merger control rules, provided that the cumulative conditions referred to in paragraph 89 above are satisfied."[98] The

below threshold mergers in EU competition law? The Illumina/Grail and Towercast judgments' (2023) Journal of Antitrust Enforcement 1–11.

[96] In parallel, in July 2021, the EU Commission opened an in-depth phase II investigation based on concerns about the impact of the transaction on the development and supply of NGS-based cancer detection tests. The EU Commission's concerns were based on non-standard theories of harm, namely threats to future competition in a vertical context. While the EU Commission's review of the transaction was still pending, the parties closed the transaction in August 2021. Subsequently, the EU Commission initiated a gun-jumping investigation against Illumina for infringing the EUMR's standstill obligation (See Case M. 10483 *Illumina/Grail (Art. 14 procedure)*, EU Commission's press release dated 19 July 2022, 'Mergers: Commission alleges Illumina and Grail breached EU merger rules by early implementation of their acquisition'). The EU Commission also imposed interim measures that require Grail to be kept separate from Illumina and be run by an independent hold separate manager. See Case M.10493 *Illumina/Grail (Interim Measures under Art. 8(5) a)*, EU Commission's press release dated 29 October 2021, 'Mergers: Commission adopts interim measures to prevent harm to competition following Illumina's early acquisition of GRAIL'.

[97] Case T-227/21 *Illumina v Commission*, ECLI:EU:T:2022:447. The General Court upholding the EU Commission's decision to accept the referral request represents a significant endorsement of the revised Article 22 policy. On the question of whether the Commission had the competence to review the merger via the Article 22 mechanism – which involved assessing whether the two legal requirements of the provision had been met – the General Court referred to the literal, historical, contextual, and teleological interpretations of Article 22. For a deeper dive into the General Court's reasoning, see E.H. Kim and M. Marquis, 'Illumina/GRAIL, Chapter 1: The Unexpectedly Broad Merger Control Powers of the European Commission' (2023) 44(4) European Competition Law Review 162, 165–66.

[98] Ibid, paras 90 and 91. The conditions referred to in para 89 of the ruling are the following: "First, the referral request must be made by one or more Member States; second, the transaction

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General Court distinguished a referral under Article 22 from one under Article 4(5), explaining that the former does not refer to the competence of the Member States, meaning that "the legislature did not intend to restrict the right of that Member State to request the referral of 'any concentration' to the Commission."[99] The General Court recalled that the objective of the EUMR is to effectively control concentrations with significant effects on the structure of competition in the EU.[100] It argued that the referral mechanism is meant to remedy the shortcomings deriving from the inflexibility of the turnover threshold, thereby allowing the review of mergers "likely significantly to impede effective competition in the internal market."[101] On 6 September 2022, the Commission adopted a decision prohibiting Illumina's acquisition of Grail[102] and Illumina has appealed the General Court's ruling on 28 October 2022.[103]

The dispute appears remarkable for many reasons. Some positions are already established. First, the recent Commission's prohibition and the General Court's ruling may reinvigorate the EU Commission's reliance on Article 22 EUMR referrals.[104] Moreover, the Commission's

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which is the subject of that request must satisfy the definition of concentration set out in Article 3 of that regulation without meeting the thresholds for a European dimension laid down in Article 1 of that regulation; third, the concentration must affect trade between Member States; and, fourth, the concentration must threaten to significantly affect competition within the territory of the Member State or States which made the referral request."

[99] Ibid, para 107.

[100] Ibid, para 140.

[101] Ibid, para 142.

[102] Case M.10188 *Illumina/Grail*, EU Commission's press release dated 6 September 2022, 'Mergers: Commission prohibits acquisition of Grail by Illumina'. Assuming that Illumina does not voluntarily sell Grail, the Commission may commence proceedings under Article 8(4) EUMR to order it to divest Grail. Furthermore, even if the full public version has not yet been published, the EU Commission's press release describes the matter in considerable detail. The EU Commission found that the transaction would give Illumina the ability and incentive to foreclose competition by Grail's rivals, for instance by refusing to supply its next-gen sequencing (NGS) systems to rivals (and/or increasing prices, degrading quality or delaying supplies). The EU Commission found that Grail and its rivals are engaged in an innovation race to develop and commercialize early cancer detection tests. Illumina could foreclose this innovation competition because Grail's rivals rely on Illumina's NGS systems to develop and run their tests. There are no credible alternatives in the short to medium term, and the barriers to entry are significant. Moreover, switching NGS providers would be a long and costly process. According to the EU Commission, Illumina would have clear incentives to foreclose Grail's rivals even though Illumina's sales of NGS technology to those rivals represent a small proportion of Illumina's sales and profits. NGS-based early cancer detection testing is expected to expand rapidly and become highly lucrative (reaching more than €40 billion per annum by 2035). Given the market potential and close innovation competition, the EU Commission considered that Illumina would have an immediate incentive to foreclose Grail's rivals, even if it would only realize benefits at a later stage.

[103] Case C-611/22 P *Illumina v Commission,* Appeal brought on 22 September 2022 by Illumina Inc. against the judgment of the General Court (Third Chamber, Extended Composition) on 13 July 2022 in Case T-227/21.

[104] On 21 March 2024, Advocate General Emiliou handed down his Opinion in Joined Cases C-611/22P and C-625/22P ECLI:EU:C:2024:264 (respectively *Illumina Inc. v European Commission and Grail LLC*, and *Illumina Inc. v European Commission*). In a detailed forensic textual and interpretative analysis of the arguments of the Commission and the General Court,

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new attitude over "killer acquisitions" is further reinforced by the fact that not only Illumina/Grail raised consistent competition concerns, but also the second case reviewed so far under the Article 22 EUMR referral mechanism – i.e. Facebook/Kustomer[105] – had the same outcome and was thoroughly scrutinized.[106]

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the Advocate General demolishes the case of both institutions, and his critique is devastating. It is not the right place to deepen the analysis, but it has to be considered that the Opinion provides a detailed literal, historical, contextual, and teleological analysis of the first subparagraph of Article 22(1) to come to that conclusion. It takes the view that notwithstanding its literal wording, the scope of the referral mechanism is profoundly limited. There was no enforcement gap that Article 22 EUMR was designed to close. Nor was it the intention of the Union legislature to create a "competence sandwich" where neither the European Commission nor the NCAs had jurisdiction over cases below their thresholds, but where if an NCA was requested to make a referral of cases below its own thresholds, the Commission would gain jurisdiction. There are, in addition two particular issues which are raised by the Advocate General. First, in such a context, the EU Commission and General Court's broader approach to the scope of Article 22(1) cannot but undermine predictability and legal certainty. This lack of predictability and certainty is reinforced by the absence of available procedures at either the EU or national level to deal with cases below national thresholds, leaving merging parties in a 'legal no man's land'. Second, as AG Emiliou argues, if the Commission takes the entirely legitimate view that it needs to review "killer acquisitions", it should, as provided by the procedures of the EUMR, seek a formal legislative extension of the jurisdiction of the Regulation from the Union legislature.

[105] Case M.10262 *Meta (formerly Facebook)/Kustomer*, EU Commission's decision of 27 January 2022.

[106] Other recent developments suggest that the Commission's prohibition of the Illumina/Grail merger was not a one-off event, but part of a broader shift. This change of direction was corroborated by other very recent Commission prohibitions of proposed acquisitions. In September 2023, the Commission prohibited the acquisition of the online flight booking service eTraveli by Booking, the leading provider of online hotel bookings in the EU. According to the Commission, the acquisition would have strengthened Booking's dominant position in the market for online hotel bookings by enabling it to expand and reinforce its travel services ecosystem. The most significant aspects of the Commission's decision were its rejection of the behavioral remedies offered by Booking, and its reliance on an ecosystem theory of harm. Notably, this is only the 11th time that the Commission has blocked a takeover in the past decade, compared to around 3,500 approvals over the same period. See Case M.10615 *Booking Holdings/Etraveli Group*. In addition, in July 2023, the Commission opened an in-depth investigation to assess, under the EUMR, the proposed acquisition of iRobot by Amazon. The Commission was concerned that the transaction would allow Amazon to restrict competition in the market for robot vacuum cleaners ("RVCs") and to strengthen its position as an online marketplace provider. In January 2024, the Commission took note of Amazon's and iRobot's decision to terminate their agreement according to which Amazon intended to acquire sole control over iRobot. The abandonment followed the findings of the Commission's in-depth investigation and the sending of a Statement of Objections in November 2023. See Case M.10920 *Amazon/iRobot*. There are currently other ongoing Phase II merger investigations: (i) the proposed acquisition of Asiana by Korean Air (Case M.10149 *Korean Airlines/Asiana Airlines*); (ii) the proposed creation of a joint venture by Orange and MasMovil (Case M.10896 *Orange/MasMovil/JV*); and (iii) the proposed acquisition of Figma by Adobe (Case M.11033 *Adobe/Figma*). This follows the Commission imposing remedies on the proposed acquisition of VMware by Broadcom (Case M.10806 *Broadcom/VMware*).

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Secondly, since Member States will now be able to use Article 22 EUMR to refer mergers that are not notifiable under their own merger regime to the Commission, it is a matter of debate how the latter will interact with the DMA, which also contains provisions for mergers within the EU.[107] Article 14 DMA requires gatekeepers to inform the Commission of any intended acquisitions "where the merging entities or the target of concentration provide core platform services or any other services in the digital sector or enable the collection of data",[108] irrespective of whether it is notifiable to the Commission under that Regulation [i.e., the EUMR] or to a competent national competition authority under national merger rules".[109]

A further layer of complication derives from the fact that, pursuant to the said Article 14(4–5) DMA, potentially relevant information will be transmitted to NCAs, which may eventually be used to request the Commission to examine a transaction under the Article 22 EUMR

[107] See V.H.S.E. Robertson, 'The future of digital mergers in a post-DMA world' (2023) 44(10) European Competition Law Review 447; T. Käseberg T, 'The DMA – Taking Stock and Looking Ahead' (2022) 13(1) Journal of European Competition Law & Practice 2; F. Schöning and F. von Schreitter, 'Showcases and showstoppers: the DMA's impact on merger control in digital markets' (2022) 7(3) Competition Law & Policy Debate 121.

[108] Furthermore, the Commission can temporarily block gatekeepers from making acquisitions in areas relevant to the DMA in case of systematic infringements under Article 18 of the DMA.

[109] According to Article 14(1) of the DMA, "[a] gatekeeper shall inform the Commission of any intended concentration within the meaning of Article 3 of Regulation (EC) No 139/2004, where the merging entities or the target of concentration provide core platform services or any other services in the digital sector or enable the collection of data, irrespective of whether it is notifiable to the Commission under that Regulation or to a competent national competition authority under national merger rules." According to V. Robertson (n 107) 3, Article 14 has been described as a "somewhat unconventional solution" to the issue of establishing jurisdiction over digital mergers, given that the obligation itself is limited to mere information disclosure. Furthermore, distinguished scholars argued that Article 14 appears to be "lacking the teeth" needed to initiate intervention or order a halt to the integration of a suspected killer acquisition (see, in this regard, N.M. Belloso and N. Petit, 'The EU Digital Markets Act (DMA): A Competition Hand in a Regulatory Glove' (2023) 48(4) European Law Review 391, 409). Following an optimistic reading, Article 14 – at least from an enforcement perspective – can be said to create a "standstill effect" of sorts, albeit one that is distinct from a formal notification requirement and the enforcement measures therein (see P. Callol, 'Merger Control Beyond Merger Thresholds and the Multiplication of Ex Ante Merger Notification' (2023) European Competition Law Review 117, 121). Less generous readings are critical of the provision – or, rather, the legislature – for lacking ambition in terms of the requirements and powers underpinning the obligation: according to T. Käseberg (n 107) 2, Article 14 is "only proof that the Commission has seen the challenge – but not addressed it in an appropriate way." According to M. Eben and D. Reader, 'Taking aim at innovation-crushing mergers: a killer instinct unleashed?' (2023) 42 Yearbook of European Law 286–321, Article 18 DMA should have been seen to achieve the desired effect of "giving teeth" to Article 14, suggesting that the interplay between Article 14 DMA and Article 12 EUMR, combined with the potential application of Article 18, has the effect of "weaponizing" merger control in an effort to enforce compliance from gatekeepers. According to T. Käseberg (n 107) 2, Article 18 DMA should have been refined by affording the Commission: (i) a power to impose a notification obligation under specified conditions; and (ii) clarity on when it 'shall' impose certain measures, thereby providing greater certainty on how discretion will be exercised.

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referral mechanism.[110] Hence, in the digital environment, the intersection between this new referral mechanism and Article 14 DMA may trigger a plethora of additional referrals likely to be reviewed by the Commission.[111]

Furthermore, when assessing unchecked digital mergers in light of the DMA, it has to be mentioned that there is also a further provision, namely Article 8 DMA. If there is systematic non-compliance with the DMA, the Commission can adopt a decision that foresees behavioral as well as structural remedies, and, in particular, it can foresee that the gatekeeper shall be prohibited from further acquisitions in the digital sector for a number of years.[112] However, before the Commission can impose such remedies, the gatekeeper needs to have been the subject of three prior non-compliance decisions over the preceding eight years.[113]

Thirdly, the Commission rejected the remedies Illumina offered to address the Commission's competition concerns.[114] For the Commission to prohibit a vertical merger is highly unusual, especially based on a relatively untested "innovation competition" theory of harm. In fact,

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[110] Article 14(4) DMA: "The Commission shall inform the competent authorities of the Member States of any information received pursuant to paragraph 1 and publish annually the list of acquisitions of which it has been informed by gatekeepers pursuant to that paragraph."; Article 14(5) DMA: "The competent authorities of the Member States may use the information received under para 1 of this Article to request the Commission to examine the concentration pursuant to Article 22 of Regulation (EC) No 139/2004."

[111] According to M. Eben and D. Reader (n 109) 316, given the perceived prevalence of killer acquisitions in digital markets, relative to other sectors, Article 14 can play a key role in populating the pipeline for Article 22 referral requests. According to S. Cisnal de Ugarte, M. Perez and I. Pico (n 86) 20, the vast majority of problematic below-threshold mergers in the digital sector will now appear automatically on the Commission's radar. It is unlikely that large firms in other sectors will interpret Article 22 as providing an analogous obligation (or recommendation) to inform the Commission of their own acquisitions. As well as identifying potential cases for referral under Article 22 EUMR, further developments in EU case law – namely, the CJ's ruling in *Towercast* (see *infra*) – have prompted some to suggest that Article 14 DMA may also act as a supplier of cases for *ex post* reviews of mergers under Article 102 TFEU. See J. Mulder and W. Sauter (n 95) 10.

[112] Article 18(2) DMA.

[113] Article 29 DMA.

[114] See Case M.10188 *Illumina/Grail*, EU Commission's press release dated 6 September 2022, 'Mergers: Commission prohibits acquisition of Grail by Illumina'. Illumina offered a license to NGS suppliers to some of Illumina's NGS patents, and a commitment to stop patent lawsuits in the U.S. and Europe against the NGS supplier BGI Genomics (China) for three years to reduce IP-related barriers to entry. However, the EU Commission received negative feedback from its market test and found that these commitments would not have ensured the emergence of a credible alternative to Illumina in the short to medium term. Among other things, the covered patents were due to expire in the short term, and Illumina has many other patents that competitors would need to develop an alternative NGS system. Even if alternative NGS systems emerged, switching providers would be a long and costly process without a guarantee of success. Illumina also offered a commitment to conclude agreements with Grail's rivals based on a standard contract until 2033. Nevertheless, the EU Commission found that the commitment did not address all the possible foreclosure strategies, such as degrading the technical support to Grail rivals for Illumina's NGS systems. The EU Commission also found that the proposed commitments would be difficult to monitor and easy for Illumina to circumvent.

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the prohibition stressed the relevance the Commission attaches to innovation competition and perhaps also reflected the growing skepticism over the effectiveness of behavioral remedies like non-discrimination commitments. On the other hand, the Commission's theory of harm in Illumina/Grail is relatively untested. Relatedly, the most comprehensive clarifications of innovation competition theories come from Dow/DuPont and Bayer/Monsanto in 2017 and 2018, respectively.[115]

6. THE ITALIAN LEGISLATIVE CONTRIBUTION ON MERGER CONTROL

Italy also contributed to this wave of reforms. A major achievement has been the AGCM's contribution to the Government's multi-year economic reform in the framework of the National Recovery and Resilience Plan, an EU-funded instrument aimed at helping the post-pandemic economic recovery of EU Member States. Every year, the AGCM addresses a comprehensive advocacy Opinion to the Government and Parliament, which outlines a series of possible measures suitable to enhance competition in crucial sectors. In 2022, the Italian Parliament approved Law No. 118/2022,[116] the contents of which largely reflect the proposals and suggestions submitted by the AGCM in its special Opinion the year before and which introduced major changes in merger review.[117]

Article 32 of Law No. 118/2022 amended Article 16 of the Italian Competition Act by introducing, in a new paragraph (1-*bis*), a regime for reviewing transactions falling below the applicable thresholds in order to capture acquisitions of nascent competitors.

The AGCM may call in a concentration by requesting its notification within 30 days[118] when:

i) there are prima facie concrete risks for competition in the Italian market (or in a relevant part of it), also considering the detrimental effects on the development and diffusion of small enterprises characterized by innovative strategies;
ii) the transaction occurred at most six months before the notification order;

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[115] Case M.7932 *Dow/Dupont*, Commission decision of 27 March 2017; Case M.8084 *Bayer/Monsanto*, Commission decision of 11 April 2018.

[116] Law No. 118 of August 5, 2022–2021 Annual Law Market and Competition (OJ General Series No. 188, 12 August 2022). Effective date of entry into force of the measure: 27 August 2022.

[117] Other important changes introduced by Law No. 118/52022 concern the substantive assessment of mergers and align the national framework to the EUMR. First, the dominance test has been replaced by the so-called SIEC test ("significant impediment to effective competition"), as set out in the EUMR. Second, all full-function joint ventures will be subject to merger control rules, regardless of their "concentrative" and "cooperative" nature. Third, efficiency gains as a factor to consider that might offset the anticompetitive effects of a merger are now explicitly mentioned in the Italian Competition Act. Finally, the calculation of the turnover of credit and other financial institutions for merger control purposes has been aligned to the ones set out in the EUMR.

[118] Failure to notify within the above-mentioned deadline leads to the application of administrative pecuniary sanctions pursuant to Article 19 of the Italian Competition Act (i.e., fines up to 1% of the relevant turnover of the undertakings concerned as referred to the last consolidated financial statement).

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iii) the transaction meets one of the two applicable and cumulative filing thresholds[119] or the worldwide overall turnover of the undertakings concerned is higher than EUR 5 billion.

This new provision also states that the AGCM shall define guidance for the application of this new regime, in accordance with the EU principles. Accordingly, on 2 January 2023, the AGCM adopted a notice on the notification of below-threshold merger transactions.[120]

The notice addresses the procedural aspects of the new regime, clarifies the meaning of "concrete risks for competition in the market" (see point i) above), and allows for voluntary notifications. In assessing the "concrete risks for competition", the AGCM will consider elements ranging from the market structure and the characteristics of the operators involved, to the thresholds realized in Italy. When no turnover figures are available or turnover is not indicative of the competitive constraint that an undertaking exercises or may exercise in the future, the Authority may take into account additional elements such as, for example, whether a firm:

1. is a start-up or new entrant with significant competitive potential that has yet to develop or adopt a business model that generates significant revenues (or is still in the early stages of implementing such a model);
2. is an important innovator or is conducting potentially important research;
3. constitutes a significant current or potential competitive force;
4. has access to competitively significant assets (such as raw materials, infrastructure, data or intellectual property rights); and/or
5. provides products or services that are key inputs/components for other industries.

The Authority may also consider in its assessment whether the value of the transaction is particularly high compared to the acquired firm's current turnover.[121]

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[119] That is, according to the latest update of March 2023, EUR 532 million for the combined turnover in Italy of all the undertakings concerned and EUR 32 million for the individual turnover in Italy of each of at least two of the undertakings concerned by the transaction.

[120] See "Comunicazione relativa all'applicazione dell'articolo 16, comma 1-*bis*, della legge 10 ottobre 1990, n. 287". The notice was adopted following a public consultation process launched in October 2022.

[121] In the event that none of the undertakings involved in the concentration develops turnover in Italy, the Authority will assess whether, in light of the specific characteristics of the transaction and of the undertakings concerned, the concentration appears in any event likely to affect competition in the national market, or in a substantial part of it, considering, for example: a) the diffusion in Italy of the activities concerned among the users/consumers of the services of the undertakings involved, even if the services are provided at zero prices: in the digital sector, for example, indicators of activity could be the daily or monthly number of users residing in Italy of such digital services or the number of accesses of individual users residing in Italy to a given website; b) the location in the national territory of the company's headquarters, production facilities and/or research or experimentation laboratories; c) the performance of R&D activities potentially relevant to the national market: for example, relevant factors for the assessment may be the circumstance that the outcome of the R&D activity is marketable in the national territory, or that the undertakings already own a particular patent (or have started the approval process) for a drug that can be distributed in the national territory; d) the existence of a plan to enter the national market: account

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Additionally, merging parties are allowed to voluntarily notify the AGCM even before the finalization of the transaction if they have doubts as to whether the concentration at stake may meet the requirements under paragraph 1-*bis* of Art. 16 of the Italian Competition Act. In the event of a voluntary notification, the Authority, based on the information received from the merging parties, will clarify whether it intends to request the formal notification of the transaction within 60 days from the receipt of the voluntary notification.

This additional power might partly echo the principles of the Commission's Article 22 referral Guidance, and undoubtedly represents an additional tool for the AGCM to tackle problematic acquisitions.[122] It is not entirely clear what the relationship will be between the AGCM's newly granted power and the Article 22 EUMR referral mechanism. For example, while an Article 22 referral request must be made "within 15 working days of the date on which the concentration was notified, or if no notification is required, otherwise made known to the Member State concerned", it is not clear if, should the AGCM request a certain concentration to be notified under the new regime, such notification will make the Article 22 referral deadline run afresh.

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will be taken, for example, of plans for opening production facilities, evidence of occurred or imminent recruitment of staff, the existence of a process for obtaining marketing authorizations, or an expectation to conclude sales contracts in Italy.

[122] Actually, the first application of AGCM's new powers took place last February 2024 in the context of the acquisition of Clear Channel Italia S.p.A by IGPDecaux S.p.A. (see Case C12583 *Igpdecaux/Clear Channel Italia*, Proceedings No. 31062 opened on 13 February 2024). Pursuant to Article 16, para 1-*bis* of the Italian Competition Act, the AGCM requested the notification of the acquisition by IGPDecaux of Clear Channel, companies active in out-of-home (OOH) advertising. The notified operation was not subject to the obligation of prior notification required under Article 16, para 1 of the Italian Competition Act, as the total turnover achieved by all the undertakings concerned did not exceed= €532 million in the last financial year at the national level. However, the total turnover achieved individually at the national level by each of the undertakings concerned exceeded the threshold of €32 million, one of the thresholds referred to in Article 16, para 1-*bis*, pursuant to which the AGCM may require the notification of a concentration within six months of its completion, to assess the risks to competition in the national market or in a substantial part thereof. Following the analysis of documents supplied by the parties, the AGCM decided that the merger did not raise competition concerns and cleared it in Phase I. Also in the context of the acquisition of Terminal San Giorgio S.r.l. by the company Ignazio Messina & C. S.p.A., AGCM requested the notification of the acquisition pursuant to Art. 16, para 1-*bis* (C12586 *Ignazio Messina & C/terminal San Giorgio*, Proceedings No. 31066 opened on 27 February 2024). Considering that the transaction under consideration appears likely to significantly impede effective competition, within the meaning of Article 6, para 1 of the Italian Competition Act, also as a result of the creation of a dominant position in the market for rolling stock terminal services and in certain vertically related markets for the maritime transport of rolling stock, the AGCM approved the opening of the investigation pursuant to Article 16, para 4 of the Italian Competition Act against the companies Ignazio Messina & C. S.p.A. and Terminal San Giorgio S.r.l.

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7. ADDITIONAL DEVELOPMENTS: THE JUDGMENT IN TOWERCAST AND ITALIAN RULING ON TICKETONE

In the face of such a scenario, competition law's response was not long in coming. The following two cases need to be read in light of the growing impact of killer acquisitions on the competition law arena.

On 24 March 2022, the Rome Administrative Court of First Instance ("TAR Lazio")[123] has annulled a previous decision by the AGCM,[124] dealing with the possibility of AGCM (and national competition authorities as a whole) applying Article 102 TFEU to conduct consisting of the acquisition of undertakings by a dominant undertaking.

In the aforementioned "TicketOne" decision, the AGCM sanctioned a unitary and complex exclusionary strategy allegedly put in place by the Eventim Group on the Italian market for the sale of tickets sale for live concerts of pop music.[125] The AGCM proceedings followed the expiry, back in 2017, of previous agreements between Ticketone S.p.A. (Eventim's subsidiary in Italy) and the main Italian promoters of live pop music live events, notified by the parties to AGCM and approved by the latter under the notification regime previously in force in Italy.

The conduct scrutinized by the AGCM, which included acquisition activities considered as part of a complex exclusionary strategy, was not assessed within the context of the EUMR or merger-specific Italian rules (for instance, Articles 5 and 16–19 of the Italian Competition Act). Instead, it was evaluated pursuant to Article 102 TFEU. The basis was the aforementioned exclusionary strategy aimed at foreclosing competitors from selling the biggest and most profitable portion of tickets for pop music live events in Italy. This exclusionary strategy would have also been part of a pre-emption strategy aimed at countering the entry into the Italian market by the potential newcomer Ticketmaster.[126]

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[123] *Tar Lazio*, judgment No. 3334 of 24 March 2022.

[124] See AGCM, case No. A523 *TicketOne/Condotte escludenti nella vendita di biglietti*, decision No. 28495 of 22 December 2020, published in the AGCM Bulletin No. 4/2021. The complex exclusionary conduct being sanctioned by the AGCM would have been carried out by Eventim Group through: (i) executing (absolute or quasi-absolute) exclusivity agreements with several national promoters of live concerts of pop music; (ii) securing exclusivity obligations on any local promoters to which the above "captive" national promoters would have transferred the right to organize specific local live events of pop music; (iii) executing exclusivity agreements with minor local ticketing operators, which subsequently acted as mere intermediaries for the sale of tickets marketed by Ticketone S.p.A.; (iv) boycotting and retaliating against local promoters not agreeing to the exclusivity obligations with Eventim/Ticketone; and, finally, (v) acquiring four important national promoters of live concerts of pop music.

[125] More recently, the Council of State (the Italian Supreme Administrative Court) confirmed the ruling of the TAR Lazio and has annulled the AGCM's fine of more than €10 million against TicketOne for abuse of a dominant position. See Council of State, judgment No. 9035 of 24 October 2022.

[126] In this regard, the AGCM argued that the concentration put in place by the Eventim–TicketOne group would not have been considered *per se* as constituting an abuse of a dominant position but only as part of a more articulated exclusionary strategy. Significantly, the AGCM stated that these acquisitions constitute, therefore, a fundamental piece of the unitary and complex abusive strategy in that, adding to the exclusive contracts already in place between TicketOne and national promoters outside the Eventim-TicketOne group and to the other conduct ascertained in

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As a result, the Eventim Group, through the acquisition of the four national promoters as well as through the other aforesaid exclusionary conduct, would have exploited its dominance in the Italian market of sale of tickets for live events of pop music in breach of Article 102 TFEU.[127] The AGCM argued, in essence, that the merger would be only a "piece" of the abusive, continuous and complex strategy put in place between the parties and relevant for the purposes of Article 102 TFEU.

Coming to the subsequent appeal – and setting aside the rejection of the procedural objection raised by the appealing parties regarding the excessive length of the pre-investigation phase and the late notification of the charges by the AGCM – the TAR Lazio, in the context of its annulment decision, focused its reasoning on the abusive acquisition by the Eventim Group of the four national promoters.

First of all, according to the TAR Lazio, the acquisition of the promoters did not have an exclusionary purpose but was justified by the need to counter the expansion of the international group, Ticketmaster, amounting to legitimate conduct.[128]

More importantly, the TAR Lazio dismissed the AGCM's approach of assessing the acquisition of the four national promoters through the lens of Article 102 TFEU. The Administrative Court's line of reasoning derived from Article 21 EUMR, which explicitly precludes the applicability of Articles 101 and 102 TFEU.

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the course of the investigation, they foreclosed the relevant market for the sale of tickets for live light music events, hindering the entry and expansion of competing ticketing operators, crystallizing the market situation and making TicketOne's competitive advantages non-replicable (para 421).

[127] According to the TAR Lazio, the complaints regarding the impossibility of challenging a concentration operation in terms of abuse of dominant position under Article 102 TFEU are also well-founded. The assertion, however, does not appear to be compatible with the EU merger rules, specifically with Article 21(1) EUMR, which expressly excludes the applicability of Articles 101 and 102 TFEU.

[128] In the context of the AGCM's proceedings, in order to demonstrate the existence of a "unitary and complex" exclusionary strategy, it has been particularly emphasized that a close correlation that would exist between TicketOne's acquisitions of national promoters and the anticompetitive intent pursued (see paras 403 ss.). Given the peculiarity of the reference market, characterized by the vertical integration between ticketing and promotion activities, TicketOne had stressed, in the course of the proceedings, that the merger operation was aimed at countering and reacting to the expansion of the Live Nation/TicketMaster group, which was a particularly significant competitor in the international arena, also integrated in both the promoting and ticketing sectors. However, when analyzing the market dynamics and retracing the alleged abusive exclusionary strategy of the parties, the AGCM did not adequately take the latter circumstance into account. Therefore, in relation to the existence of a finalistic mutual objective capable of unifying the various conducts in an anticompetitive sense (which would demonstrate the existence of the abuse), the TicketOne's statement about the acquisitions being "explicitly aimed at foreclosing the relevant market to competing ticketing operators" (see para 419 of the AGCM's proceedings) was not supported by adequate investigation and evidence. The latter circumstance was explicitly confirmed by the TAR Lazio in its reasoning. And this is because the AGCM focused exclusively on TicketOne's desire to strengthen its dominant position in the ticketing sector, rejecting the evaluation of all the additional elements demonstrating that the purpose of the acquisitions was mainly to confront the main competitor (Live Nation/TicketMaster) through the entry of the Eventim-TicketOne group in the promoting sector.

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Furthermore, we can only presume that the AGCM did not assess the acquisitions by Eventim Group pursuant to the Italian merger rules because these concentrations escaped the jurisdictional thresholds triggering the compulsory notification to the AGCM and opted instead to assess these acquisitions as part of the abusive strategy.

Following from the above, the main assumption of the TAR Lazio is that the application of Article 102 TFEU to concentrations would give rise to the subsequent disapplication of the EUMR and would thus breach the principle of legal certainty and the freedom of private business venture set forth by Article 41 of the Italian Constitution, by affecting or potentially jeopardizing mergers even several years after their implementation (as opposed to the strict deadlines and conditions to be followed for merger control pursuant to EUMR).[129]

Nevertheless, over the last year, the issue was highly debated and the CJEU very recently took the opposite direction. This clearly demonstrates that the possibility for NCAs to increase their tools to scrutinize mergers is part of the nouvelle vague on the modernization of antitrust enforcement and need not be dealt with separately at the national level as compared to the European response.

On 16 March 2023 (and in line with the Opinion by Advocate General Kokott of 13 October 2022[130]), a preliminary ruling by the Court interpreting Article 21(1) EUMR was handed down in Towercast.[131] In this judgment, the Court held that NCAs can, *ex post* on the basis of the direct application of Article 102 TFEU, challenge concentrations that were not subject to any upfront merger control review and have not been referred to the Commission.[132] Jointly, these cases suggest that the *ex ante* system of turnover-threshold-based one-stop shopping for the merger control has been expanded significantly with new possibilities for review both at the EU and national level. This is relevant to acquisitions of targets with no or very limited turnover, as this usually means that mandatory merger control rules are not triggered.[133]

The Paris Court of Appeal submitted an Article 267 TFEU preliminary reference to the CJEU, asking whether NCAs are precluded from applying Article 102 TFEU to a concentration which has no EU dimension within the meaning of Article 1 EUMR (albeit not being notified to the EU Commission). It regards questions on the interpretation of Article 21(1) EUMR that result from Towercast's challenge to a decision by the Autorité de la concurrence not to pursue its complaint that the acquisition by Télé diffusion de France (TDF) of their mutual

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[129] Apart from the principle of legal certainty and the existence of a dedicated set of laws on merger control, it is doubtful that there is no legal basis for rejecting altogether the application of Article 102 TFEU to concentrations. Indeed, Article 21 EUMR, mentioned by the TAR Lazio, precludes the application of "national legislation on competition to any concentration that has a Community dimension" and, as such, appears to be mainly driven by the need to ensure a uniform application of merger rules to EU-relevant concentrations and does not deal with concentrations having a national dimension, let alone the ones not even meeting these thresholds.

[130] Opinion of AG Kokott in Case C-449/21 *Towercast v Autorité de la concurrence, Ministère de l'Économie, Other parties: Tivana Topco S.A., Tivana Midco S.A.R.L., TDF Infrastructure Holding S.A.S., TDF Infrastructure S.A.S., Tivana France Holdings S.A.S.*, ECLI:EU:C:2022:777.

[131] Case C-449/21 *Towercast*, JECLI:EU:C:2023:207.

[132] A.S. D'Amico (n 95) 1–25; J. Mulder and W. Sauter (n 95) 1–11.

[133] It has already been made clear that not triggering any mandatory filing thresholds does not provide a "safe haven" anymore, in view of the revival of Article 22 EUMR. This means that acquirers now face the risk of such deals being referred by a national authority to the EU Commission for upfront review.

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competitor Itas amounted to an abuse of a dominant position. Towercast, TDF and Itas were active in the wholesale market for digital terrestrial television broadcasting in France. In this case, there was no referral of the transaction to the EU Commission under Article 22 EUMR or any *ex ante* review since the transaction fell below the turnover thresholds of both of the EUMR and the French national merger control regime, which were therefore not applied.

The attempt to subject the transaction to *ex post* scrutiny under Article 102 TFEU was rejected by the French competition authority on the ground that there is a "clear dividing line" between the two regimes (*ex ante* merger control and *ex post* control of anticompetitive practices pursuant to Articles 101 and 102 TFEU) and that when a merger does not fall under the EUMR, "Article 102 TFEU is no longer applicable where no anticompetitive conduct distinct from the concentration is manifested."[134] Accordingly, the EUMR applies only to concentrations falling within the meaning of Article 3, and – as per Article 21(1) EUMR – Article 102 TFEU does not apply unless there is distinct additional anticompetitive conduct.

The EU legal order presupposes a hierarchy of norms, where primary law such as that in question remains directly applicable, paving the way for individuals to enforce their Article 102 TFEU rights before national authorities and courts. This view is corroborated by the legal basis used to enact the EUMR, Article 103 TFEU, the very purpose of which is intended to "give effect" to Articles 101 and 102 TFEU.[135]

Primacy also prevents any "blocking effect" that could occur by secondary law such as the EUMR. Also, contrary national rules are not capable of blocking the EU Treaty article which aims to protect competition in the internal market through the uniform interpretation of rules throughout the EU.[136] In other words, AG Kokott highlights that Article 102 TFEU is a provision of primary law that is directly applicable and that its application cannot be precluded by a provision of secondary law such as Article 21(1) EUMR, due to the hierarchy of norms and the principle *lex superior derogat legi inferiori*.[137]

When drawing on the greater context of EU antitrust law and EU merger control, AG Kokott emphasized the relationship between the two frameworks where the application of Article 102 TFEU can contribute to the effective protection of competition in the internal market insofar as it concerns concentrations that are undesirable from a competition policy perspective but fall below the EU and national notification thresholds. More particularly, AG Kokott makes reference to the distinction between *ex post* and *ex ante* enforcement, moving from Article 21(1) EUMR which governs the scope of the latter regulation in connection with provisions of secondary EU competition law.[138]

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[134] AG Kokott Opinion in *Towercast*, para 21.

[135] AG Kokott Opinion in *Towercast*, paras 29–35.

[136] Ibid, paras 33–36.

[137] Ibid, para 30. But AG Kokott explains that when an *ex ante* assessment has taken place, *lex specialis derogat legi generali* applies, albeit Article 102 TFEU has the status of primary law and remains applicable in principle (para 59), because "a concentration which has been approved under the more specific rules of merger control, and the effects of which on market structure and competition conditions have been declared to be compatible with the internal market, could not as such be qualified (any longer) as an abuse of a dominant position within the meaning of Article 102 TFEU, unless the undertaking concerned has engaged in conduct which goes beyond that and could be found to constitute such an abuse" (para 60).

[138] The assessment of *ex post* and *ex ante* enforcement is not something new, as the matter was already addressed by the CJEU in Austria Asphalt (Case C-248/16 *Austria Asphalt GmbH*

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The AG states that case law demonstrates that Article 102 TFEU is widely applicable and can cover the acquisition of competitors by dominant undertakings, recalling that "the abusive exclusion of a competitor from the market can take a variety of forms and a dominant undertaking has a special responsibility not to allow its behavior to impair genuine, undistorted competition in the internal market".[139] She also points out that while the turnover threshold under the EUMR determines whether a concentration warrants *ex ante* control, it is not relevant in establishing whether the conduct of a dominant undertaking can be scrutinized *ex post* under Article 102, even if it relates to a concentration.[140]

AG Kokott clarified that national authorities should in such cases be able to rely on the *ex post* assessment possibility of Article 102 TFEU as a last resort.[141] She concluded that Article 21(1) EUMR must be interpreted as not prohibiting a national competition authority from reviewing a concentration under Article 102 TFEU, if it does not meet the EU and national notification thresholds for *ex ante* merger review, and has not been referred to the Commission under Article 22 EUMR.[142]

The above leads to the question of whether the judgments in *Continental Can*[143] and *Tetra Pak*[144] are still cases in point or would end up losing any relevance. In these rulings, the CJEU confirmed the ability of the Commission to look at mergers through the lens of an abuse of dominance and justified the application of Articles 101 and 102 TFEU (then Articles 81 and 82 of the Treaty) to concentrations due to the lack, at the time of that judgment, of specific EU legislation on merger control. In addition, AG Kokott also addressed the question of any potential situation of consecutive application of Article 102 TFEU and merger control rules.

According to AG Kokott, when a concentration has been approved under the EUMR, an abuse of dominant position could not occur, even if in such cases Article 102 TFEU continues

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& Co OG v Bundeskartellanwalt, ECLI:EU:C:2017:643) in relation to the differentiation between merger control on the one hand (through the EUMR) and Article 101 TFEU on the other (through Regulation No. 1/2003). In that case, the CJEU confirmed the exclusive applicability of the EUMR in relation to the assessment of concentrations and excluded the applicability of Regulation No. 1/2003 in that regard. Therefore, in Austria Asphalt, the CJEU leaves room for Article 102 TFEU still to be applicable to concentrations given that the judgment was not a "general statement on the relationship between merger control law on the one hand and Articles 101 and 102 TFEU on the other" (A. Kokott Opinion in *Towercast*, para 26).

[139] Ibid, para 45.

[140] Ibid, para 38.

[141] Ibid, para 48. She argues that, in order to protect competition, national authorities should be able to "resort at least to the 'weaker' instrument of punitive *ex post* control under Article 102 TFEU, provided that the conditions for it are met."

[142] Ibid, para 68.

[143] Case 6-72 *Europemballage Corporation and Continental Can Company v Commission*, ECLI:EU:C:1973:22.

[144] Case T-51/89 *Tetra Pak v Commission* [1990] ECR II-41. At para 1, the Court of First Instance stated that "the acquisition by an undertaking in a dominant position of an exclusive patent license for a new industrial process constitutes an abuse of a dominant position where it has the effect of strengthening the undertaking's already very considerable dominance of a market where very little competition is found and preventing, or at least considerably delaying, the entry of a new competitor in that market, since it has the practical effect of precluding all competition in the relevant market."

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to have direct effect and can be deemed directly applicable.[145] According to the principle of *lex specialis derogat legi generali*, a potential anticompetitive conduct would amount to an abuse of dominant position within the meaning of Article 102 TFEU as long as the undertaking concerned had engaged in conduct that goes beyond the implementation of the concentration as such. In AG Kokott's view, this working hypothesis clears the field from any potential additional application of Article 102 TFEU, limiting that duplication to cases which are subject to competition scrutiny from the beginning due to the presence of the criteria for defining an abuse of dominant position (such as market power) but which have not been assessed under the EUMR.[146] As a result, AG Kokott's Opinion cannot but confirm the applicability of Article 102 TFEU and of the historical case law of *Continental Can.*

In the subsequent judgment,[147] the CJEU essentially follows the reasoning of the AG. It dismissed the proposition that the direct applicability of a provision of primary law can be ruled out by the adoption of a piece of secondary law.[148] It recognized that the wording, the legislative history, and the general framework of Article 21(1) of EUMR were intended to be the only procedural instruments applicable to prior centralized vetting of concentrations in a one-stop-shop system. However, this does not mean the EU legislature intended to deprive the NCAs of the possibility to control a concentration on the grounds of Article 102 TFEU. Thus, the EUMR applies only to concentrations with a Community dimension and it is accepted that certain concentrations that escape *ex ante* control may be subject to *ex post* control.[149]

Next, the CJEU addressed the consequences of the fact that the EUMR expressly excludes the application of Regulation No. 1/2003 to concentrations defined in Article 3.

The plain text of the law would therefore at first sight leave little room for doubt that concentrations cannot be subject to *ex post* supervision by the Commission or NCAs under Article 102 TFEU. This choice by the EU legislator for exclusive *ex ante* supervision of concentrations, including notification and standstill obligations (and therefore also excluding *ex post* (behavioral) supervision), has been a logical consequence since *ex post* review of concentrations under Article 102 TFEU would undermine the effective functioning of merger control regimes and the importance of legal certainty for market participants.

In this regard, the CJEU highlighted that the prohibition of Article 102 TFEU is directly effective. At the same time, Regulation No. 1/2003 explicitly empowers the Commission and national competition authorities (based on Article 5) to apply Articles 101 and 102 TFEU in individual cases. Regulation No. 1/2003 was therefore the legal basis for the application of these articles by the Commission and NCAs. This does not mean that a mere finding that a below-threshold concentration has been strengthened is sufficient for a finding of abuse: the degree of dominance reached thereby must substantially impede competition, to the effect that only undertakings dependent upon the dominant undertaking would remain in the market.[150]

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[145] AG Kokott Opinion in *Towercast*, para 60.

[146] Ibid, para 63. And even in those cases – reassures AG Kokott – pursuant to the the principle of proportionality, there is no room for a subsequent dissolution of the concentration but rather only the imposition of a sanction.

[147] Case C-449/21 *Towercast*, ECLI:EU:C:2023:207.

[148] Ibid, paras 43–45.

[149] Ibid, paras 40–41.

[150] Ibid, para 52, with reference to Case 6/72 *Continental Can* (n 143) para 26 and Joined Cases C-395/96 P and C-396/96 P C*ompagnie Maritime Belge Transports and Others v Commission*,

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Hence, the CJEU concludes that Article 21(1) EUMR does not preclude NCAs from regarding a concentration as an abuse of dominance under Article 102 TFEU in light of the structure of a national market, if (i) that concentration has no Community dimension; (ii) is below the national threshold for *ex ante* merger; and (iii) has not been referred to the Commission under Article 22 EUMR.[151]

In light of these observations, it is worth analyzing what repercussions the *Towercast* judgment and AG Kokott's Opinion might have in the context of the broader "killer acquisitions" debate.

For the first time since the introduction of the EUMR in 1989, this ruling revisited its threshold-based system, specifically the centralized one-stop shopping system of *ex ante* control, and strengthened the Commission's Article 22 referrals Guidance, which can be seen as an alternative to reviewing the threshold system of the EUMR itself, for instance by introducing the value of the transaction as a jurisdictional criterion.

On this basis, the Commission gains control over killer acquisitions in the digital, biotech and pharmaceutical sectors, which have been surrounded by a considerable amount of concern due to an "enforcement gap". In both respects, perceived gaps are being closed in the EU merger control, and the emphasis is placed on substantive competition issues rather than formal quantitative thresholds.

Evidently, whether such concerns will gain traction depends on how the NCAs and the Commission will make use of their new instruments. It will be interesting to see whether the new Article 14 DMA, according to which the designated gatekeepers must inform the Commission about all their (notifiable and non-notifiable) intended acquisitions, may play a significant role in this regard. While this provision does not amount to a proper review mechanism, the subsequent Article 14(4) requires the EU Commission to communicate such potential concentration to Member States' competent authorities, enabling them to selectively apply the Article 22 EUMR referral mechanism to some of these acquisitions or Article 102 TFEU, as pointed out by AG Kokott. However, it has to be stressed that this intersection between referral mechanisms of Article 22 EUMR, Article 16-*bis* Italian Competition Act, and Article 14 DMA could have a discouraging effect on "tech giants" when it comes to pursuing allegedly illegitimate acquisitions. In the meantime, the first application of the *Towercast* ruling by the Belgian NCA was already reported six days after the judgment release[152] and we will

EU:C:2000:132, para 113.

[151] Ibid, para 53.

[152] Belgian Competition Authority ("BCA"), Press Release No. 10/2023 of 22 March 2023 – The Belgian Competition Authority opens an *ex officio* investigation into a possible abuse of dominance by Proximus in the context of the takeover of edpnet, in application of the *Towercast* case law. More in general, it has been suggested that, on balance, the Commission will have a preference for relying on the Article 22 referral mechanism, rather than Article 102 TFEU, as is apparent from its recent practice of inviting Member States to submit referral requests. See, in this regard, P. Callol, 'Merger Control Beyond Merger Thresholds and the Multiplication of Ex Ante Merger Notification' (2023) European Competition Law Review 117, 121. The latter author acknowledges that there might be procedural reasons why Article 102 would sometimes be a "preferable device" compared to Article 22; namely, where time limits come into play. The Commission has, however, invested considerable energy in reframing Article 22 as the "final weapon" of killer acquisitions and, given the criticism that its revised policy has encountered from the legal certainty point of view, it is very unlikely the Commission will seek to promote routine *ex post* interventions that

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appreciate whether the Commission's and NCAs' practice is consistent, transparent, and succeeds in identifying and challenging anticompetitive transactions that would otherwise have escaped merger review in the EU.

8. CONCLUSION

Killer acquisitions/mergers involving nascent competitors are becoming an increasingly relevant topic for competition authorities in several countries.

In this chapter, we acknowledge that only a tiny part of all corporate acquisitions involving nascent competitors is likely to culminate in harm to competition.

Acquisitions of nascent competitors involve a substantial degree of uncertainty and become particularly concerning from a competition standpoint because they require a counterfactual comparison between a pre-merger world and an *ex post* merger review assessment. As a result, competition law must counterbalance intervention with incentives to let undertakings grow and invest in innovation, also through welfare-enhancing strategic acquisitions.

Historically, the application of the competition law framework has been pretty lenient towards acquisitions in the pharma and tech industries, as demonstrated by Cunningham and co-authors' article, which is likely to result in competition and innovation decreasing in those industries.

Several proposals and reports have been put forward to amend the EU merger notification regime and to enable competition authorities to assess potentially harmful transactions which are not caught by the existing thresholds. One proposal would have been to lower the current turnover thresholds. However, pursuing this path in the context of a mandatory notification system would inevitably result in a large numbers of low turnover transactions being notified. This option has therefore not been pursued, but several jurisdictions (like Germany and Austria) have introduced, or propose to introduce, additional or complementary thresholds or criteria, notably value-based thresholds.

In response to this, we analyzed the opposite choice followed by the EU Commission, consisting of issuing, on 26 March 2021, the Guidance on the Article 22 EUMR referral mechanism, which seeks to allow the EU Commission to review transactions that do not have an EU dimension, but that were referred by Member States as significantly affecting competition within their territory.

It is from these premises that we decided to take as the starting point of our analysis the newly-approved Article 16-*bis* of the Law No. 118/2022 in Italy, which entrusted the AGCM with the power to request undertakings to mandatorily notify a merger or concentration that falls below the previously existing turnover thresholds set out in the Italian Competition Act (including when the transaction is already completed). This may occur only if certain cumulative conditions are met, the most relevant of which is the real risk to competition in the national market, particularly considering the potential prejudice to the development of small but innovative businesses.

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would risk even more instability for the assessment framework. Article 102 is therefore more likely to be enforced by NCAs in this context, especially those that are reluctant to cede dominion to the Commission via Article 22 requests.

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To summarize, the implementation of these two regimes at European and national levels will greatly rely on how and to what extent the Member States and the EU Commission will use their discretionary powers when referring or accepting acquisitions. Moreover, the possibility that the EU Commission and the AGCM will be empowered to review transactions that have already been implemented is a complete U-turn with respect to previous practice. The latter assumption is clearly demonstrated by the conclusions reached in the CJEU's judgment in *Towercast*. On top of that, the elephant in the room is represented by Article 14 DMA, which requires designated gatekeepers to inform the EU Commission about all their (notifiable and non-notifiable) intended acquisitions. This will be the first real test for the sound application and enforcement of the Article 22 referral mechanism. In conclusion, the new regimes at the European and Italian levels cleared away any fear or suspicion that "tech giants" could face no scrutiny at all by competition authorities for their acquisition sprees. The proposed reforms seeking to bring suspected "killer acquisitions" onto the radar of competition authorities can hopefully also be conducive to a more sober discussion on how these acquisitions should then be reviewed.

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18. Antitrust in an Age of New Modes of Economic Organization

Teodora Groza

1. INTRODUCTION[1]

As a tool of market regulation, antitrust is in a constant process of adjustment to market realities.[2] Ever since its adoption, the antitrust toolkit has had to respond to the emergence of new forms of organizing economic activities. In the early days of antitrust enforcement, the U.S. Supreme Court grappled with the question of whether the formation of corporations represents an agreement in restraint of trade that should be caught by Section 1 of the Sherman Act.[3] The contemporary dominance of the corporate form as a legal shell for carrying out business activities is a testimony to the Court's decision that agreements 'promoting the legitimate business of a corporation' do not run afoul of Section 1.[4] Decades later, the Supreme Court had to rule on whether a board of trade operating a marketplace could adopt a rule limiting the freedom of sellers to set prices for the commodities they sell.[5] The decision is heavily fact-specific, but contains an incipient approval of the business form we currently refer to as a 'platform:' an interface bringing together buyers and sellers.[6] The Supreme Court ruled that platforms have several benefits—they 'br[ing] buyers and sellers into more direct relations,' create markets that previously did not exist, and eliminate some information asymmetries affecting purchasers—and should thus be allowed to operate even if their rules bring them close to the boundaries of Section 1 liability.[7]

These examples show how, as part of their attempt to catch up with market realities, antitrust laws have evolved to accommodate new modes of carrying out business. This process was by no means confined to the early decades of antitrust enforcement. Antitrust still moves towards the future. Nonetheless, this does not happen in the form of an automatic synchronization with business developments. Instead, the law evolves to accommodate the business

[1] I would like to thank the editors of the volume for their help with developing and sharpening the ideas in this chapter, which went well beyond normal editorial duties. The paper has also benefited from comments and suggestions from Paul Oudin and Molly White.

[2] This chapter uses the terms 'antitrust' and 'competition law' interchangeably.

[3] *United States v Joint Traffic Association*, 171 U.S. 505 (1898).

[4] ibid 568.

[5] *Chicago Board of Trade v United States*, 246 U.S. 231 (1918).

[6] World Trade Organization, Organization for Economic Cooperation and Development and United Nations, *Handbook on Measuring Digital Trade* (2nd edition, International Monetary Fund 2023) 92 (defining digital platforms as 'online interfaces that facilitate, for a fee, the direct interaction between multiple buyers and multiple sellers, without the platform taking economic ownership of the goods or rendering the services that are being sold').

[7] *Chicago Board of Trade* (n 5) 240.

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forms which are believed to be best suited for achieving its goals.[8] In the early days of antitrust enforcement, anti-bigness sentiments led to a preference for decentralized market structures and small businesses.[9] Throughout the second half of the twentieth century and up until recently, the gradual adoption of the consumer welfare standard[10] has influenced a preference for large firms which are managed as top-down hierarchies, integrate vertically backward and forward to secure economies of scale and scope, and are clearly separated from their competitors.[11] This particular pattern of the firm was long considered the best vehicle to achieve allocative efficiency, secure low consumer prices, and fuel economic growth.[12]

Today, antitrust is again at an inflection point. Technological developments and the rapid pace of innovation are leading to the gradual spread of new modes of economic governance. Two examples stand out in terms of the extent to which they deviate from the pattern of the large firm: innovation networks and decentralized autonomous organizations (DAOs). On the one hand, as opposed to the standard antitrust firm which is integrated across several stages of the production process, today's firms active in certain highly innovative industries tend to go in the opposite direction: they prioritize certain products or functions for which they can invest in cutting-edge innovation, and turn to external suppliers for key design, component, and even system inputs.[13] The increasing reliance on outside firms is done through agreements which go well beyond one-off business contracts, often involving close coordination between different firms' production functions and innovation activities. Building on the heightened

[8] Herbert Hovenkamp, 'Antitrust Policy, Federalism, and the Theory of the Firm: An Historical Perspective' (1990) 59 Antitrust Law Journal 75 (tracing the evolution of antitrust's preference for different types of firms).

[9] Spencer Weber Waller, 'Antitrust and Democracy' (2019) 46 Florida State University Law Review 807, 809 (quoting Senator Sherman: 'if we will not endure a king as a political power, we should not endure a king over the production, transportation, and sale of any of the necessities of life').

[10] Daniel A. Crane, 'The Tempting of Antitrust: Robert Bork and the Goals of Antitrust Policy' (2014) 79(3) Antitrust Law Journal 835 (offering a historical overview of how antitrust policy in the US drifted towards the goal of consumer welfare).

[11] Naomi R. Lamoreaux, *The Great Merger Movement in American Business, 1895–1904* (Cambridge University Press 1985) (analyzing how this template of the firm was incipiently crafted during 'The Great Merger Movement').

[12] Naomi R. Lamoreaux, Daniel M.G. Raff and Peter Temin, 'Beyond Markets and Hierarchies: Toward a New Synthesis of American Business' (2002) National Bureau of Economic Research Working Paper 9029 5 (discussing that commentators have attributed the success of the US economy in the twentieth century to 'the rise of the large, vertically integrated, managerially directed enterprises'); David Coen, 'The Evolution of the Large Firm as a Political Actor in the European Union' (1997) 4(1) Journal of European Public Policy 91, 93 (discussing the centrality of large firms for the success of the project of the internal market).

[13] William Powell, 'Neither Market Nor Hierarchy: Network Forms of Organization' (1990) 12 Research in Organizational Behavior 295 (discussing the emergence of business networks as replacements for vertical integration). Importantly, the acquisition patterns of big tech companies show that the phenomenon discussed by Powell is limited and cannot be generalized into a definitive trend. *See,* for instance, Federal Trade Commission, 'Non-HSR Reported Acquisitions by Select Platforms, 2010-2019: An FTC Study' (15 September 2021) available at https://www.ftc.gov/system/files/documents/reports/non-hsr-reported-acquisitions-select-technology-platforms-2010-2019-ftc-study/p201201technologyplatformstudy2021.pdf accessed 12 January 2024.

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degree of coordination these agreements involve, scholars have called for the recognition of these 'long-term relationships […] in which the parties voluntarily choose to continue dealing with each other' as a *sui generis* mode of organizing economic activity[14] which are often referred to as 'strategic alliances'[15] or 'innovation networks.'[16] Showing the extent of these phenomena, news outlets and business blogs report that the boundaries of the firm are being redrawn[17] to the point that we witness the emergence of 'the boundaryless firm,' which cannot be detached from its business networks.[18]

On the other hand, the emergence of innovation networks is part of a broader trend which drives the organization of industry towards more collaborative structures, not only in terms of their interactions with outside firms, but also when it comes to their internal management. Blockchain technologies have enabled the creation of DAOs—virtual communities that operate as networks in which decisions are taken democratically in accordance with customized voting procedures. Instead of being run by a clearly defined group of managers, DAOs are run collectively by token holders who are requested to cast their votes on all decisions, and as soon as a certain voting threshold is reached, the decision at stake is carried out by self-executing code.[19] This new mode of governance enables the creation of economic structures which cannot be controlled by any single constituency, and could thus be leveraged to enact a move towards more democratic business forms.[20]

These technological developments are, however, not the only disruptors of the existing antitrust framework. The rise of the digital platforms labeled as 'big tech' and the current wave of antitrust enforcement dedicated to containing their power have rekindled anti-bigness sentiments,[21] putting into question antitrust's preference for large firms as modes of organizing economic activity. Nonetheless, with the exception of the recent attitudes towards big

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[14] Lamoreaux and others (n 12) 7 (arguing that 'the intermediate form, between firms and markets, is important enough to be identified as a third major type of coordination mechanism').

[15] The concept was coined by Powell (n 13) and taken over, amongst others, by D. Gordon Smith, 'The Exit Structure of Strategic Alliances' (2005) University of Illinois Law Review 303.

[16] Marion Schultes, 'Company Networks and the Dichotomy and Statics of Competition Law—a Combined Dynamic Control of Conduct and Structure as a Solution Approach' in Stefanie Jung, Peter Krebs and Gunter Teubner, *Business Networks Reloaded* (Nomos 2015) 198 (and the other contributions to the volume); Matthew Elliott and Andrea Galeotti, 'The Role of Networks in Antitrust Investigations' (2019) 35(4) Oxford Review of Economic Policy 614.

[17] 'How Technology is Redrawing the Boundaries of the Firm', *The Economist* (8 January 2023) https://www.economist.com/business/2023/01/08/how-technology-is-redrawing-the-boundaries-of-the-firm accessed 7 September 2023.

[18] Larry Hirschhorn and Thomas Gilmore, 'The New Boundaries of the "Boundaryless" Company' Harvard Business Review, May-June 1992, https://hbr.org/1992/05/the-new-boundaries-of-the-boundaryless-company accessed 10 July 2023.

[19] Samer Hassan and Primavera De Filippi, 'Decentralized Autonomous Organizations' (2020) 10(2) Internet Policy Review, https://policyreview.info/glossary/DAO accessed 15 October 2023.

[20] Olivier Rikken, Marijn Janssen and Zenlin Kwee, 'Governance Challenges of Blockchain and Decentralized Autonomous Organizations' (2019) 24(4) Information Polity 397 (exploring the governance mechanisms of decentralized autonomous organizations).

[21] Lina Khan, 'Amazon's Antitrust Paradox' (2017) 126 Yale Law Journal 710 (arguing that Amazon's rise to dominance proves the incapacity of the current antitrust framework to target its dominance and suggesting a revival of traditional antitrust policy principles).

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tech,[22] antitrust laws both in the EU and the US are still tailored to the image of the large, vertically integrated firm, opening up limited space for alternative modes of economic organization. Building on this desynchronization, the aim of this chapter is threefold. First, it seeks to explain why antitrust laws privilege firms in general, and the large firm in particular, as the default mode of organizing economic activity. The argument put forward is that antitrust's current preference for firms and this particular vision of the firm is based on an efficiency calculus, according to which this mode of organizing economic activity is perceived as more efficient than others.[23] Second, it shows that the modes of economic organization introduced above—strategic alliances and DAOs—produce significant efficiency gains. Given these efficiency gains, the antitrust framework should fine-tune its cost-benefit analysis and adapt to these new entities. Third, it discusses briefly how the law can be tweaked to allow the functioning of these new modes of organization. There are two possible legal interventions: 1) an unorthodox one of broadening antitrust's concept of the firm, and 2) a safer, preferred option of opening up the antitrust framework to the recognition of more collaborative modes of production as valid organizational modes whose functioning would be allowed subject to *ex ante* approval akin to the merger control framework. The first option is discussed as a theoretical exercise in thinking beyond antitrust's fixed categories, and should be read as setting the groundwork for the second option. To a certain extent, the antitrust framework, both in the US and in the EU, already opens up space for inter-firm collaboration under the rule of reason and Art. 101(3) analysis, as well as under the constellation of block exemption regulations (BERs) in the EU and the guidelines for collaborations among competitors in the US.[24] This chapter argues that this analysis should be more capacious, providing more room for collaborative organizations.

It should be noted that both innovation networks and DAOs have significant non-efficiency benefits compared to traditional firms. Innovation networks can lead to a more collaborative economy, allowing small innovative players to benefit from joint projects with their larger counterparts without being absorbed through mergers. DAOs can provide an alternative economic governance model which gives a platform to counter-party voices (workers, community representatives, environmental activists, etc.). This chapter does not engage with these merits because there is little room under the existing antitrust framework for factoring them in. The aim is to show that, even remaining within the confines of the current efficiency-oriented paradigm, antitrust laws should be more open towards collaborative modes of production.

The chapter is structured as follows. Part I introduces the conceptual toolkit, which is leveraged throughout the chapter to explain the efficiency merits of different modes of organizing economic activity: the industrial organization (IO) literature on theories of the firm. Part II presents the vision of the organization of industry that antitrust builds on and the template of the standard antitrust firm. Part III elaborates on the functioning of innovation networks and DAOs and highlights the efficiency gains they bring about. Part IV builds on the efficiency

[22] The epitome of the backlash against big tech is the EU's adoption of the Digital Markets Act. *See* European Parliament and Council, 'Regulation on Contestable and Fair Markets in the Digital Sector and Amending Directives (EU) 2019/1937 and (EU) 2020/1828 (Digital Markets Act)' (2022).

[23] *See* Part I.1. below, particularly text to n 97.

[24] *See* Part IV.1. below, particularly text to n 35.

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advantages of these new modes of economic governance and discusses how the antitrust framework can be adapted to allow for their functioning.

2. THE ECONOMICS TOOLKIT

2.1 From Markets to Firms

One of the main questions economists have been trying to answer for the past decades is how industry—i.e., large-scale economic activity—should be organized to achieve allocative efficiency. If at the turn of the twentieth century the fundamental preoccupation of the discipline was determining the appropriate scope of governmental intervention in markets,[25] in the following decades the focus shifted to understanding how firms function and how their behavior impacts market dynamics. This new line of inquiry was prompted by an article published in 1937 by Ronald Coase, in which the author explains that there are two different modes of organizing economic activity: on the one hand, markets, where the allocation of resources is determined by the price mechanism, and on the other hand, firms, where the use of resources is directed by an entrepreneur.[26]

Coase's contribution is monumental for two reasons. First, up until then, economists had focused almost exclusively on making sense of the intricacies of the functioning of markets and had treated firms as black boxes that simply respond to the price mechanism and have no internal mechanics of their own.[27] Under this view, firms were mere transformers of inputs into outputs. Coase's first merit is to have shown how crude this image was and how little was known about firms. Second, having shown that firms exist alongside markets as different modes of organizing economic activity, Coase raised the question of why firms exist altogether—in other words, why doesn't all economic activity take place in the form of market interactions? When Coase wrote his article, markets were theorized as decentralized 'organisms' within which resources are allocated on the basis of the price mechanism, and the standard view was that 'the economic system works itself' and is 'under no central control.'[28] But Coase observed that firms are entirely different: inside the firm, market transactions are eliminated, and coordination happens through the 'conscious power' of the entrepreneur.[29] His dilemma was why such 'islands of conscious power' emerge in the 'ocean of unconscious cooperation'[30]—or, in less lyrical terms, why do we witness centralized entities emerging in decentralized markets?

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[25] Harold Demsetz, 'The Theory of the Firm Revisited' (1988) 4(1) Journal of Law, Economics, & Organization 141, 142 (arguing that the debate that dominated economics and led to the development of the perfect competition model was 'about the proper scope of government in economic affairs').

[26] Ronald Coase, 'The Nature of the Firm' (1937) 4(16) Economica 386.

[27] Carlo Cristiano, 'Theories of the Firm in England Before Coase: Stemming the Tide of "Rationalization" on the Eve of "The Nature of the Firm"' (2015) 37(4) Journal of the History of Economic Thought 597 (surveying the economic literature on firms that preceded Coase).

[28] ibid 387.

[29] ibid 388.

[30] ibid (quoting D. H. Robertson).

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This question gave rise to an entire body of literature dedicated to making sense of why firms exist, how they work, and how they differ from markets, called 'the theory of the firm.'[31] This literature is key for understanding the relative efficiency merits of various modes of organizing economic activity, as well as the difference between organizing economic activity on markets or within firms. We turn to this literature next, looking at 1) the efficiency gains of firms, and 2) the differences between firms and markets.

2.2 The Efficiency Gains of Firms: Avoiding Transaction Costs and Hold-ups

Why do firms emerge, when economic activity could take place entirely in markets? Looking at the functioning of markets, Coase observed that relying on the price mechanism to coordinate economic activity is not costless.[32] Discovering the relevant prices, haggling, and negotiating contracts for every exchange gives rise to significant costs, which have been subsequently labeled as 'transaction costs.'[33] But these costs do not apply to the functioning of firms. Recall that instead of coordinating their economic activity based on prices, firms are managed by entrepreneurs who make decisions on inputs, outputs, and production methods. Reliance on entrepreneurs bypasses the costs associated with market exchanges: instead of bargaining between different departments and divisions, inside firms resources are directed according to entrepreneurial decisions. Coase observed that this helps save the transaction costs introduced above, rendering firms more efficient than markets at carrying out certain activities.[34]

Yet, firms cannot expand endlessly. As firms grow too large, there are diminishing returns to management, because entrepreneurial oversight capacity is limited. When divisions that are too detached from the center are not well managed, it is necessary to outsource the aspects of the production function they are responsible for to external firms and organize those activities as market-based interactions. Building on this dynamic, the key question Coase asked is the following: is it cheaper to carry out a transaction in a market, through arm's-length bargaining, or to integrate it within the boundaries of a firm?[35] This question is, in fact an efficiency calculus, which seeks to determine which mode of organizing economic activity is less costly and hence more operationally efficient. This efficiency calculus is referred to as the make-or-buy decision: should firms 'make' the inputs they need, or should they 'buy' them from external sources through market transactions?[36]

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[31] Nicolai J. Foss, Henrik Lando and Steen Thomsen, 'The Theory of the Firm' in Boudewijn Bouckaert and Gerrit De Geest (eds), *Encyclopedia of Law and Economics, Volume III: The Regulation of Contracts* (Edward Elgar 2000) 632.

[32] Coase (n 26) 402.

[33] Oliver E. Williamson, 'The Economics of Organization: The Transaction Cost Approach' (1981) 87(3) American Journal of Sociology 548 (arguing that 'the transaction cost approach to the study of economic organization regards the transaction as the basic unit of analysis and holds that an understanding of transaction cost economizing is central to the study of organizations.').

[34] Coase (n 26) 403.

[35] Coase (n 26) 390 ('our task is to attempt to discover why a firm emerges at all in a specialised exchange economy'; 'the main reason why it is profitable to establish a firm would seem to be that there is a cost of using the price mechanism').

[36] For an overview of the literature on the make-or-buy decision, *see* Steven Tadelis, 'Complexity, Flexibility, and the Make-or-Buy Decision' (2002) 92(2) The American Economic Review 433.

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Nonetheless, reducing transaction costs is not the only efficiency advantage of firms. The property rights theory of the firm showcases another efficiency gain firms secure.[37] This theory presents firms as defined by the assets they own and the property rights attached to these assets. A firm is thus identified with the industrial plants it owns, including all the tools, equipment, and immaterial assets required for its production function. In its most radical rendition, this theory views firms as 'collections of assets.'[38] It is intuitive that firms need assets for their production functions. But going back to the Coasean firm-or-market decision, how is asset ownership different from the alternative of relying on assets owned by other firms and renting them through market contracts?

The property rights theory is based on the assumption that market contracts are 'incomplete,' in the sense that they can never fully capture all possible contingencies.[39] When unforeseen circumstances arise, conflicts on how assets are to be used and at what costs are likely. For example, to handle a natural emergency requiring production at extra capacity, firms renting machinery need to renegotiate the terms of the contracts. In such cases, the owners of essential machinery have strong incentives to require compensation well beyond mutually advantageous levels. This means that relying on contractual dealings for accessing necessary assets is inherently risky. But on top of unforeseen circumstances, there are other risks which render contractual dealings costly. Think, for instance, of a firm that rents out complex physical machinery that is tailored to the production function of another firm and cannot be utilized by any other firms. At the outset, the renting firm will enter into a contract with the producing firm which will be mutually advantageous for both parties and will incentivize the producing firm to invest in customizing the asset. But once a commitment is made, the asset cannot be redeployed in any other business relationship, and the renting firm can leverage its position as a unique trading partner to extract more favorable terms from the producing firm. This phenomenon is referred to in the literature as the threat of 'hold-ups:' after a contract is completed, the party with the superior bargaining power can always impose more onerous conditions on its contractual partner.[40]

How does ownership solve these issues? As to the problem of contingencies, asset owners are always in the position to make decisions that have not otherwise been made in contractual negotiations.[41] According to Oliver Hart and Sanford Grossman, this is the essence of

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[37] For an overview of this theory, *see* Armen A. Alchian and Harold Demsetz, 'Production, Information Costs, and Economic Organization' (1972) 62(5) The American Economic Review 777; Eirik G. Furubotn and Svetozar Pejovich, 'Property Rights and Economic Theory: A Survey of Recent Literature' (1972) 10(4) Journal of Economic Literature 1137.

[38] John Moore, 'The Firm as a Collection of Assets' (1992) 36 European Economic Review 493.

[39] Oliver Hart and John Moore, 'Foundations of Incomplete Contracts' (1999) 66(1) The Review of Economic Studies 115 (offering an economic analysis of contractual incompleteness); Ian Ayres and Robert Gertner, 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules' (1989) 99 Yale Law Journal 87 (offering a legal account).

[40] Oliver E. Williamson, *Markets and Hierarchies, Analysis and Antitrust Implications: A Study in the Economics of Internal Organization* (The Free Press 1975) 25.

[41] Sanford J. Grossman and Oliver Hart, 'The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration' (1986) 94(4) Journal of Political Economy 691.

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ownership: the capacity to decide on the undecided.[42] If an emergency not foreseen in the initial contract requires machinery to be used at 120% capacity, it is the owner of the machinery—not the contractual lessee—who decides whether the machinery will be deployed at excess capacity. As to the threat of hold-ups, ownership erases it altogether. Bringing us back to Coase's insight that firms bypass the price mechanism when a firm owns the assets it needs for its production function, it is under no risk that it will need to pay itself more to use the requisite assets. This is why, particularly in cases where the assets at stake are tailored to the production function of a specific business partner, efficiency considerations demand that the idiosyncratic asset should be owned by the producing firm. This is one of the key reasons why firms have historically tended to integrate vertically backwards, acquiring their suppliers of key inputs.

2.3 Firm-or-Market, or Firm-like and Market-like?

Coase detached firms from market dynamics and explained that they are alternative modes of organizing economic activity. But are firms that different from markets? Contrary to the theories discussed so far, the nexus of contracts theory proposed by Michael Jensen and William Meckling claims that the distinction is not that sharp.[43] Under this view, drawing a hard line between firms and markets is misguided because firms are just special kinds of market contracting. The key difference between firms and regular market contracts is one of degree rather than kind. Instead of creating different modes of organizing economic activity altogether, firms can be distinguished from regular contracts by their long-term nature, given that they require a continuity of association between the firm and the owners of inputs with whom the firm contracts, such as suppliers and employees. The theory highlights that key stakeholders of the firm, from workers providing input labor to customers purchasing outputs, are not located inside the firm but tied to it by contractual relations. Consequently, it makes little sense to talk about firms as distinctive organizational entities. The firm-market distinction collapses into a spectrum in which certain contracts can be characterized as being more firm-like, but there are no such things as firms. As Jensen and Meckling put it, 'there is in a very real sense only a multitude of complex relationships (i.e. contracts) between the legal fiction of the firm and the owners of […] inputs and the consumers of the firm's outputs.'[44]

This theory is useful for conceptualizing economic and technological phenomena which render the boundaries of firms more porous. Since firms are just bundles of contracts and transactions, these bundles can take a multiplicity of forms, varying from rigid, long-term contracts with stable providers of workforce and inputs to looser associations with constituencies that change frequently. This point can be traced back to Oliver Williamson, who claimed that the most granular unit in the organization of industry is not the firm, but rather each individual transaction. Starting from transactions as the relevant unit of analysis, Williamson observed that they can be governed through various structures, ranging from mixes of contractual, market-based mechanisms to centralized structures that are closer to the Coasean

[42] ibid (making the argument that ownership is 'the purchase of residual rights' which allows the owner to decide how to deal with unforeseen circumstances).

[43] Michael C. Jensen and William H. Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3(4) Journal of Financial Economics 305.

[44] ibid 311.

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vision of the firm run by an entrepreneur.[45] This is a key insight to which we circle back in Part III, when discussing the efficiency merits of hybrid modes of organizing production that are neither firms nor pure market transactions.

The fundamental merit of the nexus of contract theory is that it puts forward a vision of the organization of industry which moves beyond the firm-or-market binary, opening up space for the recognition of hybrid modes of organization. Nonetheless, two key points are not addressed by this theory. First of all, as the property rights theory emphasizes, not all relationships that firms enter into are of a contractual nature: the firm can also act as an owner of assets, and asset ownership is far from inconsequential for the firm's operational efficiency. This is why Jensen and Meckling's contribution is associated less with the view of the firm as a nexus *of* contracts and more with that of a nexus *for* contracts, introduced in passing in the same article and unfortunately not elaborated upon.[46] This view is more reflective of the fact that most firms are legally organized not as free-floating bundles of contracts, but take the corporate form: a 'standard-form legal entity'[47] which comes with several features that cannot be replicated by market contracting, such as asset partitioning, which separates the assets of the firm from those of its owners and vice versa, and transferable shares, which allow the firm to continue its operation uninterruptedly as the identity of its owners changes.[48]

Second, and relatedly, reducing the firm to a nexus of contracts—as opposed to a nexus *for* contracts—fails to account for the impact of the legal forms firms take. As the next part elaborates, the legal forms chosen for carrying out business operations impact operational efficiency through the different regulatory regimes they are subjected to. When it comes to antitrust law, the impact of organizational forms is distinctly intricate: antitrust has its own approach to defining economic entities, with important implications for the degree of freedom they enjoy under the antitrust framework. We turn to it in the next Part.

3. ANTITRUST'S VISION OF THE ORGANIZATION OF INDUSTRY

Antitrust law has an implicit vision of how economic activity should be organized in order to maximize allocative efficiency. This vision has two dimensions, which are explored in-depth below. The first one is a technique for identifying the boundaries of economic entities, or, in simple words, what counts as a firm for antitrust purposes. This is a key aspect, because antitrust treats conduct which takes place within the boundaries of a single firm differently from that between separate firms. The second dimension is a template for the type of firm that antitrust considers most efficient. For the past few decades, the most efficient firm has been considered to be the large, vertically integrated enterprise, governed by centralized management.

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[45] Williamson (n 40).

[46] Jensen and Meckling (n 43) 311 ('The private corporation or firm is simply one form of legal fiction which serves as a nexus *for* contracting relationships,' own emphasis).

[47] Henry Hansmann and Reinier Kraakman, 'The Essential Role of Organizational Law' (2000) 110(3) The Yale Law 387, 390.

[48] Reinier Kraakman et al., *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd edition, Oxford University Press 2017) 1–15.

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Nonetheless, before expanding on these dimensions, two caveats are necessary. First, antitrust's vision of the standard firm is implicit because it transpires neither from statutes nor from case law; to unearth it, we need to connect different disparate threads. Second, this image is not set in stone. Quite the opposite: in the early decades of antitrust enforcement, particularly in the US, the template of the standard firm looked fundamentally different from the template that undergirds contemporary antitrust enforcement. However, the changing nature of this vision does not diminish the claims made in this chapter; in fact, it even strengthens them. The shifting nature of antitrust's vision of how economic activity should be organized shows that this vision is pegged to the dominant economic ideas of each period.[49] This means that if economic ideas are fine-tuned or replaced by new research, antitrust laws can adapt to them; consequently, the law could plug into these novel insights and adopt a new vision of how firms and market relationships should be structured.

3.1 Antitrust's Technique for Defining Firms and its Implications

The antitrust community has spent little time theorizing about firms. But this lack of engagement is not surprising. The firm is an economic concept, whereas antitrust laws operate with different— legal—concepts. Sections 1 and 2 of the Sherman Act apply to 'persons', which include 'corporations and associations existing under or authorized by the law.'[50] European competition law applies to 'undertakings,' defined as 'any entit[ies] engaged in an economic activity regardless of [their] legal status and the way in which [they are] financed.'[51] Out of all major jurisdictions, the South African Competition Act is the only one which mentions firms.[52] If antitrust laws have their own vocabulary, why is it necessary to talk about an economic notion, and what does this discussion bring to the argument of this chapter?

The schism between antitrust and economics is a byproduct of a lingering divide between market realities and the law's attempt to capture them. In economics, firms are the real-life producers of commodities which make exchange—and, ultimately, markets—possible. The theories of the firm discussed in Part I try to make sense of how these real-life producers function—they deal directly with market realities. On the other hand, different fields of law craft different concepts for regulating the activities of firms, and they deal with specific aspects of their functioning. The legal forms firms take are not inconsequential—they have significant implications for the degree of commercial freedom firms enjoy and the liability regimes they fall under. Organizing a firm as a corporation places it under a different regime of rights and obligations compared to organizing it as a partnership or a cooperative. This is an insight that goes back at least to Coase. In his seminal piece *The Nature of the Firm* he explained that the law is not organizationally blind: 'if we consider the operation of a sales tax, it is clear that it is a tax on market transactions and not on the same transactions organized within the firm.'[53] The organization of economic activities, as market-based or within firms, impacts the legal

[49] *See* Hovenkamp (n 8) (tracing the evolution of economic theory and the impact of the dominant views of each historical period on antitrust enforcement).

[50] Sherman Antitrust Act (1890) 15 U.S.C. §§ 1-38, §§1-2.

[51] Case C-41/90 *Klaus Höfner and Fritz Elser v Macrotron Gmbh* [1991] ECR I-1979, para 21.

[52] The Competition Act of 1998, Government Gazette No. 19412 Article 1(1)(ix) (the firm 'includes a person, partnership or a trust').

[53] Coase (n 26) 393.

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regime they fall under. Furthermore, there is no unitary legal form that firms take, but rather a plurality of legal shells which come with their own regulatory regimes. To give an example of regulatory affordances granted to certain legal forms but refused to others, the corporate form comes with asset partitioning, which grants firm owners the privilege of limited liability—contrastingly, this privilege is refused to owners of firms organized as partnerships.[54]

Furthermore, different fields of law employ different techniques for identifying what counts as a firm. The theories of the firm discussed in the previous Part, particularly Coase's account, placed significant emphasis on how the boundaries between firms and markets are drawn. Regulatory regimes also employ their own techniques for defining firms from the broader market dynamics they are part of. For instance, corporate law identifies each corporate person as a separate entity—a separate firm—regardless of whether it belongs to a broader corporate group. This means that even subsidiaries that are wholly owned by their parent companies are considered to be independent economic actors. Nonetheless, this is only the baseline rule. Once we zoom in on the intricacies of corporate law's treatment of firms, the picture is more complicated. In reality, corporate separateness is not upheld in all circumstances. Pargendler shows that the law sometimes 'peeks' behind corporate boundaries to assign rights and duties of the parent company to subsidiaries and vice versa. In such instances of 'veil peeking,' corporate law treats parents and subsidiaries as being one firm, proving that, in fact, 'corporate separateness is on-and-off.'[55]

Antitrust laws in the EU and the US employ different techniques for identifying the boundaries of economic actors. Both jurisdictions generally disregard 'legal formalities' in favor of economic realities and refuse the vocabulary of corporate law, employing the concepts of 'single economic entity' and 'undertaking' instead.[56] The use of these bespoke concepts has two functions. Firstly—and fundamentally to this chapter's argument—these concepts are used to define what counts for antitrust purposes as a firm. In identifying the reach of undertakings or single economic entities, antitrust is actually delineating the boundaries of firms, and thus also the boundaries between firms and other modes of organizing economic activity. As Florence Thépot put it, competition law 'draws the external boundaries of firms,' 'marking [them] as entities within a larger society.'[57] Secondly, these concepts are used in the EU to assign liability for antitrust infringements. Briefly, antitrust's disregard of corporate separateness means that in the EU, parents are frequently held liable for the conduct of subsidiaries

[54] Kraakman and others (n 48) 2 ('shareholders enjoy limited liability—while, say, general partners in a partnership do not').

[55] Mariana Pargendler, 'Veil Peeking: The Corporation as a Nexus for Regulation' (2021) 169 University of Pennsylvania Law Review 717, 724.

[56] Nonetheless, out of the two jurisdictions, the US has a stronger attachment to the corporate form and has a higher regard for separate legal personality, particularly in the context of the assignment of liability. *See* J. Matthew Schmitten, 'Antitrust's Single-Entity Doctrine: A Formalistic Approach for a Formalistic Rule' (2012) 46 Columbia Journal of Law and Social Problems 93 (providing a critical overview of the treatment of separate legal personality under US antitrust laws).

[57] Florence Thépot, *The Interaction Between Competition Law and Corporate Governance* (Cambridge University Press 2019) 34. *See* also Thibault Schrepel, *Blockchain + Antitrust: The Decentralization Formula* (Edward Elgar 2021) 94 (noting that 'the concept also plays the role of 'defining the firm's boundaries,' which is a 'necessary step in understanding competitive dynamics').

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they control.[58] The complexities of different degrees and mechanisms of parental control, as well as of corporate reorganizations, have produced an intricate body of case law creating a liability regime that is difficult to navigate. Since the granularities of the attribution of liability for antitrust infringements are not consequential to the argument that follows, we do not expand further on the topic.[59]

What is crucial is antitrust's technique for identifying the boundaries of firms. The 'firm' label functions not only as a sword, but also as a shield. As a sword, it extends liability across separate corporate entities for breaches of the antitrust rules: in the EU, entities which are legally separate from the perpetrators but belong to the same economic group—the same firm—can be held liable for antitrust violations. As a shield, it comes with 'group privilege:' intra-group agreements—or, in the vocabulary of US antitrust, intra-enterprise conspiracies—are not caught by Article 101 TFEU and Section 1 of the Sherman Act.[60] This doctrine best illustrates how competition law's baseline technique for identifying the boundaries of firms differs from the corporate law one. To competition law, organizational boundaries are far less consequential: as long as a subsidiary is controlled by a parent company, it is treated akin to a division of a single firm.[61] We do not view the functioning of firms as different departments 'agreeing' or 'conspiring' with each other and thus breaching the antitrust prohibition of cartels. Applying the same logic to collaborations between parent companies and their subsidiaries, they are considered incapable of conspiring since they are viewed as 'a single competitive force'[62] or as enjoying 'unity of purpose and a common design.'[63] In simple words, 'as a practical matter, there [is] no real difference between an unincorporated division of a corporation (for example, a sales department) and a wholly owned, separately incorporated subsidiary.'[64]

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[58] The language employed by the EU courts and the Commission focuses on control by using proxies such as 'decisional independence,' 'autonomy,' and 'freedom.' For decisional independence, *see* C-107/82 *AEG-Telefunken v Commission* [1983] ECR I-03151, para 49 ('the fact that a subsidiary has separate legal personality is not sufficient to exclude the possibility of imputing its conduct to the parent company; particularly so where the subsidiary […] *does not decide independently* upon its own conduct on the market,' own emphasis). For autonomy, *see* C-73/95 *Viho Europe BV v Commission* [1996] ECR I-05457, para 13 (the parent 'and its fully owned subsidiaries form a single economic unit within which the subsidiaries *do not enjoy real autonomy* in determining their course of action in the market,' own emphasis). For freedom, *see IJsselcentrale and others* (Case IV/32.732) Commission Decision 91/50/EEC OJ L28/32, para 23 ('the undertakings form an economic unit within which the subsidiary has *no real freedom* to determine its course of action on the market,' own emphasis).

[59] Please see chapters 7, 8 and 9 in the Handbook.

[60] David Bailey and Okeoghene Odudu, 'The Single Economic Entity Doctrine in EU Competition Law' (2014) 51(6) Common Market Law Review 1721 (providing an analysis of the mechanics in EU competition law); Herbert Hovenkamp, '*American Needle* and the Boundaries of the Firm in Antitrust Law' (2010) (University of Pennsylvania All Faculty Scholarship, 1833) available at https://scholarship.law.upenn.edu/faculty_scholarship/1833/ accessed September 2023 (providing an overview of the mechanics in US antitrust).

[61] This discussion is more nuanced in the US. *See* Hovenkamp (n 60) for an overview.

[62] Bailey and Odudu (n 60) 1723.

[63] *American Needle, Inc. v National Football League*, 560 U.S. 183 (2010), quoting *Copperweld v Independence Tube*, 467 U.S. 752, 771 (1984).

[64] Schmitten (n 56) 112.

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But there is more to the doctrine of intra-group agreements and intra-enterprise conspiracy than just shielding firms from Art. 101 or Section 1 liability. In allowing firms to coordinate their different departments—even when these departments are incorporated as separate subsidiaries—antitrust defines the limits of legal coordination. This is a key insight of a strand of scholarship recently revitalized by Sanjukta Paul, according to which, in defining the boundaries of firms, antitrust allocates 'coordination rights.'[65] The gist of this scholarship is that despite the fact that antitrust seeks to promote competition and is inherently skeptical towards forms of collaborative production, it allows and *encourages* the formation of firms. Thinking of firms as collaborations requires taking a step back from the entrenched practice of viewing them as unitary market actors. But in reality, firms bundle together various suppliers of inputs, including labor, and harness their collective energies.[66] This aspect was much more visible in the early days of antitrust enforcement—as mentioned in the introduction, in the 1898 case of *United States v Joint Traffic Association*, the Supreme Court addressed the question of whether the formation of corporations—which is the default legal form firms take—should be caught by Section 1 of the Sherman Act. Even if in the meantime (antitrust) lawyers have come to adopt almost exclusively a unitary view of firms, economists working on the theory of the firm paint a more nuanced picture. Highlighting their collaborative nature, Easterbrook and Fischel define firms as 'aggregation[s] of people banded together for a longer period of time'[67] and note that seeing them as unitary is a matter of convenience, not of economic reality. In their words, we think of the firm 'as an *it*' because it is 'convenient' to do so.[68]

Despite the fact that firms are also collaborative modes of production, antitrust allows their functioning, and in doing so, grants them certain affordances which are refused to other collaborative economic organizations. To understand how antitrust privileges firms, take the basic example of joint production. Antitrust allows joint production by independent market actors only under strict conditions,[69] whereas for firms, joint production represents the essence of their functioning: every output requires the collaboration of various departments and input providers. To home in on this, take the related example of setting market prices. Every firm *sets* the price of the commodity it sells as a routine business decision, whereas price *fixing* agreements by independent firms are considered a hardcore restriction of competition.[70]

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[65] Sanjukta Paul, 'Antitrust as Allocator of Coordination Rights' (2020) 67(2) UCLA Law Review 378 (arguing that antitrust, in allowing certain forms of organizing economic activity but prohibiting others, allocates coordination rights); *see* also Sanjukta Paul, 'On Firms' (2023) 90(2) The University of Chicago Law Review 579 (discussing antitrust's technique for defining what counts as a firm).

[66] Even if it is hard to see it as such, since firms are collaborative entities, allowing their functioning goes against antitrust's mission of promoting competition. For instance, in *National Cotton Oil Co. v Texas*, the Court declared that 'competition, not combination, should be the law of trade.': *National Cotton Oil Co. v.Texas*, 197 U.S. 115 (1905).

[67] Frank H. Easterbrook and Daniel R. Fischel, 'The Corporate Contract' (1989) 89(7) Columbia Law Review 1416, 1434.

[68] ibid, own emphasis.

[69] Carl Shapiro and Robert D. Willig, 'On the Antitrust Treatment of Production Joint Ventures' (1990) 4(3) Journal of Economic Perspectives 113 (exploring the US landscape); Luis Silva Morais, *Joint Ventures and EU Competition Law* (Hart Publishing 2014) (exploring the EU landscape).

[70] When undertaken by cartels, these business practices are considered the 'supreme evils' that competition laws are designed to prosecute. *Verizon Communications v Law Offices of Curtis V.*

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Nonetheless, the privilege of coordination rights antitrust bestows upon firms is not arbitrary. Despite the fact that these justifications are not articulated anywhere in the law, antitrust privileges firms in general—and a particular vision of the firm, which is explored in the next subpart—as modes of coordinating economic activity because of the efficiencies they bring about.

3.2 The Standard Antitrust Firm

Antitrust law does not only rely on a technique for identifying the boundaries of firms, but also on a template for how the ideal firm should look. This is not to say that antitrust enforcement has always been informed by a static, unchanged image of a standard firm. The claim made here is much more modest, namely that by bringing together different separate threads from the case law and the enforcement priorities of antitrust agencies, it is possible to discern how at different times the law was undergirded by different patterns of the firm. The evolution of these patterns was influenced primarily by the succession of economic theories, which brought with them various visions of ideal modes of organizing economic activity. A comprehensive survey of the succession of these images is beyond the scope of this chapter, and there is already extensive literature on the topic.[71]

For the purposes of our argument, it suffices to highlight that the current image of the standard firm is that of the large, vertically integrated, and managerially-directed enterprise. This image was transplanted from the US to the EU and is informed by the efficiency orientation which was plugged into the law from the 1970s onwards pursuant to the rise of the Chicago School.[72] Antitrust was repurposed as a consumer welfare enterprise, which came with the diktat that 'efficiency, however obtained, must have its way.'[73] Practices that were previously caught by the prohibition against monopolization, such as resale price maintenance[74] and non-price vertical restrictions,[75] were to be treated as efficiency producing and rarely (if ever) challenged. As to mergers, vertical integration was not perceived as problematic, since it would avoid double marginalization and lead to a mere 'realignment of trading partners:' previously independent firms are now fully embedded in the same production function.[76]

Trinko, 540 U.S. 398, 408 (2004).

[71] *See* Hovenkamp (n 8); William E. Kovacic and Carl Shapiro, 'Antitrust Policy: A Century of Economic and Legal Thinking' (2000) 14(1) Journal of Economic Perspectives 43; Lina Khan, 'The New Brandeis Movement: America's Antimonopoly Debate' (2018) 9(3) Journal of European Competition Law & Practice 131; Roger D. Blair and Daniel Sokol, 'Welfare Standards in U.S. and E.U. Antitrust Enforcement' (2013) 81 Fordham Law Review 2474, and the literature cited therein.

[72] Daniel Crane, 'Ordoliberalism and the Freiburg School' in Daniel Crane and Herbert Hovenkamp (eds), *The Making of Competition Policy: Legal and Economics Sources* (Oxford University Press 2013) 254 (arguing that 'in the last decade, European competition law has shifted considerably toward effects-based analysis').

[73] Robert Bork, *The Antitrust Paradox: a Policy at War with Itself* (Free Press 1978) 246.

[74] *Per se* rule eliminated in *Leegin Creative Leather Products, Inc. v PSKS, Inc.*, 551 U.S. 877 (2007).

[75] Vertical customer and territory restrictions became very difficult to challenge after *Continental Television v GTE Sylvania*, 433 U.S. 36 (1977).

[76] Mark Glick, 'Antitrust and Economic History: The Historic Failure of the Chicago School of Antitrust' (2019) Institute for New Economic Thinking, Working Paper No. 95, available at https://

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It is easy to see why the existing framework is tilted in favor of large firms. If the goal is efficiency, then large firms which benefit from economies of scale and scope seem best positioned to achieve it. The theories of the firm discussed in Part I provide explanatory tools for making sense of how these efficiencies are achieved. Moving from the general to the specific, the Coasean transaction cost framework explains that firms, because they rely on centralized management to allocate resources, bypass the costs associated with market transactions. Furthermore, the property rights theory showcases that vertical integration saves hold-up costs and the costs associated with negotiating how assets are to be used in unforeseen circumstances.

But are large, vertically integrated, managerially-directed firms the only economic organizations capable of securing these efficiencies? In the next Part, we argue that they are not. But before moving on, a caveat is necessary. Despite the fact that Chicago School economics and its corresponding vision of the large firm have informed antitrust for several decades, this consensus has frayed. Recent attitudes towards big tech on both sides of the Atlantic signal a potential shift away from efficiency and from the corresponding preference for large firms. Nonetheless, as clarified in the introduction, this does not impact our analysis: the point that antitrust should open up more room for collaborative modes of production holds true even within the confines of the current efficiency paradigm.

4. NEW MODES OF PRODUCTION AND THEIR EFFICIENCY GAINS

The theories of the firm discussed in Part I make the case that firms have significant efficiency gains compared to other modes of production. Recall that the property rights theory of the firm argues that firms need to integrate vertically to avoid hold-up threats and the costs associated with deciding on unforeseen circumstances. Nonetheless, this theory has a blind spot—it assumes that only integration in the form of ownership can mitigate these costs. This ignores a key feature of a relatively new mode of organizing economic activity: close relationships among firms pursuing innovative projects together that lead to the emergence of innovation networks. Innovation networks involve close collaborations between firms which include sharing material and immaterial assets, adjusting each other's production functions to mutual needs, and at times joint production. Firms integrated in such networks do not just engage in regular market exchanges, but 'collaborate together almost as closely as if they were a single corporation.'[77] Through prolonged and repeated collaboration, a positive externality emerges: participating firms learn how to work efficiently together, and this knowledge incentivizes them to safeguard their relationship and, conversely, to refrain from opportunistic behavior. Information about each other and how to work together is a commitment mechanism that serves a similar function to vertical integration—it prevents, to a certain extent, hold-up threats and minimizes the costs associated with deciding on asset use in the context of unforeseen circumstances.

www.ineteconomics.org/uploads/papers/WP_95-Glick-Antitrust.pdf accessed 1 October 2023.

[77] Pablo M. Baquero, *Networks of Collaborative Contracts for Innovation* (Hart Publishing 2022) 17.

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To highlight what makes innovation networks special, it is necessary to re-emphasize that they are dedicated to the pursuit of highly innovative projects. This aspect is crucial, because the production of innovation has certain special characteristics that enhance the synergies between collaborating firms and solidifies their commitment to their business relationship. When one of the contractual parties innovates, this gives rise to responsive innovation on the part of its counterparts that need to integrate the updated input into the production function. Gilson et al. have labeled this phenomenon 'innovation cascades:' innovation is not an insular event that can be attributed to an identifiable contractual party, but rather a 'cycle that becomes self-perpetuating' since 'innovation by one party requires coordination with a second party, whose response then requires adjustment by and further coordination with the first party.'[78] The outcome is that innovation happens across firm boundaries, and through continued collaboration, firms exchange information and know-how that enhance their innovation capabilities. To give an example of the operation of such a network, tire manufacturer Michelin engages in close relationships with its suppliers with the aim of 'creat[ing] value through innovating together.'[79] Furthermore, the firm is actively seeking to enlarge its innovation network, enabling interested parties to propose 'innovation partnerships.'[80]

Innovation networks are not the only disruptors of traditional modes of organizing economic activity. Another novel mode of economic governance that is challenging IO dogmas is the DAO. Given their novelty, there is no standard definition of DAOs; however, a brief survey of different attempts to define them manages to capture their distinctive nature. In technical terms, DAOs are 'networks of stakeholders with no central governing body' and 'which are regulated by a set of automatically enforceable rules on a public blockchain.'[81] In ordinary language, DAOs are 'congregations of strangers who are geographically dispersed but share a common goal.'[82]

DAOs hold the promise of providing a new form of economic governance that evades the strictures of traditional corporate forms. As opposed to managerially run corporations, DAOs seek to offer decentralized, democratic governance which is independent of any nucleus of centralized control.[83] To do so, they are run on the basis of rules that are embedded in smart contracts. These rules are agreed upon before the smart contract code is written, and once they are enshrined in code, they are not only hard—or even impossible—to modify, but also self-executing. The most important rules refer to how voting rights are allocated and what thresholds are required to trigger the self-execution of smart contracts. When the requisite threshold of votes is met, the transaction that was subjected to a vote is automatically executed. A

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[78] Ronald J. Gilson, Charles F. Sabel and Robert E. Scott, 'Contracting for Innovation: Vertical Disintegration and Interfirm Collaboration' (2009) 109 Columbia Law Review 431, 449.

[79] Michelin, 'Because Innovation Creates Value' available at https://purchasing.michelin.com/en/want-share-idea-innovation/ accessed 8 May 2024.

[80] ibid

[81] DAOstack, 'An Operating System for Collective Intelligence' (DAOstack White Paper, 2018) available at https://daostack.io/wp/DAOstack-White-Paper-en.pdf accessed 2 September 2023.

[82] Jonathan Ruane and Andrew McAfee, 'What a DAO can—and can't—do', Harvard Business Review (10 May 2022) available at https://hbr.org/2022/05/what-a-dao-can-and-cant-do accessed 28 August 2023.

[83] Usha Rodrigues, 'Law and the Blockchain' (2019) 104 Iowa Law Review 179 (offering an overview of the difference between traditional business associations, including corporations, and DAOs).

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real-world example of this mechanism is CityDAO's purchase of a plot of land in Wyoming, which happened pursuant to a virtual vote without any human intervention.[84]

Zooming in on the governance structure of DAOs, it is important to highlight that voting rights are granted exclusively to token holders. Despite the temptation of associating tokens with shares in traditional corporate structures, tokens are different in two key ways. On the one hand, they do not bestow any ownership rights on the DAO in the traditional sense, but only governance rights.[85] Furthermore, these tokens do not give rise to any returns on the profits the DAO may earn. In fact, tokens are de facto digital currencies issued by the DAO. What purchasers buy is a unit of exchange which can be instrumentalized towards achieving a goal, not a promise for future profits or an ownership stake. On the other hand, as opposed to shareholders who are called on to decide only on a handful of aspects of corporate governance and are detached from its day-to-day functioning, token holders collectively run the DAO.[86] Their operations cannot be dictated by any single stakeholder. All decisions are taken in accordance with the voting procedures established at the outset, and the smart contracts are self-enforceable.

The self-activating or 'autonomous' nature of DAOs, coupled with their democratic functioning, disrupts the Coasean vision of the firm as an entity that is run by a manager. Instead of relying on an entrepreneur, DAOs are governed by code that gauges the views of token holders and implements their decisions when the requisite voting thresholds are met. Yet the code is just an interface that mediates the collaboration of token holders. It can be best understood as an alternative to lengthy meetings where disagreements can lead to prolonged discussions. This analogy is particularly useful, since it shows that not only the presence of an entrepreneur can save transaction costs. Reliance on decision-making procedures that employ voting mechanisms, whose results are self-enforceable, eliminates the costs associated with organizing, mediating, and implementing collective decisions.

This is not to say that the functioning of DAOs is always smooth sailing. To begin with, DAOs are hard to reconcile with traditional legal entities due to their 'unowned' character. Since nobody owns and manages a DAO, questions ranging from assigning liability to paying taxes are difficult to answer. As Ruane and McAfee put it, 'knowing who you are dealing with' is a crucial prerequisite of most economic activity.[87] Given these features, DAOs are difficult to capture by existing legal categories and their regimes, and their operations occur overwhelmingly in unregulated spaces. On top of their ambiguous legal status, there are inherent limitations to relying on smart contracts as a governance mode. Crises and unforeseen events may require token holders to express their views 'off-chain'—i.e., beyond the voting mechanisms enshrined 'on-chain' in the smart contracts.[88] But using off-chain decision-making processes is tricky, as it puts into question the decentralized and autonomous nature of DAOs.

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[84] Ruane and McAfee (n 82). The purchase was made possible by the fact that DAOs can be legally registered in Wyoming. Nonetheless, as the article cited explains, it is unclear what legal claims—if any—the token holders have over the land.

[85] Rodrigues (n 83) 680.

[86] Wessel Reijers et al., 'Now the Code Runs Itself: On-chain and Off-chain Governance of Blockchain Technologies' (2021) 40 Topoi 821 (elaborating on the governance system of DAOs).

[87] Ruane and McAfee (n 82).

[88] Reijers (n 86) (providing an overview of 'The DAO' attack, i.e. a crisis undergone by a DAO which put into question the limits of code-based governance).

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There is an ongoing debate in the DAO community as to whether off-chain decision-making procedures should be used only to solve technical problems, or also substantive disagreements as to the goals the DAO seeks to achieve.

Nonetheless, these problems and limitations are commonplace for novel modes of organization: recall that at the turn of the twentieth century, the corporate form faced antitrust scrutiny under Section 1 of the Sherman Act.[89] Furthermore, it is a fact that the influence of DAOs follows an ascending trend. A website which tracks the number of existing DAOs recorded more than 19,000 as of September 2023; in May 2022, this number was as low as 5,000.[90] Legal developments solidify this trend. Notably, in July 2021, the state of Wyoming created a tailored form of limited liability company for DAOs, providing a jurisdictional home for entities seeking to legally formalize their existence.[91] Similar accommodations have been made by European jurisdictions, too.[92]

5. POSSIBLE ADJUSTMENTS

The previous Part has showcased that innovation networks and DAOs have efficiency gains that are comparable and, at times, superior to those of traditional firms. This Part explores how the antitrust framework can be tweaked in order to allow for their functioning. Under the existing regime, coordination between entities which do not count as a firm is treated almost as flatly illegal, with very limited space for collaborative modes of production, which are briefly discussed below. To go beyond these limitations, a possible solution would be to propose a new understanding of antitrust's concept of the firm, i.e., the undertaking in the EU and the single economic entity in the US. Nonetheless, taking this route at this stage could be a hurried and risky development, for several reasons underlined in the following section. In this sense, the discussion of this possibility should be read as a theoretical exercise in thinking beyond antitrust's current fixture and as instrumental in setting the groundwork for the second, preferred option. This second option is to recognize hybrid, non-firm entities as valid organizational options and to allow their functioning subject to *ex ante* approval, akin to the merger control framework.

5.1 Expanding the Undertaking or the Single Economic Entity

The concept of the firm in EU competition law—i.e., the undertaking—could prove malleable enough to respond to incremental changes in the organization of industry. This story does not hold true for the US notion of the single economic entity, though. This is because in the US, the test for identifying a single economic entity also includes the criterion of 'unity of interest,' according to which economic actors that have 'separate corporate consciousness' and whose commercial objectives are not overlapping do not constitute a single economic

[89] *United States v Joint Traffic Association* (n 3).

[90] DAOstack (n 81).

[91] Ruane and McAfee (n 82).

[92] Sven Riva, 'Decentralized Autonomous Organizations as Subjects of the Law—the Recognition of DAOs in the Swiss Legal Order' (2020) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3515229 accessed 10 November 2023.

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entity.[93] Consequently, even if separate entities have a shared objective with respect to a certain market conduct, such as fine-tuning a product together, the fact that their interests in, for instance, dividing the profits do not perfectly overlap prevents them from being considered a single entity.[94] This criterion appears to rule out the recognition of either innovation networks or DAOs as single economic entities. Neither the separate nodes in the network nor the DAO token holders can be assumed to have perfectly overlapping interests, although one can imagine scenarios where this could be the case, particularly for the DAOs.

In the EU, though, the concept of the undertaking can prove more capacious. A good illustration of its flexibility is the recent *Sumal* judgment of the European Court of Justice (ECJ). In this case, the ECJ established new criteria for deciding whether a parent and a subsidiary are to be considered as a unitary actor for the purpose of assigning liability for an antitrust violation. The criteria the court put forward are the existence of i) economic, organizational, and legal links tying the parent and the subsidiary, and ii) a specific link between the economic activity of that subsidiary and the subject matter of the infringement.[95] The facts of the case made it futile to rely on a control-centered understanding of the undertaking: since the subsidiary was to be held liable for the conduct of the parent, it was impossible to argue that the subsidiary controlled the parent. But based *inter alia* on the fact that the subsidiary and the parent commercialized the same product, the ECJ established the economic unity of the two. This ruling can be seen as opening the possibility for outlining a new vision of the firm in EU competition law as a production line engaged in bringing a certain commodity to the market.[96] Nonetheless, the case dealt only with the 'sword' function of the concept of the undertaking, i.e., that of expanding liability within a group entity. This takes us only halfway to the 'shield' function, which would grant coordination rights to groups engaged in a shared production function. Should the courts make this legal move, we could imagine a future in which innovation networks would be considered as undertakings and thus insulated from the threat of Art. 101 liability. However, this would not be without negative consequences. The drawback of this approach is that if an innovation network were to be recognized as an undertaking, different members of the network could be held liable for each other's conduct, thereby raising the costs of engaging in joint innovation.

When it comes to DAOs, it is an open question to what extent they could qualify as undertakings for the purposes of EU competition law. In the 2010 *Knauf Gips* case, the definition of the undertaking put forward in the context of assigning liability was that of 'a unitary organization of personal, tangible and intangible elements, which pursue a specific economic aim on a long-term basis.'[97] Given the decentralized and virtual nature of DAOs, as well as the shifting identity of token holders, it is hard to imagine that they could fit within this definition. Nonetheless, in the same case, the ECJ noted that the lack of a controlling voice and 'the pos-

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[93] *American Needle* (n 63).

[94] Hovenkamp (n 60); Schmitten (n 56).

[95] C-882/19 *Sumal SL v Mercedes Benz Trucks España* [2019] ECLI:EU:C:2021:800, para 51.

[96] This conceptualization is reminiscent of Gérard Debreu's theory, according to which firms are 'abstract producers:' 'when one abstracts from legal forms of organization (corporations, partnerships) and types of activity, one obtains the concept of a producer,' meaning 'an economic agent whose role is to choose (and carry out) a production plan.' *See* Gérard Debreu, *Theory of Value* (Wiley 1959) 37.

[97] C-407/08 P *Knauf Gips KG v European Commission* [2010] ECR I-06375, para 84.

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sibility of varying majorities forming within a group of companies does not, by itself, exclude the possibility of the existence of a single economic unit.'[98] This means that we can imagine a future in which economic entities lacking a controlling voice are recognized as undertakings. Furthermore, the lack of legal personality of DAOs should not pose an issue. In *Dansk Rørindustri,* the ECJ clarified that 'the concept of the undertaking does not require that the economic unit concerned have legal personality.'[99]

The problem with making predictions about whether DAOs could count as undertakings is that previous litigation focused exclusively on the corporate form and whether (controlling) shareholders are to be considered as undertakings. In *Casa di Risparmio di Firenze,* the ECJ ruled that 'the mere fact of holding shares, even controlling shareholdings, is insufficient to characterize as economic an activity of the entity holding those shares'[100] but that 'an entity which, owning controlling shareholdings in a company, actually exercises that control by involving itself directly or indirectly in the management thereof must be regarded as taking part in the economic activity carried out by the controlled undertaking.'[101] Translated to the DAO ecosystem, given the active involvement of token holders in day-to-day management, this could mean that the token holders and the DAO could be considered as an undertaking for purposes of EU competition law. On the other hand, it could also mean that token holders could count as *separate* undertakings and risk liability under Art. 101 TFEU, putting into question the legality of DAOs.

This brings us to the following question: should antitrust redefine its concept of the firm? This chapter has shown that the organization of industry is undergoing significant transformations which may question its firm-oriented framework. Nonetheless, such an approach may be premature for several reasons. First, as the literature on theories of the firm helps us understand, antitrust's preference for firms is backed by the reality that firms secure important efficiency gains. It is true that, as the previous Part has shown, some of these efficiencies can also achieved by intermediate forms of organization, through means that do not require full integration or centralized decision-making. But the realization that there are intermediate, neither-firm nor-market, modes of organizing economic activity that can be as or more efficient than firms at carrying out certain activities does not justify a wholesale redefinition of the concept of the firm—or at least, not yet. A broader reassessment of the concept of the firm would put into question antitrust's capacity to police coordinated conduct taking place across firm boundaries. Prohibiting inter-firm coordination is a key pillar of antitrust enforcement, and it prevents serious harms to consumers caused by output-limiting and price-fixing cartels. Loosening the boundaries of the concept of the firm to the point of labeling non-firm actors as undertakings or single economic entities risks blunting the law's capacity to reach harmful coordination. At the extreme, it also risks jeopardizing the merger control framework. If separate economic entities would not need to be considered as a firm to integrate their production functions, they could avoid merging for the sake of not coming under the scrutiny of antitrust agencies.

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98 ibid, para 56.

99 C-189/02 P *Dansk Rørindustri v Commission* [2005] ECLI:EU:C:2005:408, para 113.

100 C-222/04 *Casa di Risparmio di Firenze* [2006] ECLI:EU:C:2006:8, para 111.

101 ibid, para 112.

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5.2 Granting Coordination Rights Beyond the Boundaries of the Firm

Nonetheless, inter-firm coordination—or coordination between different economic actors in forms that do not fit within the framework of the firm—can have significant economic benefits. As the previous section has shown, in highly innovative industries, inter-firm collaboration can speed the pace of innovation by allowing firms to access assets and know-how located beyond their boundaries, while focusing their internal production functions on the commodities for which they can maintain cutting-edge technology. Furthermore, DAOs can economize both the costs associated with centralized management and those flowing from traditional democratic decision-making processes which leave room for disagreement.

An alternative avenue for enabling the functioning of these novel structures would be to recognize them as valid organizational alternatives to complete integration in the form of mergers. In practice, this may require the creation of a new form which would exist alongside the undertaking / the single economic entity and would be granted coordination rights and, consequently, insulated from liability for cartel-like behavior. This is not to say that under the current framework, collaborative structures are automatically caught by the prohibition of coordinated conduct. There are already two mechanisms in place which testify to antitrust's potential openness towards inter-firm collaborations / non-firm structures. First, Article 101 and Section 1 provide for a case-by-case efficiency assessment under which individual practices are allowed to continue provided that their benefits outweigh their costs. Second, both the EU and the US provide safe harbors for certain types of collaborative structures provided that the joint market shares of the collaborating parties are below a certain threshold. The system in the EU is more structured, comprising a series of BERs tailored to different types of agreements, whereas in the US there are looser guidelines for collaboration among competitors.[102] In the same vein, antitrust jurisdictions worldwide grant exemptions from liability for coordinated conduct to handle crisis situations, a prominent illustration thereof being the lenient treatment of inter-firm collaboration in strategic sectors during the Covid pandemic.[103]

Nonetheless, these existing pockets for inter-firm collaboration are unsatisfactory. On the one hand, the assessment under Article 101 / Section 1 is *ex post* and case-by-case, meaning that it does not provide any legal certainty for parties beyond those immediately involved in the dispute, and even for those it is limited to the agreement or configuration at stake. The *ex post* nature also means that actors willing to rely on these hybrid structures face the looming threat of potential antitrust liability, which provides a significant disincentive from using them

[102] In the EU, the Horizontal Block Exemption Regulation for Research & Development Agreements allows collaboration between competitors for innovation purposes, provided that the combined market share of the collaborating firms is below 25%. In the US, the joint FTC and DOJ Guidelines for Collaborations Among Competitors stipulate a safety zone below 20%. Commission Regulation (EU) 2023/1066 of 1 June 2023 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of research and development agreements [2023] OJ L143/9; Fair Trade Commission and US Department of Justice, 'Antitrust Guidelines for Collaborations Among Competitors' (April 2000) 5.

[103] *See*, for instance, International Competition Network, 'ICN Steering Group Statement: Competition during and after the COVID-19 Pandemic' (April 2020) https://www.internationalcompetitionnetwork.org/wp-content/uploads/2020/04/SG-Covid19Statement-April2020.pdf accessed 30 December 2023.

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to begin with. On the other hand, the BERs and safe harbors operate on the basis of structural presumptions regarding what collaborations can be considered harmless to competition based on their market shares. Given the novelty of the forms of organization analyzed in this chapter, such structural presumptions are premature and could end up throwing into the uncertainty of Article 101 / Section 1 assessment collaborations which should be allowed to function without the threat of liability.

A preferred approach would be to recognize these collaborative, intermediate forms as a *sui generis* mode of industrial organization and to require their *ex ante* approval in a fashion similar to the merger control framework. This proposal is less revolutionary than it may sound at first read. The merger control system was added to the US antitrust toolkit as a supplement to the prohibition of cartels and monopolization pursuant to certain developments in state corporate law which have led to the proliferation of mergers.[104] Again, this example shows that antitrust has gradually recognized and regulated new forms of industrial organization as they gained traction, as part of its attempt to stay synchronized with market developments. We can imagine a scenario where business networks for innovation and DAOs are recognized as modes of industrial organization in their own right, not as deviations from the standard firm pattern. In this scenario, their members / token holders can request antitrust immunity from Article 101 / Section 1 in the same fashion in which parties to proposed mergers do.

6. CONCLUSION

In an article written at the turn of the past century, George Bittlingmayer notes that 'if competition or the search for efficient forms govern structure, [then] the scope of firms, the extent of cooperation between firms and the emergence of hybrid forms […] will be governed by their relative costs.'[105] The spirit of this quote perfectly encapsulates the argument of this chapter. Assuming that the types of economic organizations enabled by the antitrust framework are governed by an efficiency calculus, it is time for antitrust to open up its structure towards novel forms that bring non-trivial efficiency gains. This is not a novel argument. Business law, from corporate law to antitrust, has been in constant adaptation to technological and managerial innovations. This chapter argues that we are at yet another inflection point at which antitrust needs to fine-tune its efficiency calculus and open up its framework to allow for the functioning of two hybrid modes of organization: innovation networks and DAOs. The preferred legal move is not to expand antitrust's concept of the firm, but rather to grant these hybrid entities *ex ante* the possibility to collaborate subject to a cost-benefit analysis.

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[104] For a historical overview of this development, see Daniel Crane, 'The Dissociation of Incorporation and Regulation in the Progressive Era and the New Deal' in Naomi R. Lamoreaux and William J. Novak (eds), *Corporations and American Democracy* (Harvard University Press 2017) 109; Eric Hilt, 'Corporation Law and the Shift toward Open Access in the Antebellum United States' in Naomi R. Lamoreaux and John Joseph Wallis, *Organizations, Civil Society, and the Roots of Development* (University of Chicago Press 2017) 147.

[105] George Bittlingmayer, 'Antitrust and Business Activity: The First Quarter Century' (1996) 70(3) The Business History Review 363, 367.

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PART IV

CORPORATE GOVERNANCE AND ANTITRUST COMPLIANCE AND ENFORCEMENT

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19. When Bad Things Happen in Good Business: The Need for Compliance Focused Antitrust Enforcement

Andreas Stephan

1. INTRODUCTION

The rise of competition law enforcement globally has prompted significant investment in antitrust specific compliance measures among the world's largest businesses.[1] The need to take compliance seriously has been heightened by both increases in the level of fines imposed by established competition authorities like the European Commission, and the emergence of newer antitrust jurisdictions that are also increasingly active in international enforcement. The additional potential for private actions for damages and reputational harm, help make the case for significant compliance investment all the more compelling. There has also been a very significant increase in business regulation more generally since the 1980s, that is increasingly creating positive compliance obligations.[2] Antitrust compliance measures appear to be strongest among large international corporations that are active in multiple jurisdictions, particularly those that have been subject to some public enforcement activity in the past.[3] By contrast, small and medium sized businesses appear significantly less likely to invest in antitrust compliance or even have a good understanding of what competition law involves, unless they have a particularly proactive trade body or their industry has been subject to enforcement.[4]

The design of an effective antitrust compliance programme and the appropriate level of resourcing depends on the characteristics of the business and the market(s) in which it operates.[5] The starting point will generally be a risk assessment of the likelihood of anticompetitive behaviour. This will depend on a range of internal and external factors, from product characteristics to market share and the extent to which the business has to engage in legitimate communication with competitors. It is essential there is a strong commitment from top-level management to ensure compliance is embedded in the culture of the business and taken

[1] See for example: Gianni De Stefano and Andreas Stephan, 'Impact of Cartel Enforcement on Compliance in the Chemical Industry' (2023) 11(3) Journal of Antitrust Enforcement 400

[2] There is a vast literature on this topic related to the seminal work of John Braithwaite, 'Enforced Self-Regulation: A New Strategy for Corporate Crime Control' (1982) 80(7) Michigan Law Review 1466.

[3] Ibid.

[4] A report by ICM on behalf of the Competition and Markets Authority (2018); see also: UK businesses' understanding of Competition Law, a report prepared for the CMA by IFF Research (26 March 2015).

[5] 'The Elements of a Credible Compliance Programme' in Anne Riley, Andreas Stephan and Anny Tubbs (eds), *Perspectives on Antitrust Compliance* (Concurrences 2022).

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seriously by managers.[6] Training and education are key to ensuring employees understand competition rules and a particular focus is needed on those who are involved in formulating competitive strategy, have contact with competitors, or who work in remote subsidiaries and divisions of the organisation. There should also be appropriate due diligence procedures in place to deal with risk associated with business relationships, such as with suppliers, industry bodies, customers, agents and any joint ventures or common distribution systems.[7] An equally important element of compliance is reporting and auditing mechanisms. A company should monitor its business practices on an ongoing basis and there should be clear and open ways in which employees can report possible risks, raise concerns, or simply seek guidance and advice on whether certain conduct is appropriate. This might occur naturally within management structures but should also include confidential and anonymous channels involving a compliance team.[8] The rapid development and use of automation mean that training and monitoring must also extend to the design and implementation of technology (such as pricing algorithms) and any third-party software that is also used by competitors.[9] However, technology can also allow for better monitoring, for example through the screening of big data.[10] Finally, it is essential that a business regularly reviews the risk assessment and its compliance programme, especially in dynamic industries or in the face of a rapidly evolving enforcement landscape.

Antitrust contrasts sharply with other areas of regulation by providing little or no emphasis on what measures a business took to comply with the law, or the role of individual decision-makers within it.[11] For example, Thépot points out how anti-corruption rules allow businesses to potentially escape liability altogether where they have implemented 'adequate procedures' to comply with the law.[12] This is not the case in competition law, where prohibitions do not contain any such compliance defence other than where parties are able to demonstrate resulting

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[6] See Siegwaart Lindenberg and others, 'Social Contagion and Goal Framing: The Sustainability of Rule Compliance' in Benjamin van Rooij and D. Daniel Sokol (eds), *The Cambridge Handbook of Compliance* (CUP 2021).

[7] See 'Bringing the Outside In – M&A, Joint Venture and Third Parties' in Riley, Stephan and Tubbs (n 5) 237.

[8] The 2019 EU Whistleblower Directive provides an added incentive for businesses to have such channels in place: Directive (EU) 2019/1937 of the European Parliament and of the Council of 23 October 2019 on the protection of persons who report breaches of the law [2019] OJ L305.

[9] Ariel Ezrachi and Maurice E. Stucke, 'Artificial Intelligence and Collusion: When Computers Inhibit Competition' (2017) Illinois Law Review 1785; Justin Johnson and D. Daniel Sokol, 'Understanding AI Collusion and Compliance' in van Rooij and Sokol (n 6); Rosa M. Abrantes-Metz and Albert D. Metz, 'Antitrust & Regulatory Compliance in the 21st Century: New Challenges, New Opportunities and the Role of AI' CPI Antitrust Chronicle, September 2023.

[10] Rosa M. Abrantes-Metz and Albert D. Metz, 'Screening as a "Must Have" Tool for Effective Antitrust Compliance Programmes' in Riley, Stephan and Tubbs (n 5); Joseph Harrington, 'Behavioural Screening and the Detection of Cartels' in Claus-Dieter Ehlermann and Isabela Atanasiu (eds), *European Competition Law Annual 2006: Enforcement of Prohibition of Cartels* (Hart Publishing 2007).

[11] Joseph Murphy, 'What Can Competition Law Enforcers Learn From Others?' in Riley, Stephan and Tubbs (n 5).

[12] Florence Thépot, 'Antitrust v. Anti-Corruption Policy Approaches to Compliance: Why Such a Gap?' CPI Antitrust Chronicle, June 2015 (2), citing Section 7(2) of the UK Bribery Act 2010.

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efficiencies or an objective justification for their conduct.[13] Absent these, two businesses party to the same infringement will face similar liability, even if one made honest efforts to comply with the law, while the other encouraged its employees to ignore it. A limited number of jurisdictions only recognise compliance as a mitigating factor when calculating the fine or require it as a prerequisite for granting leniency.[14] The approach now taken by the US Department of Justice, which goes further, will be discussed later in this chapter.

Despite offering no protection from liability where an infringement has occurred and is being investigated, larger businesses are nevertheless investing heavily in antitrust compliance because it yields two very important benefits.[15] First, it makes it less likely antitrust liability will arise within the business in the first place. A better understanding of the rules may also push employees to focus on beneficial forms of competition, such as helping to drive new and better-quality products, or better customer support. Second, where an infringement has occurred, compliance monitoring and reporting mechanisms make it more likely it will be detected early (thereby limiting the extent of the liability) and that the business will be rewarded for early cooperation with the competition authority. In their study of antitrust compliance following an intense period of cartel enforcement in the chemicals industry, De Stefano and Stephan find that those businesses that invested in compliance early may have had a significant advantage in being first through the door for subsequent investigations, thereby securing immunity or significant fine discounts under the EU's leniency programme.[16] These benefits also reduce possible liability in private enforcement, where actions for damages may be brought independently of whether a competition authority has taken enforcement action. The shorter the infringement due to internal detection mechanisms, the harder it will be for potential claimants to demonstrate there was any anticompetitive harm.

This chapter looks at why competition law infringements can occur even where a business has made serious efforts to comply with the law and calls for a compliance focused approach to antitrust enforcement – one that has regard for whether a business has reasonable compliance measures in place or where there is genuine uncertainty as to how the law applies. The current approach, common to most competition law regimes, is to view businesses as monoliths for whom compliance is an entirely internal matter and where all infringements of the law amount to failed compliance. This appears to rest on two assumptions: (i) that it is within the power of businesses to eliminate the risk of liability entirely when they commit

[13] See Case C-501/11 *Schindler Holding Ltd and Others v Commission* EU:C:2013:522, paras 139–144, where the Court of Justice of the European Union accepted the Commission's contention that the 'appropriate recompense for such a programme' is the absence of the infringement itself. For an overview of the arguments for and against taking compliance into account when calculating antitrust fines, see: Wouter Wils, 'Antitrust compliance programmes and optimal antitrust enforcement' (2013) 1(1) Journal of Antitrust Enforcement 52; and Damien Geradin, 'Antitrust compliance programmes and optimal antitrust enforcement: a reply to Wouter Wils' (2013) 1(2) Journal of Antitrust Enforcement 325.

[14] See for example the change in approach by the US Department of Justice: Ann O'Brien and Alyse F. Stach, 'US Department of Justice Antitrust Division Incentivises Investment in Corporate Compliance Programmes' in Riley, Stephan and Tubbs (n 5); see also OECD Roundtable on *Competition Compliance Programmes* (June 2021). Available at: https://www.oecd.org/daf/competition/competition-compliance-programmes.htm accessed 12 July 2024.

[15] De Stefano and Stephan (n 1).

[16] De Stefano and Stephan (n 1).

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to compliance with the law;[17] and (ii) that there is sufficient legal certainty for businesses to reliably distinguish lawful from unlawful conduct. This chapter demonstrates how both these assumptions are highly questionable in competition law. Section 2 identifies the practical limitations of antitrust compliance programmes and why infringements can occur despite the best efforts of an organisation. Section 3 discusses how the wide and often unpredictable application of competition rules can make it difficult for businesses to determine whether certain activities are illegal. This can lead to either under-compliance (where businesses calculate that the possibility of enforcement is remote enough to treat the behaviour as de facto legal) or over-compliance (where the fear of enforcement leads them to treat the behaviour as de facto illegal) depending on how they calculate risk. Section 4 then provides a preliminary outline of how a compliance focused approach to EU competition law enforcement might work and discusses the benefits it would bring in making enforcement fairer and more effective.

2. THE PRACTICAL LIMITS OF ANTITRUST COMPLIANCE

Even where an antitrust compliance programme is well-resourced and there is a strong institutional commitment to comply with the law, its effectiveness will always be subject to certain limitations. The first is that employees are not competition law experts, and there will be limits to their reasonable comprehension of how the rules work, especially if they are also required to complete a wide spectrum of other compliance training. The second is that employees can act in very irrational ways, and their perception of lawful conduct can be highly subjective and shaped by the pressures and incentives they are exposed to. The third is that competition law is generally concerned with punishing businesses and not individual decisionmakers within an organisation. This can make it very challenging to ensure the compliance message is underpinned by credible disciplinary procedures, especially in light of the incentives created by leniency programmes in cartel cases.

2.1 The Limits of Compliance Training

Speak with any university student who has completed a class in competition law, and they will likely tell you that aspects of the subject are complicated and difficult to grasp. Those responsible for compliance within an organisation have the formidable task of ensuring all relevant employees have a sound understanding of the key principles of competition law and how to spot behaviour that could potentially create risk. They must do this with finite (or often very limited) resources and fully engage employees who face an increasingly crowded array of compulsory compliance training. A typical employee in a large organisation might expect some training in: equality and diversity in the workplace; unconscious bias; data protection; cybersecurity; performance management/appraisal; health and safety; anti-money laundering; anti-bribery; competition law; and any professional or sector-specific regulatory requirements. Most businesses have responded to this challenge of 'compliance fatigue' by moving away from face-to-face training type exercises and are relying primarily on online repositories of

[17] See for example: Case T-343/06 *Shell Petroleum NV and others v European Commission* EU:T:2012:478, discussed later in this chapter. See also Florence Thépot, *The Interaction Between Competition Law and Corporate Governance: Opening the 'Black Box'* (CUP 2019) 158.

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interactive compliance training packages, that allow employees to complete the training when they have time and over a number of sessions at their convenience.[18]

How ever antitrust compliance training is designed or delivered, there are limits to employees' comprehension of the rules.[19] For example, they may understand that naked price-fixing and customer sharing are illegal but fail to grasp that less obvious arrangements will also fall foul of the law. A good example of this is the practice of 'cover pricing' uncovered in the UK construction industry. The illegality of bid-rigging (agreeing which company will win a competitive tender) was widely known in the industry from previous enforcement action, but it came as some shock to the vast majority of the companies under investigation (and in some cases, to their non-specialist legal representatives) that 'cover pricing' amounted to the same breach of the law. This is because any direct communication between competitors about their future pricing intentions is generally prohibited and treated as a 'hard-core' restriction of competition.[20] Cover pricing occurs where a firm bidding for a procurement contract (say, to build a school) contacts a competing construction company seeking a credible losing bid (a cover price). Typically, the motivation of the party seeking the cover bid is to participate in the process without winning the contract. This can occur because they do not have the capacity to undertake the work but want to ensure they are invited to take part in future tendering processes.[21] Cover pricing was a very common practice in a market that was characterised by frequent interactions between competitors through trade associations and also for the purposes of sub-contracting work for larger projects. The cover pricing case serves to highlight how wide antitrust prohibitions like Article 101 of the Treaty on the Functioning of the European Union (TFEU) are in scope and the fact that a mistaken belief or honest pursuit of some other lawful purpose alone, offers no defence to liability.[22]

One issue that compounds the limits of employees' understanding of antitrust rules, is the tension that exists between the objectives of competition law and the core aims of the business. The former strives for lower prices, while the latter is primarily concerned with increasing profits. This tension is particularly pronounced when dominant firms seek to develop strategies to avoid losing market share and profitability to new competition. As Ennis explains, traditional theories of business strategy generally focus on getting the firm as close as possible to

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[18] See Riley, Stephan and Tubbs (n 5) Chapter 3.

[19] See Benjamin van Rooij, 'Do People Know the Law? Empirical Evidence about Legal Knowledge and Its Implications for Compliance' in van Rooij and Sokol (n 6) 467.

[20] See Andreas Stephan, 'The Price-Fixer: Compliance Tales from the Other Side' in Riley, Stephan and Tubbs (n 5) 256.

[21] See Andreas Stephan and Morten Hviid, 'Cover Pricing and the Overreach of 'Object' Liability under Article 101 TFEU' (2015) 38(4) World Competition, discussing OFT Decision No. CA98/02/2009, Bid rigging in the construction industry in England, 21 September 2009 (Case CE/4327-04).

[22] See Case C-551/03 *General Motors BV v Commission of the European Communities* [2006] ECR I-3173, [2006] 5 CMLR 9, para 64; Case C-209/07 *Competition Authority v Beef Industry Development Society Ltd* [2008] ECR I-8637, [2009] 4 CMLR 310, para 21; the same point was made by the General Court in Cases T-49/02 etc *Brasserie Nationale SA v Commission* [2005] ECR II-3033, [2006] 4 CMLR 266, para 85. Richard Whish and David Bailey, *Competition Law* (10th edn, OUP 2021) 120.

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monopoly profit.[23] This can include competitor selection (where strategy is used to discourage competition in the market), product differentiation (making it harder for competitors to launch comparable products), and defensive strategies (that reduce the likelihood of successful entry by new competitors). He concludes that while business strategies taught to managers are in the main perfectly lawful, they can raise the risk of antitrust liability where businesses enjoy a dominant position. It may be necessary for managers to 'unlearn' or adapt some business school knowledge.

Competition law generally expects businesses to maintain and grow their profitability through innovation and improved efficiency, but this is not always easy to achieve. Take, for example, an industry that produces a good or service that is highly price sensitive, where there is little or no scope for innovation or product differentiation. Employees in such an industry may simultaneously face antitrust compliance training and also pressures (either internal or because of challenging market conditions) to improve sales and profitability. Even in the context of non-dominant firms, the tension between competition in the marketplace and business success can create significant risk. One example relates to unlawful so-called 'hub-and-spoke' and minimum price maintenance type outcomes. Marketing teams within a business generally 'tweak' products to keep them fresh and interesting for buyers. When these are presented to retailers, they may seek some assurances from the supplier that they will remain competitive if they accept the recommended price of the tweaked product. While in this situation the best course of action is to focus on the value of the tweak itself, marketing teams may be tempted to disclose information about arrangements with rival retailers or give assurances that no retailer will charge below a minimum price.[24] The dynamic observed here becomes even more problematic and uncertain where businesses employ algorithms or pricing software designed by third parties, that are possibly also used by competitors.[25]

These examples serve to illustrate how effective compliance requires employees to have a sophisticated understanding of how antitrust rules apply and how they impact their everyday work. Even where the application of those rules is clear as a matter of law, such a level of comprehension is hard to achieve in practice. For example, while employees might understand the harmful nature of a horizontal hard-core cartel, the rationale for prohibiting cover pricing or certain restrictive vertical conduct may be harder to fathom. To a marketing team, conduct that amounts to minimum resale price maintenance might seem essential to successfully launching a new or improved product among retailers.[26] So while compliance training will likely reduce the scope for the most blatant forms of antitrust infringement, there will be limits to employees' comprehension of how the rules apply, and the greatest risk will lie on the periphery of those prohibitions.

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[23] Sean F. Ennis, 'Business Strategy and Antitrust Compliance' in Riley, Stephan and Tubbs (n 5), 31.

[24] See Stephan (n 20) 259.

[25] See Ariel Ezrachi and Maurice E. Stucke, 'Algorithmic tacit collusion' in Peter Whelan, *Research Handbook on Cartels* (Edward Elgar 2023).

[26] For a discussion of this, see: Kenneth G. Elzinga and David E. Mills, 'The Economics of Resale Price Maintenance' (2008) 3 Issues in Competition Law and Policy 1841.

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2.2 Irrational Decision Making by Employees

Even if the limits to employees' comprehension of the law could be overcome, the idea that compliance programmes can effectively eliminate the risk of liability rests on the assumption that all employees within a business act rationally and in accordance with its internal policies and training. In reality, some employees may choose to ignore their compliance training and even make efforts to hide their activities from others in the business.[27] Neo-classical economic theory relies heavily on hyper-rational models of how businesses and consumers behave. Much of the economics literature on deterrence and leniency programmes rests on a central assumption that businesses constantly weigh up the benefits of collusion against the cost and likelihood of enforcement.[28] While these studies are very important in understanding how punishment and leniency ought to work, in practice the behaviour of individual decision-makers within a business can be highly unpredictable. This is something that is recognised in the growing literature of behavioural antitrust and the notion of 'bounded rationality', which acknowledges that rational behaviour is limited by intellectual, cognitive and other constraints that exist when a decision is made.[29] This is compounded by the tendency for individuals to resort to proxy rules and rules of thumb to navigate laws they do not fully understand.[30]

One key driver of irrational decision making in the context of competition is crisis. Many anticompetitive practices come about in response to either the threat of new competition, or a significant drop in demand within a particular market (or the wider economy) that leads to overcapacity and the danger of bankruptcy for at least one competitor.[31] As a result, anticompetitive agreements and abusive conduct can often be reactive and achieve very little.[32] This is because individuals' perception of wrongdoing can be strongly influenced by context and the pressures they are personally exposed to. As Feldman and Kaplan point out, decisionmakers within a business do not necessarily make a conscious choice to commit wrongdoing, but rather ignore or downplay the wrongfulness of their actions.[33] The danger of bankruptcy or

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[27] Andreas Stephan, 'See No Evil: Cartels and the Limits of Antitrust Compliance Programs' (2010) 31(8) Company Lawyer 231.

[28] See for example: Michael K. Block and Joseph G. Sidak, 'The Cost of Antitrust Deterrence: Why Not Hang A Price Fixer Now and Then?' (1980) 68(5) Georgetown Law Journal 1131–1140.

[29] See Amelia Fletcher, 'The Role of Behavioural Economics in Competition Policy' in *Cambridge Handbook of Theoretical Foundations of Antitrust and Competition Law* (CUP 2024). Draft available on SSRN: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4389681 accessed 12 July 2024; Richard Thaler, *Misbehaving: The Making of Behavioural Economics* (W. W. Norton, 2015; Penguin Books, 2016); David Currie, 'Homo Economicus and Homo Sapiens: The CMA Experience of Behavioural Economics', Speech, 21 April 2015, https://www.gov.uk/government/speeches/david-currie-speaks-about-the-cma-experience-of-behavioural-economics accessed 12 July 2024.

[30] Creg Pogarsky, 'Heuristics and Biases in the Criminology of Compliance' in van Rooij and Sokol (n 6) 531.

[31] Andreas Stephan, 'Price Fixing in Crisis: Implications of an Economic Downturn for Cartels and Enforcement' (2012) 35(3) World Competition 511.

[32] See for example: Case COMP/E-1/36.212 – Carbonless Paper [2004] OJ L115.

[33] Yuvel Feldman and Yotam Kaplan, 'Behavioral Ethics as Compliance' in van Rooij and Sokol (n 6) 50.

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of losing one's job because of underperformance becomes a matter of survival that justifies the behaviour.

This danger is compounded by how notions of right and wrong are not as strong in business misbehaviour as they are in relation to 'traditional' forms of wrongdoing.[34] Anticompetitive agreements often occur around industry body events and legitimate opportunities for competitors to meet, where the lines of acceptable behaviour with respect to competition can be easily blurred.[35] Similarly, market perceptions can also be important. For example, a perception that customers are taking advantage of an economic downturn to squeeze suppliers for a low price can serve to make cartel or abusive conduct more palatable.[36] Moreover, the fact anticompetitive behaviour primarily benefits the employer (in terms of profitability) and not the employee, makes it easier for the individual to justify than other forms of corporate wrongdoing, like embezzlement or bribery.[37]

2.3 Lack of Credible Punishment for Individual Decisionmakers

One of the biggest challenges to effective competition law compliance is the lack of credible punishment mechanisms for employees who fail to take antitrust compliance seriously, fail to seek guidance or use reporting methods, and particularly those who deliberately choose to break the law and attempt to hide it. While there has been enormous growth in both the number of jurisdictions enforcing competition law and in the size of the sanctions imposed, punishment is still overwhelmingly focused only on the business. The behaviour of individual employees is largely irrelevant, as even where individual sanctions exist, they are generally imposed infrequently or not at all.[38] The EU's approach to enforcement is that high corporate fines should ensure companies comply with the law. The Court of Justice of the European Union (CJEU) has repeatedly rejected attempts by businesses to mitigate their responsibility by arguing that the principal managers of the organisation were not aware the conduct was occurring, or that the conduct was committed by a 'rogue trader'.[39] For example, in Shell's appeal of the 2006 *Dutch Bitumen* cartel decision, it claimed the infringement was caused

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[34] See Robert J. Apel 'Deterrence Perceptions' in van Rooij and Sokol (n 6) Chapter 18.

[35] See Joseph E. Harrington, 'How Do Cartels Operate?' (2006) 2(1) Foundations and Trends in Microeconomics 1.

[36] See Andreas Stephan, 'The Cartel Trial: Issues of Dishonesty and Jury Nullification' (2023) 19(2) Journal of Competition Law and Economics 312. and also the characterisation of customers by members of the Lysine cartel: See James Lieber, *Rats in the Grain: The Dirty Tricks of Archer Daniels Midland, the Supermarket to the World* (Basic Books 2002).

[37] See for example the chat room exchanges by those involved in the manipulation of *Libor* and the defence arguments that were raised at trial. Libor rates could be changed for a Mars bar, court hears' (*BBC News,* 8 July 2015); see also *Hayes v R* [2015] EWCA Crim 1944.

[38] In the context of criminal cartel laws, see the comparative study in Terry Calvani and Rory Jones, 'Why do countries with criminal antitrust sanctions fail to incarcerate price fixers?' (2024) Journal of Antitrust Enforcement. E-publication ahead of print. Available at https://academic.oup.com/antitrust/advance-article-abstract/doi/10.1093/jaenfo/jnad050/7613871 accessed 12 July 2024; See also: Andreas Stephan, 'Four Key Challenges to the Successful Criminalisation of Cartel Laws (2014) 2(2) Journal of Antitrust Enforcement 333.

[39] See for example: Case C–68/12 *Protimonopolný úrad Slovenskej republiky v Slovenská sporiteľňa as* EU:C:2013:71, para 25. Discussed in Fabrizio Di Benedetto, 'The "Rogue Employee"

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by two rogue employees in their subsidiary, who had explicitly disregarded the training they had received.[40] As the UK's Competition Appeals Tribunal (CAT) has stated, any question of whether a single employee exceeded their authority while in the business's employment 'would be a contractual matter to be resolved [between them]'.[41] The focus on corporate fines coupled with the very wide meaning of 'undertaking' for the purposes of competition law in the EU and elsewhere,[42] mean even the largest of organisations are entirely liable for the actions of just one employee. As Arlen and Kraakman note, this standard strict vicarious liability approach can lead to some odd outcomes within a business, including the possibility of making internal investigations into past conduct less likely for fear of uncovering more liability.[43]

By focusing on the corporate entity alone, competition law risks creating a troubling misalignment of incentives within a business. Employees are told to take competition law seriously, but the only credible consequence is the imposition of corporate fines on the employer. By the time a fine is imposed (if at all), the employees may not even still be with the business.[44] Creating effective *internal* punishment mechanisms can be very challenging as a result, and their absence can make it more likely for employees to downplay the importance of following the rules and self-justify breaking them.[45] Some businesses have responded by seeking to mimic the criminal law in their own internal investigations and procedures.[46] This might include police style internal interviews and strict disciplinary procedures. However, the effectiveness of this approach is questionable.[47] For example, it might send out a strong deterrent message, but have a chilling effect on compliance reporting and employees' willingness to have informal discussions with their superiors about tricky compliance issues. In its appeal against a cartel fine, escalator manufacturer Schindler noted how its compliance system inadvertently '…made the internal discovery of infringements which had occurred more difficult, since the employees who had committed the infringements were under threat of serious penalties'.[48] Somewhat overlooking the true significance of this statement, in her Opinion, AG

Doesn't Exist: The "First Commandment" of an EU Antitrust Compliance Programme' in Riley, Stephan and Tubbs (n 5) Chapter 16.

[40] Case T-343/06 *Shell Petroleum NV and others v European Commission* EU:T:2012:478, paras 62–63.

[41] *Kier Group PLC and others v Office of Fair Trading* [2011] CAT 3, Annex to judgement, Part B, paras 10–11.

[42] Case 41/90 *Höfner and Elser v. Macroton GmbH* [1991] ECR I-1979.

[43] J Arlen and R Kraakman, 'Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes' (1997) 72(4) New York University Law Review 687; see also Stephen Daly and Alison Jones, 'The Undertaking and Single Entity Doctrine in EU and UK Competition Law: Proposals for a Refined Approach' – Chapter 7 in this Handbook.

[44] Andreas Stephan and Ali Nikpay, 'Leniency Decision-Making from a Corporate Perspective: Complex Realities' in Caron Beaton-Wells and Christopher Tran (eds), *Anti-Cartel Enforcement in a Contemporary Age: The Leniency Religion* (Hart Publishing 2015).

[45] Feldman and Kaplan (n 33).

[46] See for example: Todd Haugh, 'Criminalized Compliance' in van Rooij and Sokol (n 6) Chapter 11.

[47] Ibid, 133.

[48] Opinion of Advocate General Kokott, Case C-501/11P *Schindler Holding Ltd and Others v European Commission* EU:C:2013:522, fn 112.

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Kokott noted, 'it would be absurd to reward an undertaking for such a manifestly ineffective compliance programme with a more lenient fine'.[49]

Even softer approaches to disciplinary procedures can be made more difficult by the requirements of leniency programmes in cartel cases. The success of leniency in uncovering cartel arrangements is clear, with around two thirds of cartels investigated in the EU involving at least one leniency application by 2015.[50] As mentioned earlier, compliance programmes have helped businesses limit their antitrust liability by making it more likely they are either first to report a cartel in return for immunity, or among the first companies to cooperate in return for a significant discount in fines.[51] While leniency is often characterised as a 'race to the competition authority,' in reality, the decision to apply for leniency is not taken lightly. In a 2012 survey of 234 US antitrust lawyers undertaken by Sokol, most reported having had at least one client in the previous two years come to them with a serious cartel issue that did not go on to be investigated by the Department of Justice.[52] One of the main reasons leniency is less of a race in practice, is that a business first needs to gather as much information as they can about the alleged infringement to be confident of its extent and that it can actually be put to an end. This is important in determining whether the alleged conduct is serious enough to report to the competition authority, and whether enough information exists to cooperate meaningfully with any investigation. Typically, the most effective and expedient way of doing this is by enlisting the cooperation of the manager(s) responsible.[53] Indeed, leniency programmes generally create a positive obligation on the business applying for leniency to ensure the continued cooperation of both current and former employees, or risk leniency being withdrawn.[54] This very much undermines the credibility of any internal disciplinary procedure a business wishes to pursue alongside cooperating with the competition authority. When the consequences of their actions become clear, the employees responsible are likely to seek independent legal advice and make any cooperation with their employer contingent on certain conditions, such as an undertaking to not end their employment and an agreement to cover their legal expenses.[55]

Thus, competition law generally ignores the behaviour and role of individual employees who give rise to breaches of competition law and makes internal disciplinary measures more difficult because of the requirements of leniency programmes. Businesses therefore have to take a measured approach when it comes to influencing employee behaviour. For many, the priority has to be on monitoring, reporting and uncovering information, even if that is at

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[49] Ibid, para 185.

[50] Ibid.

[51] De Stefano and Stephan (n 1).

[52] D. Daniel Sokol, 'Cartels, Corporate Compliance, and What Practitioners Really Think About Enforcement' (2012) 78(1) Antitrust Law Journal 201.

[53] See discussion in Stephan (n 20).

[54] See: European Competition Network, 'ECN Model Leniency Programme' available at: https://ec.europa.eu/competition/ecn/model_leniency_en.pdf accessed 12 July 2024; Gary R. Spratling (Deputy Assistant Attorney General, Antitrust Division), 'The Corporate Leniency Policy: Answers to Recurring Question' (Speech to the ABA Antitrust Section Spring Meeting, Washington, DC, 1 April 1998).

[55] This is not unusual in the US, where immunity for the business extends to its employees. See Michael D. Hausfeld and others, 'Observations from the Field: ACPERA's First Five Years' (2009) 10 Sedona Conference Journal 95, 109.

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the expense of disciplining those who may have acted in a delinquent or reckless manner. Businesses have even gone as far as to offer a blanket immunity to employees to uncover the full extent of their liability and cooperate with the competition authority in a timely manner.[56]

3. UNCERTAINTY AS TO HOW COMPETITION RULES APPLY

The challenges described in Section 2 exist even if there is relative certainty (albeit with complexity) as to how competition rules apply. Compliance programmes are most effective where there are clear boundaries between lawful and unlawful behaviour that can be easily communicated to employees, and where the law and its enforcement remain stable over time. These are conditions that arguably do not hold true in competition law. There is not the space in this chapter to give a full and comprehensive analysis of uncertainty in competition law. Instead, this section provides some illustrative examples from EU competition law, focused around two themes: (i) the open-ended nature of prohibitions and the considerable discretion of competition authorities and courts; and (ii) the role of economic effects-based rules.

3.1 Open-Ended Prohibitions and Wide Discretion

Articles 101 and 102 TFEU contain a range of well-established prohibitions; however, the literal article wording does not reflect their full application today or how they might continue to evolve in the future. They contain illustrative, not exhaustive, lists of anticompetitive and abusive conduct, leaving the European Commission and the CJEU considerable discretion in shaping precisely how these rules apply to novel situations and new markets.

In the application of Article 101, there is still uncertainty as to where the line should be drawn between conduct that has the 'object' of restricting competition (and is therefore assumed to be harmful regardless of its effects) and conduct that should be considered as to its anticompetitive effect. The European Commission has repeatedly tried to push the boundaries of the 'object' box, even where the circumstances of the bilateral arrangements are complicated and overlap with legitimate exchanges. Presumably, this is because establishing liability on this basis is more straightforward than proving anticompetitive effect. The question of whether alleged conduct should be treated as a 'by object' restriction has usually fallen on the Court of Justice to determine, with shifting approaches over time.[57] The judgment in *T-Mobile* appeared to accept a very wide test for a 'by object' restriction, stating that 'it is sufficient that it has the potential to have a negative impact on competition'.[58] The Court of Justice eventually restored a narrower approach in *Groupement des Cartes Bancaires*.[59] They held that both the Commission and the General Court had erred in holding that a fee structure established by nine members of a payment card system had the object of restricting competition because it prevented new entry. It was held that in determining whether an agreement has the object of restricting competition,

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[56] De Stefano and Stephan (n 1).

[57] See in particular: Case C-209/07 *Beef Industry Development Society* EU:C:2008:643; Case C-8/08 *T-Mobile* EU:C:2009:343; Case C-67/13 P *Cartes Bancaires v Commission* EU:C:2014:2204.

[58] Case C-8/08 *T-Mobile v Commission* EU:C2009:343.

[59] Case C-67/13 *Groupement des Cartes Bancaires v Commission* EU:C:2014:2204.

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> regard must be had to the content of the provisions, its objectives and the economic and legal context of which it forms a part. When determining that context, it is also necessary to take into consideration the nature of the goods or services affected, as well as the real conditions of the functioning and structure of the market or markets in question (para 53).

This strand of case law highlights how competition law provisions are capable of expanding and contracting. The period between *T-Mobile* and *Cartes Bancaires* caused considerable uncertainty as to which side of the 'object' box a wide spectrum of arrangements between competitors would fall. This is a problem because, as noted in Advocate General Kokott's Opinion in *T-Mobile*, the existence of object restrictions, 'creates legal certainty and allows all market participants to adapt their conduct accordingly'.[60] Therefore clearly defining the boundaries of the object box is of great importance to legal certainty. While *Cartes Bancaires* and subsequent case law[61] has restored some discipline to this issue, it is still not entirely clear how much analysis is needed to determine with confidence how conduct on the fringes of Article 101 will be treated by the Commission or the CJEU.[62] While conduct that falls outside the object box can still have the *effect* of restricting competition, such cases are far less likely to be brought by competition authorities – so much so that cartel prohibitions hinging on effects are typically not enforced at all in most jurisdictions.

In principle, Article 101(3) TFEU is there to save beneficial practices (whether they fall under object or effect), to ensure they are not discouraged. Yet in practice, it is very difficult for businesses to determine with confidence whether conduct that could infringe Article 101(1) will meet the criteria of Article 101(3). This is because: (i) the efficiency exception operates on a self-assessed basis, meaning there is no possibility of seeking prior approval from the European Commission; (ii) the burden is on the business to satisfy the requirements of 101(3) and if they fail to do so then the liability under 101(1) still stands; and (iii) the inherent uncertainty and difficulty in satisfying all four of the 101(3) criteria. The reluctance among businesses to rely on Article 101(3) as a shield is illustrated by the apparent unwillingness among some competitors to engage with each other on legitimate goals like net zero and sustainability. A number of European competition authorities, including the Commission, have had to publish guidelines clarifying and reassuring businesses on how Article 101 (and equivalent prohibitions) will apply to sustainability initiatives, and how such arrangements can meet the four conditions of Article 101(3).[63] However, some believe these guidelines are ineffective without a more explicit carve out.[64]

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[60] Case C-08/08 Opinion of Advocate General Kokott in *T-Mobile v Commission* EU:C:2009:110 para 43.

[61] See Case C-345/14 *Maxima Latvija v Konkurences padome* EU:C:2015:784; Case C-228/18 *Gazdasági Versenyhivatal v Budapest Bank Nyrt. and Others* EU:C:2020:265.

[62] See discussion in Whish and Bailey (n 22) 129.

[63] European Commission, Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements [2003] OJ C259/1 at 9.2 and 9.4. Competition and Markets Authority, Draft guidance on the application of the Chapter I prohibition in the Competition Act 1998 to environmental sustainability agreements. Draft Guidance. 28 February 2023. CMA 177; Dutch Authority for Consumers & Markets, Guidelines on sustainability agreements. 16 January 2021.

[64] See for example, Edith Loozen, 'EU antitrust in support of the Green Deal. Why better is not good enough' (2024) 12(1) Journal of Antitrust Enforcement 75.

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The fact determinations of Article 101(3) have, since May 2004, been made by National Competition Authorities and courts (as well as the Commission itself) may have created further uncertainty as to its precise application.[65] The Commission's own studies of the functioning of Regulation 1/2003 found no major difficulties in national authorities applying Article 101(3). They report a 'substantial level of convergence' in the application of EU competition rules and appear to ascribe any divergence to procedural and institutional differences between Member States.[66] However, empirical work by Brook suggests there may be significant divergence in the substantive application of Article 101(3). Possibly fuelled by the lack of binding rules and spartan case law, Brook finds that national competition authorities and courts have adopted different approaches to the types of benefits that can be taken into account.[67] These findings have implications for the uniformity and coherence of EU Competition Law. From a compliance perspective, they suggest that the likelihood of an Article 101(3) exception could vary depending on the individual authority or court the case is heard by, further complicating the task for businesses seeking to manage the risk of coordination they believe to be beneficial. Recital 38 of Regulation 1/2003 states that businesses can seek informal guidance from the Commission where there is genuine uncertainty, and the Commission can issue a guidance letter to address such uncertainty, but it is unclear whether the Commission is allowing this mechanism to be used extensively.[68]

Block exemptions provide a significant source of legal certainty by creating safe harbours or carve-outs where certain conditions are met. This is especially important in relation to areas such as research and development and vertical agreements. The effect of a block exemption is to assume the conditions of Article 101(3) have been met in relation to certain beneficial conduct, so long as the conditions of the block exemption are met. They therefore significantly reduce the need to individually rely on Article 101(3) as a defence. However, even block exemptions can be problematic from a compliance perspective. The first problem is they are generally quite static in describing market situations that prevail at the time of drafting. This means that where new situations arise in a dynamic market, the precise application of a block exemption can be unclear. The second problem is that it can be hard to determine with certainty whether the conditions of the block exemption are met. For example, a key condition in EU block exemptions is that market shares do not exceed 30%. In certain markets, it can be difficult for businesses to determine their exact market share and be sure the threshold has not been exceeded.[69] This may have been exacerbated in the context of vertical agreements, by the introduction under Regulation 330/2010 (now replaced with Regulation 2022/720) of a requirement to take into account the supplier's and buyer's market shares.[70]

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[65] See discussion in Whish and Bailey (n 22) 159–160.

[66] See: European Commission, Report on the functioning of Regulation 1/2003; Commission, Ten Years of Antitrust Enforcement under Regulation 1/2003.

[67] Or Brook, 'Struggling with Article 101(3) TFEU: Diverging Approaches of the Commission, EU Courts, and Five Competition Authorities' (2019) 56 Common Market Law Review 121.

[68] Notice on informal guidance relating to novel questions arising under Articles [101 and 102 TFEU] (Guidance letters); Whish and Bailey (n 22), 261.

[69] See Alison Jones, Brenda Sufrin and Niamh Dunne, *EU Competition Law: Texts, Cases and Materials* (7th edn, OUP 2019) 790.

[70] Ibid.

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This issue of open-ended prohibitions and wide discretion is even more pronounced in relation to abusive conduct under Article 102. Whereas Article 101 hinges on the fairly straightforward principle that competing businesses should make independent decisions on sensitive issues such as price, Article 102 can potentially apply to a wide spectrum of unilateral business behaviour that is not deemed 'fair' or consistent with the somewhat nebulous notion of 'competition on the merits'.[71] Dominance rules create particular difficulties for compliance because they concern unilateral behaviour (including rational, strategic business responses to competition) and because their reach can be very hard to predict. Take, for example, the Commission's 2017 €2.42 billion fine in the *Google Shopping* case, which Google challenged (unsuccessfully) before the General Court on the grounds of legal uncertainty.[72] The Commission found that Google had abused its dominance as a search engine by giving an illegal advantage to another Google product, its comparison shopping service.[73] However, rather than applying the existing criteria of the 'refusal to supply' case law, the theory of harm centred on the practice of 'favouring' (self-preferencing) that the Commission found fell outside the scope of competition on the merits.[74]

On appeal, Google argued that: (i) the Commission applied no clear legal test; (ii) they had assumed exclusionary effects were necessarily detrimental to competition (going against previous case law); (iii) the behaviour amounted to refusal to supply (which would mean the stricter *Bronner* criteria should apply) and not the 'favouring' characterisation the Commission had pursued; and (iv) the case law of the German Bundesgerichtshof had consistently been of the view that a dominant company does not commit an abuse by self-favouring, because they are under no obligation to subsidise their competitors. The General Court dismissed the action in its entirety, explicitly recognising self-preferencing practices as amounting to an abuse of dominance and that its legality is not dependent on established tests relating to essential facilities or refusal to supply.[75] While there may be clear benefits to consumers of intervening to stop Google's self-favouring behaviour in its shopping services, this does not mean the company could reasonably have anticipated the law would apply in precisely this way. From a compliance perspective, they may have been confident that the stricter *Bronner* criteria would apply and that the conduct would likely fall outside of Article 102. Indeed, the case creates significant uncertainty as to when the *Bronner* criteria should be used and when it is not appropriate.[76]

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[71] This emphasises fair and open competition on the merits of products and services, as opposed to anticompetitive tactics or the use of market power to harm or deter competition. See OECD, *What is Competition on the Merits?* (June 2006).

[72] For a full discussion see: Yasmine Bouzoraa, 'Between Substance and Autonomy: Finding Legal Certainty in *Google Shopping*' (2022) 13(2) Journal of Competition Law and Practice 144.

[73] Case AT. 39740 – *Google Shopping* [2017] OJ C9/11.

[74] Ibid., para 341. Competition on the merits means competition based on the merits of the product or service, such as improved quality or lower price.

[75] Case T-612/17 *Google and Alphabet v Commission* EU:T:2021:763.

[76] See for example, Elias Deutscher, '*Google Shopping* and the Quest for a Legal Test for Self-Preferencing Under Article 102 TFEU' (2021) 6(3) European Papers 1345.

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3.2 Effects-Based Rules

Uncertainty as to how competition rules apply is also inherent in the move towards greater effects-based rules. These have a very strong policy rationale – rules based on form are blunt and fail to take into account particular market characteristics, the broader commercial context, or changes over time. This means that form-based prohibitions tend to capture benign or beneficial behaviour when they are too broad, or fail to capture harmful behaviour when they are too narrow.[77] The issue of effects analysis is most pressing in relation to Article 102, where the welfare effects of practices such as exclusive dealing and the use of loyalty rebates by dominant businesses can be very different depending on the particular circumstances of the market. Although Article 101 TFEU applies where an agreement or concerted practice has the object *or effect* of restricting competition, as discussed earlier, purely effects cases are rare because competition authorities tend to prioritise less administratively burdensome investigations concerning object. Nevertheless, much of the discussion that follows is also relevant to Article 101 and in particular the application of Article 101(3), which essentially requires parties to demonstrate that their conduct should escape liability on the grounds that likely efficiencies outweigh any anticompetitive effects arising from the conduct.

The 2017 Court of Justice judgment in *Intel v Commission* marked an important shift away from prohibitions in Article 102 that were based on form.[78] The Commission's 2009 decision (upheld by the General Court) held that loyalty rebates were categorised as abusive without any analysis of the circumstances of the case or the economic effects of the rebates. The Court of Justice held that in order for conduct to be abusive, it must be capable of restricting competition and, in particular, producing exclusionary effects.[79] There are nevertheless some categories of abusive conduct that are so obviously harmful that an assessment of their likely effects is unnecessary – in particular conduct that prevents competition and creates no efficiencies.[80] Where it is not clear that the object of the dominant firm's conduct is to harm competition, an exclusionary abuse only arises where it can be shown there is an actual or likely anticompetitive effect on the market.[81] While the *Intel* judgment was welcomed for embracing an effects-based approach to abuse of dominance, it lacked detail as to how businesses might expect effects analysis to operate in practice, with some criticising the decision for raising more questions than it answered.[82]

Effects-based rules should provide for better outcomes by prohibiting harmful practices while allowing beneficial behaviour. However, from a compliance perspective, they create

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[77] See Whish and Bailey (n 22) 204–205.

[78] C-413/14 P *Intel v Commission* EU:C:2017:632; Giorgio Monti, 'Article 82 EC: What Future For the Effects-Based Approach' (2010) 1(2) Journal of European Competition Law & Practice.

[79] C-413/14 P *Intel v Commission* (n 78) para 138., citing Case 85/76 *Hoffmann-La Roche* v *Commission*, EU:C:1979:36, para 89.

[80] European Commission, *Guidance on Article 102 Enforcement Priorities*, para 22.

[81] See discussion in Whish and Baily (n 22) 206, citing *Case* C-52/09 *Konkurrensverket v TeliaSonera Sverige* AB EU:C:2011:83 and Case C-209/10 *Post Danmark I* EU:C:2012:172.

[82] See for example: Giorgio Monti, 'Rebates after the General Court's Intel Judgement' (2023) 60(1) Common Market Law Review 107; Viktoria HSE Robertson, 'Loyalty Rebates under EU Competition and US Antitrust Law' in Pinar Akman, Or Brook and Konstantinos Stylianou (eds), *Research Handbook on Abuse of Dominance and Monopolization* (Edward Elgar 2023).

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considerable uncertainty unless businesses can be confident their own effects analysis will reach the same conclusion as that of the competition authority, or that it will be more convincing than the authority's own diverging view when the issue is considered on appeal. The main drivers of this uncertainty are:

Ex post vs ex ante – Analysis undertaken by the competition authority after the conduct has occurred may reach different conclusions to that undertaken by the business before engaging in that conduct, because more information is available after the event.

Theories of harm – The European Commission need only establish that anticompetitive effects are likely.[83] This requires a clear sense of both how the conduct has departed from 'competition on the merits' and how it differs to the counterfactual (a world where the conduct never occurred). As with complicated questions of law, economic theories of harm can lead to diverging interpretations and judgments.[84] This divergence is evident in the conflicting arguments made before the Court of Justice by the Commission and the businesses seeking to challenge their infringement decisions. It is notable that the court will not seek to second guess the Commission's own assessment of the economics in complex economic matters. In addition, economic knowledge and methods continues to evolve over time.[85]

The absence of a prescribed methodology – As Whish and Bailey discuss, the Court of Justice has been fairly fluid with both the tools that can be employed in effects analysis and the precise standard of proof that needs to be attained by that analysis. For example, the 'as-efficient competitor test'[86] is considered 'one tool among others' for assessing whether there is an exclusionary abuse.[87] This means the European Commission has considerable discretion in shaping its effects methodology when seeking to establish there is an abuse.

The cumulative uncertainty created by open-ended prohibitions and effects-based rules might shape the internal compliance efforts of a business around a binary choice – either engaging in practices that could fall within ambiguous rules or avoiding them altogether. As discussed earlier in this chapter, compliance training and reporting mechanisms do not cope well with complexity because of employees' limited ability to develop subject-specific expertise. Also, significant investment in legal and economic advice, coupled with risk management strategies, may only go some way in reducing the uncertainty.[88] On the one hand, businesses may conclude that enforcement of ambiguous rules is unlikely and that it therefore makes sense to ignore them so as to reap the benefits of engaging in practices that may fall fould of them.[89] This amounts to treating ambiguous prohibitions as de facto legal (i.e., under-compliance). On the other hand, risk averse businesses may decide to treat ambiguous rules

[83] Case C-23/14 *Post Danmark II* EU:C:2015:651 para 49.

[84] See OECD, 'Safe Harbours and Legal Presumptions in Competition Law' Background Note by the Secretariat. 5–6 December 2017.

[85] See discussion in Monti (n 82).

[86] The test essentially examines whether the conduct would be profitable for an equally efficient competitor, to help determine whether it should be treated as an abuse of dominance.

[87] Whish and Bailey (n 22) 207, citing Case C-23/14 *Post Danmark II* EU:C:2015:651 para 57; See also Pablo Ibáñez Colomo, 'Anticompetitive Effects in EU Competition law' (2020) 17(2) Journal of Competition Law & Economics 309–363.

[88] On risk management generally, see: Thomas Wolke, *Risk Management* (Walter De Gruyter 2017).

[89] On the costs and benefits of compliance, see Donald C. Langevoort, 'Compliance as Liability Risk Management' in van Rooij and Sokol (n 6) 123–132.

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as per se illegal (i.e., over-compliance with the law) and seek to avoid any conduct that might create the risk of liability under them. While this may limit the business' ability to engage in beneficial practices that, in principle, should be permitted by competition rules, the certainty of avoiding liability may be preferable to any cost associated with forgoing those practices.

4. COMPLIANCE FOCUSED ANTITRUST ENFORCEMENT

The chapter has established that there are limits to what antitrust compliance programmes can achieve, because it is difficult to educate and control the behaviour of all employees, and because there is genuine uncertainty as to how competition rules apply to certain categories of behaviour. It is for this reason that bad things can happen in good businesses. That is, even businesses that make honest and comprehensive efforts to comply with competition law are unlikely to eliminate the risk of an infringement completely.[90] The question is whether it is right that these businesses face broadly the same treatment in antitrust enforcement as those who made little or no compliance effort, or who may even have permitted a culture of deliberate rule breaking and anticompetitive behaviour. There will also be many businesses that fall somewhere in between these two extremes. In 2019, the US Department of Justice (DoJ) announced an important change to how it regarded compliance programmes.[91] The DoJ announced that it would take into account good faith compliance efforts at the charging stage of antitrust offences, when deciding whether to treat the alleged infringement as a criminal matter, as well as in sentencing. It also said it would consider proceeding by way of a deferred prosecution agreement against companies that are not first to report a cartel but have (among other things) a robust antitrust compliance programme in place.[92] This new approach contrasts sharply with EU competition law (and the vast majority of jurisdictions in the world), where compliance efforts are generally given little or no consideration.

A more compliance focused approach in the EU would result in fairer and more proportionate enforcement outcomes and encourage businesses to engage with the rules in a more constructive way. Indeed, proportionality is not only an important principle in EU law, it can also help improve compliance with competition rules. There is research to suggest that procedurally just outcomes help enhance compliance with the law by increasing the perceived legitimacy of the rules the enforcement is seeking to uphold.[93] If compliance is ignored in the enforcement process, more employees may question whether competition law rules are just

[90] See discussion of 'residual risk' in Johannes Paha and Florence Thépot, 'Antitrust Compliance: Collusion' in van Rooij and Sokol (n 6) 868–879.

[91] See Makan Delrahim, 'Wind of Change: A New Model for Incentivizing Antitrust Compliance Programs', Speech to New York University School of Law, Program on Corporate Compliance and Enforcement, 11 July 2019, New York.

[92] In US Antitrust Law, 'leniency' refers only to the immunity granted to the first business to report an infringement. Reductions in fines for subsequent cartel members in return for cooperation are not mandated by the leniency programme, but can be secured through a negotiated plea bargain.

[93] See literature reviewed in Daniel S. Nagin and Cody W. Telep, 'Procedural Justice and Legal Compliance' in van Rooij and Sokol (n 6) 385.

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and should be followed. The remainder of this section will provide a preliminary outline of what a more compliance focused approach might look like.

The European Commission has considerable discretion in deciding whether to issue a statement of objections (essentially a preliminary finding of wrongdoing) and how to calculate any penalty as part of an infringement decision. Article 9 of Regulation 1/2003 allows the Commission to adopt a *Commitment Decision*. This is where the parties under investigation offer to enter into commitments to address the concerns of the Commission without the finding of an infringement and imposition of a fine. It is also notable that Regulation 1/2003 gives the Commission considerable discretion in calculating the penalty, stating only that 'regard shall be had both to the gravity and to the duration of the infringement'.[94] In its guidelines on calculating fines, the Commission states that 'the assessment of gravity will be made on a case-by-case basis for all types of infringement, taking account of all the relevant circumstances of the case'.[95] However, the Commission has explicitly designed the guidelines to have a heavy emphasis on deterrence in relation to all infringement decisions. The starting point for calculating fines is up to 30% of the value of sales, depending on the nature of the infringement, combined market share of the undertakings involved, the geographical scope of the infringement, and whether it was implemented. There is also a specific uplift for deterrence. Mitigating circumstances include cases where the infringement was committed as a result of negligence, but not anything pertaining to compliance efforts or genuine uncertainty as to how the law applies.[96] Beyond these factors, the guidelines do not seek to understand the circumstances surrounding the existence of the infringement, or the extent to which the infringement was in fact successful in achieving an anticompetitive outcome, if at all. In this respect, there is little distinction between an attempted cartel and an actual one.

A compliance focused approach to enforcement would involve recalibrating the Commission's approach only where there is genuine benefit in doing so. This warrents significant further research,, but one possible approach could be a clearer scale of enforcement that rewards good compliance, takes a more measured approach to genuine uncertainty and reserves the heaviest fines for where the need for deterrence is strongest. For example, this might be achieved through a three-tiered approach to enforcement:

1. *Infringement decision and full deterrent fine* – this should be reserved for the most serious infringements, meaning those that are: (i) a clear breach of an established 'object' type rule; (ii) that was deliberately implemented (i.e., not negligent) and operated for a period of time (i.e., not just an isolated incident); and (iii) was either promoted, left unchallenged, or should reasonably have been detected and prevented by the business. These are cases where it is very likely there is anticompetitive harm on the market and where reasonable compliance efforts were not implemented.
2. *Infringement decision and nominal fine* – this is appropriate in two situations: (i) where a clear infringement is detected through a business' compliance and monitoring mechanisms and is reported to the Commission before it has been fully implemented; or (ii)

[94] Council Regulation (EC) 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, Article 23(2)(c).

[95] Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003 [2006] OJ C210/2, para 19.

[96] Ibid, para 29.

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where the infringement has come about due to the isolated behaviour of employees, despite the business having taken reasonable steps to educate them and monitor their actions. The first situation is easy to discern. The second could rely on certain minimum measures that should be in place within businesses above a certain size. This would be a similar approach to that taken in other areas of regulation (such as anti-bribery) where a business' compliance efforts are more central to the determination of their liability.

3. *Commitment decision in lieu of an infringement decision and fine* – the use of these could be widened to include: (i) where there is genuine uncertainty as to how the law applies (for example because it concerns an entirely novel situation) and the business has taken reasonable steps to avoid anticompetitive outcomes; or (ii) where the application of the law hinges on effects analysis, the business can demonstrate it took reasonable steps to establish a beneficial or neutral impact on competition, and is willing to adapt its behaviour in response to the Commission's diverging analysis. The first situation here would require the competition authority to publish some guidance on how they feel the law should be applied to the novel situation. This is necessary for legal certainty but also to fill the gap created by the absence of the court providing clarification through its adjudication of legal challenges to infringement decisions. The second situation would not be an efficiency defence as such, but rather provide greater protection from potential effects type prohibitions. The business would be protected where they can demonstrate they undertook a reasonable *ex ante* view (based on the information available at the time) that the conduct they engaged in would not have an anti-competitive effect.

The availability of commitment decisions would be contingent on the business and its employees having made no attempt to hide their behaviour or mislead the Commission. It would also depend on the willingness of businesses to amend their behaviour in response to concerns raised by the Commission. Where there are diverging views as to the correct effects analysis, it may be preferable to engage in some kind of arbitration mechanism instead of adopting an infringement decision and penalty that could later be overturned at appeal.[97] The imposition of a nominal fine in the second category would require a new approach to the Commission's fining guidelines and a willingness to assess reasonable compliance measures and how an infringement actually came about within an organisation. It is suggested that nominal fines should be 30% of what the full deterrent fine would have been. The leniency programme in cartel cases would continue to apply in the same way regardless of the level of fine imposed.

Such a compliance focused approach to enforcement would bring about a number of benefits. It would make antitrust enforcement more proportionate by creating a half-way option between a full fine and a commitment decision, thereby strengthening both the incentive to invest in compliance and to cooperate with the competition authority. It would also encourage the Commission and businesses to engage in a more constructive and less combative manner when dealing with genuine legal uncertainty or effects-based rules. However, the one problem identified in this chapter that is not overcome by this approach is the lack of credible punishment for delinquent employee behaviour. To address this, it may be desirable for leniency

[97] The introduction of the Digital Markets Act demonstrates the possibility of adopting alternative institutional structures to achieve compliance through cooperation. See Anna Tzanaki and Julian Nowag, 'The Institutional Framework of the DMA: From Hybrid to Mature?' Journal of European Competition Law & Practice, Forthcoming.

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programmes to place less emphasis on the importance of businesses ensuring the cooperation of current and former employees. Ultimately, the best way of overcoming this is by ensuring the availability of individual sanctions that can be imposed where it is appropriate to do so. Where criminal sanctions are not available or cannot be effectively enforced, alternative civil tools exist, such as individual fines and director disqualification. Yet there is currently no legal basis for the Commission to punish individuals, even though many Member States do apply such sanctions in their domestic enforcement work.[98]

5. CONCLUDING REMARKS

The ultimate aim of competition law should be to prevent anticompetitive outcomes from occurring in the first place. Antitrust compliance programmes have a key role to play in achieving this outcome. The general deterrent effect of enforcement (beyond businesses that have been subject to enforcement in the past) can only be realised if it is possible, *ex ante*, to take reasonable steps to significantly reduce the risk of liability. An effective compliance programme will do this by either preventing potential infringements or detecting them soon after they occur. Yet, in contrast to other areas of regulation, competition enforcement tends to largely ignore the question of whether an infringement occurred despite a business having taken reasonable steps to comply with the law. The idea that high corporate fines alone will always enhance deterrence, or that all infringements amount to failed compliance, is flawed. This chapter has explored why infringements can occur despite good compliance, either because of the limits of effective training and monitoring of employees, or because there is genuine uncertainty as to how competition law applies to certain situations or as to the analysis undertaken for effects-based rules. A heavy emphasis on punishment and deterrence is of little practical value where businesses have already taken reasonable compliance measures or are genuinely unsure as to how the law applies. While the US Department of Justice has taken some positive steps towards addressing this important issue, the vast majority of jurisdictions follow a similar approach to the European Commission, in giving little or no regard to the internal compliance efforts of a business. Given how many of these jurisdictions have competition law regimes modelled on that of the EU and are influenced by developments in EU policy, the European Commission could help bring about a global change in culture, should it decide to adopt the sort of compliance focused antitrust enforcement model suggested in this chapter. This would strengthen the incentive for businesses to take compliance seriously, improve the perceived legitimacy of competition rules by taking a more proportionate approach to enforcement in this rapidly evolving area of law, and encourage businesses to engage in a more constructive way with areas of legal uncertainty and effects-based rules.

[98] See for example discussion in Peter Whelan, 'The Emerging Role of Director Disqualification in UK Competition Law', in Barry Rodger and others (eds), *The UK Competition Regime: A Twenty-Year Retrospective* (OUP 2021).

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20. Antitrust and Regulatory Compliance in the 21st Century: New Challenges, New Opportunities and the Role of AI

Rosa M. Abrantes-Metz and Albert D. Metz

1. INTRODUCTION[1]

We have previously made the case that the high penalties for cartels, the expansion of leniency programs, the new incentive provided by the U.S. Department of Justice (DOJ) with its 2019 antitrust compliance guidelines, and the increased use of screening methods by competition authorities and private litigants would motivate corporations to enhance their antitrust compliance programs. In particular, that corporations would increasingly incorporate screens as part of such programs. We have, indeed, observed a greater focus on antitrust compliance over the last few years, even more so with new regulations on competition in the tech space.

Antitrust compliance was, for a long time, part of a process that had to exist because it was simply required, and it was not characterized by many as a particularly exciting and dynamic area. But a combination of recent new demands and challenges from an ever more complex and intense regulatory environment, as well as new powerful technologies and tools, are transforming this area of work into a highly creative and value-added activity, extending much beyond antitrust compliance to several of the functions of the corporation as a whole.

Just as we have, for some time, been advocating for the use of screens in antitrust compliance, in this chapter we will advocate for the use of AI in that same context. Both detection and deterrence of anticompetitive conduct could get a major boost with the assistance of these tools, allowing corporations to stay ahead of the game in a cost-efficient way, potentially significantly minimizing the risk of non-compliance and regulatory violations, at a time when the stakes for non-compliance are becoming very high. We note that while most of the discussion in this chapter relates to the United States, the same principles apply to other jurisdictions.

[1] The authors have been involved in the use of screens for antitrust compliance and more generally using screens in the detection of collusion and manipulation more generally for over two decades, contributing to the adoption of these tools worldwide. They have also advised on the design and implementation of antitrust compliance programs, and authored several articles on this topic. The authors also thank Henry M. Metz for excellent research assistance, and Joseph Murphy for many interesting discussions over the years on antitrust compliance. The views expressed in this chapter are the authors' and do not represent the views of the organizations with which they are affiliated or their clients. A prior version of this chapter was published in the Antitrust Chronicle at Competition Policy International, which won the Les Concurrences 2024 prize for the Business Digital category.

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2. THE IMPORTANCE OF ANTITRUST COMPLIANCE

The United States Sentencing Commission 2021 Guidelines Manual ("Sentencing Guidelines") states that an organization's diligence in preventing and detecting criminal conduct has a "direct bearing on the appropriate penalties" if that organization is convicted and sentenced for a criminal offense.[2] With this in mind, the Sentencing Guidelines establish the requirements for an effective compliance and ethics program more broadly.[3] In particular, they explain that such a program "shall be reasonably designed, implemented, and enforced so that the program is generally effective in preventing and detecting criminal conduct,"[4] and the program need not prevent or detect every offense in order to be considered effective.[5] These apply, of course, to antitrust conduct as well.

While the Sentencing Guidelines do not specifically focus on antitrust compliance programs, they provide a list of steps for corporations to undertake if they are to get credit in sentencing in federal court, which also applies to antitrust compliance. They effectively represent the starting point when prosecutors assess a company's compliance programs to decide whether and how to proceed against it.[6]

The Sentencing Guidelines' overarching requirement for an effective program is for the organization to "exercise due diligence to prevent and detect criminal conduct" and "otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law."[7] In particular, the Sentencing Guidelines emphasize the following requirements: a specific individual with day-to-day operational responsibility for the program, development of effective training programs, monitoring and auditing of the program, periodic evaluation of the program's effectiveness, a system for anonymously reporting violations, and development of appropriate incentives and punishments to encourage compliance with the program.[8] These standards require that "…[t]he organization shall take reasonable steps…to ensure that the organization's compliance and ethics program is followed, including monitoring and auditing to detect criminal conduct…"[9] The Sentencing Guidelines also stress the importance of the involvement of high-level personnel.[10] Thus, companies are advised to engage in purposeful and focused efforts, inclusive of antitrust compliance, to be proactive in seeking out potential violations, and to not simply rely on training and manuals to prevent them.

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[2] United States Sentencing Commission (2021) *Guidelines manual*. ("Sentencing Guidelines"). Available at: https://www.ussc.gov/sites/default/files/pdf/guidelines-manual/2021/GLMFull.pdf

[3] Sentencing Guidelines § 8.B2.1.

[4] Sentencing Guidelines p. 517.

[5] Sentencing Guidelines p. 517 ("The failure to prevent or detect the instant offense does not necessarily mean that the program is not generally effective in preventing and detecting criminal conduct.").

[6] See Rosa Abrantes-Metz, Patrick Bajari and Joseph Murphy, 'Enhancing compliance programs through antitrust screening' (2010) 4(5) The Antitrust Counselor.

[7] Sentencing Guidelines p. 517.

[8] Sentencing Guidelines § 8.B2.1.

[9] Sentencing Guidelines § 8B2.1(b)(5)(A).

[10] Sentencing Guidelines pp. 517–518.

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Also of importance to antitrust compliance is the U.S. Justice Manual, from the Department of Justice. When evaluating a corporate compliance program for the purposes of charging and sentencing, the U.S. Justice Manual explains that "[t]he fundamental questions a prosecutor should ask are: (1) Is the corporation's compliance program well designed? (2) Is the program being applied earnestly and in good faith? In other words, is the program adequately resourced and empowered to function effectively? And (3) Does the corporation's compliance program work in practice?"[11]

Further guidance has more recently been provided by the DOJ with its 2019 guidelines for evaluating compliance programs, specifically within the context of criminal antitrust investigations.[12] The purpose of these guidelines is "to assist [DOJ] prosecutors in their evaluation of antitrust compliance programs at the charging and sentencing phases of an investigation."[13] The DOJ has identified elements of an effective antitrust compliance program as: (1) the design and comprehensiveness of the program; (2) the culture of compliance within the company; (3) responsibility for, and resources dedicated to, antitrust compliance; (4) antitrust risk assessment techniques; (5) compliance training and communication to employees; (6) monitoring and auditing techniques, including continued review, evaluation, and revision of the antitrust compliance program and the use of screens; (7) reporting mechanisms; (8) compliance incentives and discipline; and (9) remediation methods.[14] We will discuss these new guidelines further in Part 3.

Other competition authorities around the world have also outlined similar principles for successful antitrust programs, such as, for example, the Canadian Competition Bureau. In Canada, these include senior management involvement, the establishment of clear compliance policies, risk-based compliance assessment, training and education, monitoring and reporting mechanisms, and consistent disciplinary procedures and incentives.[15] Florence Thépot (2019) provides an overview of the position on antitrust compliance in the EU and in some Member States.[16] More broadly, the 2021 OECD Report on competition compliance provides guidance for the adoption of antitrust compliance programs,[17] while the International Chamber of Commerce provides an antitrust compliance toolkit that gives similar guidance to those referenced above.[18]

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[11] U.S. Department of Justice, 'Principles of Federal Prosecution of Business Organizations" (updated November 2018) 25 June 2024, paras 9-28, 800. ("Justice Manual"). Available at: https://www.justice.gov/jm/jm-9-28000-principles-federal-prosecution-business-organizations.

[12] U.S. Department of Justice, *Evaluation of corporate compliance programs in criminal antitrust investigations* (July 2019) ("DOJ Antitrust Compliance Program Guidelines"). Available at: https://www.justice.gov/atr/page/file/1182001/download.

[13] DOJ Antitrust Compliance Program Guidelines p. 1.

[14] DOJ Antitrust Compliance Program Guidelines pp. 3–4.

[15] Competition Bureau Canada, *Corporate Compliance Programs*. Available at: https://ised-isde.canada.ca/site/competition-bureau-canada/sites/default/files/attachments/2022/cb-bulletin-corp-compliance-e.pdf.

[16] Florence Thépot, *The Interaction Between Competition Law and Corporate Governance* (Cambridge University Press 2019) ch 8, 'Cartel Enforcement: Corporate Compliance Programmes'.

[17] Available at: https://www.oecd.org/daf/competition/competition-compliance-programmes-2021.pdf.

[18] International Chamber of Commerce Commission on Competition, *The ICC Antitrust Compliance Toolkit*. Available at: https://compliance.concurrences.com/en/page/pdfjs/?id

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There is no doubt that effective compliance programs have become more valuable. Joseph Murphy and William Kolasky, recognized antitrust compliance counsel, published an article in *Antitrust* magazine describing the key elements of successful antitrust compliance programs into 20 fundamental points. These reflect the guidance from the agencies cited above. Among other important elements, they discuss clearly articulated standards, senior management support and designation of a chief ethics and compliance officer (CECO), training and communication, auditing and monitoring mechanisms, and reporting systems that prevent retaliation.[19]

3. WHY USE AI IN ANTITRUST AND REGULATORY COMPLIANCE

Corporate antitrust compliance programs largely revolve around training. While compliance training is a necessary tool, both the history of major cartels and the incentive to enhance antitrust compliance programs support the obvious conclusion that training alone would no longer be considered an effective program. Compliance programs have been incorporating additional tools to enhance the robustness of these programs, which are more objective and less dependent on people's good faith.[20] These include audits, direct monitoring, and reviews. While record reviews and personnel interviews may identify conduct that was otherwise hidden, these tools have limitations: they are somewhat disruptive, and are typically very expensive. Moreover, if they are not focused on the highest risk areas, their resource-intensive nature can generate management hostility.

We have for a long time advocated for the use of screens in antitrust compliance as one of the options available, which can focus on targeted risk areas and be both effective and less resource intensive. The added value of screens for antitrust compliance was first recognized in Abrantes-Metz and Bajari (2009), in more detail in Abrantes-Metz, Bajari and Murphy (2010), and has continued since then.[21]

_document=64530.

[19] Joseph Murphy and William Kolasky, 'The Role of Anti-Cartel Compliance Programs in Preventing Cartel Behavior' (2012) 26(2) Antitrust 61–64.

[20] Ibid.

[21] Rosa Abrantes-Metz and Pat Bajari, 'Screens for Conspiracies and their Multiple Applications' (2009) 24(1) The Antitrust Magazine, Fall; Rosa Abrantes-Metz, Pat Bajari and Joe Murphy, 'Enhancing Compliance Programs Through Antitrust Screening' (2010) 4(5) Antitrust Counselor. This recognition continued through the last decade in various other articles, including, among others, Rosa Abrantes-Metz, 'Why and How to Use Empirical Screens in Antitrust Compliance?' (2012) CPI Antitrust Chronicle, February. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2006576; Rosa Abrantes-Metz and Daniel Sokol, 'Antitrust Corporate Governance and Compliance' in Daniel Sokol and Roger Blair (eds), *The Oxford Handbook of International Antitrust Economics* (Oxford University Press 2015) 586–618. (working paper version available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2246564); Rosa Abrantes-Metz and Elizabeth Prewitt, 'Antitrust Compliance 2.0: The Use of Structural Analysis and Empirical Screens to Detect Collusion and Corruption in Bidding Procurement Processes' (2015) CPI Antitrust Chronicle, June. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3291651; Stefan Frübing and Kai Hüschelrath, 'Competition Law Compliance Programmes:

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Additional tools, such as AI more generally and machine learning in particular, have the potential to further significantly enhance antitrust compliance and heightened regulatory compliance across many sectors.[22] Below we summarize some of the key reasons why, in our view, AI-based antitrust and regulatory compliance programs will be a need-to-have for corporations.

3.1 Enhanced Collection, Organization and Processing of Very Large Volumes of Information

First and foremost, AI has the capability of quickly organizing large datasets, documents, and communications in a way that facilitates not only their categorization but also makes it easier to locate them, significantly enhancing efficiency.

And then, of course, AI is capable of processing and analyzing such large information in a variety of ways. To start, it can monitor business communications to identify individuals and content that could signal potential anticompetitive conduct such as price fixing, bid rigging, threating of competitors, monopolization, and other types of anticompetitive conduct, as well as conduct not meeting regulatory compliance requirements. AI can not only monitor emails and text messages, but also video meetings, and potentially all types of communications, in addition to being capable of analyzing the context in which certain content appears.

3.2 Enhanced Quantity and Quality of Antitrust of Review and Compliance

We know that AI can enhance the quantity of compliance tasks undertaken, if nothing else, through automation. But just as importantly, AI can also improve the quality of such tasks, not only performing them faster and across more sources, but also minimizing the likelihood of errors, particularly human errors when review is more manual. One does need to be conscious, though, that (i) if you put garbage in, you get garbage out; and (ii) one size does not fit all. Hence, human input and expertise are critical. Furthermore, there will need to be continued investment in AI to not only allow for the identification of the right inputs to generate the most reliable outputs, but also to hire and train experts such as antitrust counsel, data scientists and economists. And while AI can make a real impact in antitrust compliance, we believe that human input will continue to be critical for an effective and efficient compliance program.

A Law and Economics Perspective' in Johannes Paha (ed), *Competition Law and Compliance Programmes* (Hart Publishing 2016) ("*Competition Law and Compliance Programmes*"); Ulrich Schwalbe, 'Antitrust Compliance and Abusive Behavior' in Johannes Paha (ed), *Competition Law and Compliance Programmes* and Florence Thépot, 'Can Compliance Programmes Contribute to Effective Antitrust Enforcement?' in Johannes Paha (ed), *Competition Law and Compliance Programmes*; Rosa Abrantes-Metz and Albert Metz, 'The Role of Screening in Antitrust Compliance' in Concurrences (ed), *A Guide to Antitrust Compliance* (Concurrences 2021).

[22] See also, Justin Johnson and D. Daniel Sokol, 'Understanding AI Collusion and Compliance' in Ruth Nielsen and Morten Broberg (eds), *The Cambridge Handbook of Compliance* (Cambridge University Press 2021) ch 60.

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3.3 New Challenges for Corporations: Increasingly Complex Rules and Regulations, with Very High Stakes

The antitrust and regulatory environments are becoming increasingly complex and demanding. There are ever more regulations and more active antitrust enforcement around the globe, with varied requirements depending on jurisdictions. Corporations have to comply with all of them simultaneously.

While not the only new regulation, great focus has been given to the regulation of the tech industry around the world, not just in Europe and China, but also being discussed in the U.S. The sheer amount, complexity, and different requirements of these regulations are going to demand just as great a focus from the tech companies.

The amount of investment that platforms will have to undertake in order to ensure compliance with new regulations and enhanced antitrust compliance cannot be overstated. We are no longer talking about detecting collusion only, but also, for example, determining whether companies engaged in self-preferencing and other types of conduct which are not clearly forbidden. The European Commission has put forward the most substantial effort to regulate the digital economy, the Digital Markets Act ("DMA"), to, among other goals, prevent what it has determined to be anticompetitive conduct. Compliance with all such rules will be challenging.

On September 7 2023, we learned that the European Commission (EC) designated six tech companies as "gatekeepers" under its DMA. As explained by the EC in a news release, "[u]nder the DMA, the European Commission can designate digital platforms as 'gatekeepers' if they provide an important gateway between businesses and consumers in relation to core platform services." These companies are Alphabet, Amazon, Apple, ByteDance, Meta and Microsoft, and the services targeted include social networks (such as Facebook, Instagram, TikTok), intermediation (Google Ads, Amazon Marketplace, Apple App Store), and operating systems (Android and iOS). As explained by Google, "[t]he DMA will require Google and other companies to make various changes to the way their products and services work."[23] These are unprecedented changes which will require unprecedented efforts from corporations in order to ensure compliance.

Let's recall the experience with the Dodd-Frank Act, enacted in 2010.[24] This sweeping post-financial crisis regulation has cost the banks billions of dollars. To comply, U.S. banks hired many tens of thousands of employees and built new systems, among other changes. For example, JPMorgan Chase disclosed that in its mortgage business alone, its employees spent 800,000 hours in compliance training in just one year. We stress that this was just for one of the many sectors within JPMorgan, and only compliance training, not any other compliance functions.

The current and upcoming regulations in the tech industry are going to be no smaller task than Dodd-Frank. One may argue they will be more complex to implement, monitor, and coordinate across multiple jurisdictions. The stakes are very high, and so are potentially the penalties. We expect AI to play a critical role in many aspects of these regulations.

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[23] See https://ec.europa.eu/commission/presscorner/detail/en/ip_23_4328; see also https://blog.google/outreach-initiatives/public-policy/building-for-compliance-with-the-digital-markets-act/#:~:text=The%20legislation%20comes%20into%20effect,their%20products%20and%20services%20work

[24] See https://www.congress.gov/111/plaws/publ203/PLAW-111publ203.pdf

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3.4 Greater Guidance and Incentive for Corporations from the 2019 DOJ Guidelines on Antitrust Compliance[25]

We have long argued for the value and enhancement of antitrust compliance programs in the fight against collusion. We have also encouraged competition authorities to support such programs. Incentives, such as reduced fines or no criminal prosecution need to be in place, which are strong enough for corporations that have developed reliable compliance programs. After all, such programs may lead to the internal self-identification of collusion and other anticompetitive conduct, which is exactly what we want: self-monitor and self-report. Everything else being equal, high deterrence within the corporations and a high likelihood of internal detection would reduce the need for as many resources to be put in place by authorities for these purposes.[26]

As mentioned in Section II of this chapter, the enhanced value of effective antitrust compliance programs due to the DOJ's new 2019 guidelines cannot be overstated. In his speech at New York University Law School on July 11, 2019, former Assistant Attorney General Makan Delrahim explained that:[27]

> I believe the time has now come to improve the Antitrust Division's approach and recognize the efforts of companies that invest significantly in robust compliance programs. In the words of our former Deputy Attorney General Rod Rosenstein, "[t]he fact that some misconduct occurs shows that a program was not foolproof, but that does not necessarily mean that it was worthless. We can make objective assessments about whether programs were implemented in good faith."[28]

This means that the Antitrust Division now takes into consideration compliance programs at the charging stage of criminal antitrust investigations, just as was already true for the rest of the Department of Justice in all other areas except antitrust. Specifically, Division prosecutors will consider "the adequacy and effectiveness of the corporation's compliance program at the time of the offense, as well as at the time of the charging decision."[29]

Furthermore, the Division explains that "a truly effective antitrust compliance program gives a company the best chance to obtain the significant benefits available under the Division's Corporate Leniency program."[30] In addition, under section 6 of the Antitrust Division Manual covering "Periodic Review, Monitoring and Auditing," the Division asks as follows:

> What monitoring or auditing mechanisms does the company have in place to detect antitrust violations? See U.S.S.G. § 8B2.1(b)(5)(A). For example, are there routine or unannounced audits (e.g. a periodic review of documents/communications from specific employees; performance evaluations and employee self-assessments for specific employees; interviews of specific employees)? Does the

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[25] Assistant Attorney General Makan Delrahim (remarks delivered at the New York University School of Law Program on Corporate Compliance and Enforcement, 11 July 2019). "Delrahim's Speech". Available at: https://www.justice.gov/opa/speech/assistant-attorney-general-makan-delrahim-delivers-remarks-new-york-university-school-l-0.

[26] Rosa Abrantes-Metz and Albert Metz, 'Why Screening is a "Must Have" Tool for Effective Antitrust Compliance Programs' (2019) CPI Antitrust Chronicle, November.

[27] See Delrahim's Speech.

[28] *Id*.

[29] Justice Manual paras 9-28-300.

[30] *Id.* at pp. 10

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company use any type of screen, communications monitoring tool, or statistical testing designed to identify potential antitrust violations?"[31]

The recognition of the value of screens and statistical analyses is noteworthy. However, all other compliance functions identified by the DOJ can and should also be enhanced and undertaken more extensively and in a cost-efficient way through the use of AI.

3.5 Having Proven to be Successful, Screens Must be a Part of an AI-based Antitrust Compliance Program

The ability to flag unlawful behavior through economic and statistical analyses is commonly known as screening. A screen is an empirical analysis based on a statistical model or hypothesis and a theory of the alleged illegal behavior. It is designed to (i) identify whether collusion, manipulation, or any other type of cheating may exist in a particular market; (ii) determine who may be involved; and (iii) ascertain how long it may have lasted. Screens use commonly available data such as prices, bids, quotes, spreads, market shares, volumes, and other data to identify patterns that are anomalous or highly improbable under a theory of competition.[32]

We and other economists, lawyers and reporters have been advocating for the use of screens by all sides involved in litigation and pre-litigation for two decades now.[33] Screens successes have been notable and numerous over the last decade or so. The antitrust community is very

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[31] *Id*. at pp. 10

[32] Rosa Abrantes-Metz and Patrick Bajari, 'Screens for Conspiracies and their Multiple Applications' (2009) 24(1) The Antitrust Magazine; Joseph Harrington, 'Detecting Cartels' in Paolo Buccirossi (ed), *Handbook of Antitrust Economics* (MIT Press 2008); Michael Doane, Luke Froeb, Brijesh Pinto and David Sibley, 'Screening for Collusion as a Problem of Inference' in Roger Blair and D. Daniel Sokol (eds), *Oxford Handbook of International Antitrust Economics* (Oxford University Press 2015). A non-exhaustive "check list" of characteristics that influence the susceptibility of a market to tacit or explicit collusion includes: number of firms and market concentration, differences among competitors, product heterogeneity, demand volatility, barriers to entry, benefits of cheating, transparency, and multi-market contact. See Rosa Abrantes-Metz, 'Antitrust Guidelines for Horizontal Collaborations among Competitors for Central and South American Countries' Regional Center for Competition in Latin America, First Conference, Santo Domingo, Dominican Republic, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3291659; see also *Proof of Conspiracy under Antitrust Federal Law* (American Bar Association Editions, April 2010) ch VIII.

[33] Donald Klawiter, 'Conspiracy Screens: Practical Defense Perspectives' (2012) CPI Antitrust Chronicle, March; Carlos Ragazzo, 'Screens in the Gas Retail Market: The Brazilian Experience' (2012) CPI Antitrust Chronicle, March; Carlos Mena-Labarthe, 'Mexican Experience in Screens for Bid Rigging' (2012) CPI Antitrust Chronicle, March; Submissions by invited panelists Rosa Abrantes-Metz, Bill and M. Peter Schinkel, are contained in OECD's 'Ex Officio Cartel Investigations and the Use of Screens to Detect Cartels' 2013, available at: http://www.oecd.org/daf/competition/exofficio-cartel-investigation-2013.pdf; Rosa Abrantes-Metz and Luke Froeb, 'Competition Authorities are Screening for Conspiracies: What Are They Likely to Find?' The American Bar Association Section of Antitrust Law Economics Committee Newsletter (Spring 2008); Rosa Abrantes-Metz, 'Time to rethink deficient market structures' Opinion article *Financial Times* (11 April 2016), available at: https://www.ft.com/content/f95648f8-d499-11e5-829b-8564e7528e54.

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familiar nowadays with the critical role that screens played when assisting the uncovering of some of the largest collusion and conspiracy cases of modern times.[34] These included USD Libor, Yen Libor, Euribor, Foreign Exchange, Gold and Silver fixings, ISDAfix and market abuse in several other markets.[35]

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[34] See generally Testimony of Rosa Abrantes-Metz on behalf of the Office of Enforcement Staff, Fed. Energy Reg. Commission (22 September 2014), available at: http://elibrary.ferc.gov/idmws/doc_info.asp?document_id=14274590; Testimony of Margaret Levenstein, University of Michigan, To Senate Committee on the Judiciary Subcommittee on Antitrust, Competition Policy and Consumer Rights On "Cartel Prosecution: Stopping Price Fixers and Protecting Consumers" (14 November 2013), available at: https://www.judiciary.senate.gov/imo/media/doc/11-14-13LevensteinTestimony.pdf; Abrantes-Metz and Froeb (n 33); Abrantes-Metz and Bajari (n 21); Kai Hüschelrath, 'Economist's Note: How are Cartel Detected? The Increasing Use of Proactive Methods to Establish Antitrust Infringements' (2010) Journal of European Competition Law and Practice 1–7; Doane, Froeb, Pinto and Sibley (n 32).

[35] Carrick Mollenkamp and Laurence Norman, 'British bankers group steps up review of widely used Libor' *Wall Street Journal* (17 April 2008); Carrick Mollenkamp and Mark Whitehouse, 'Study casts doubt on key rate; WSJ analysis suggests banks may have reported flawed interest data for Libor' *Wall Street Journal* (29 May 2008); Rosa Abrantes-Metz and Michael Kraten; Albert Metz and Gim Seow, 'LIBOR Manipulation?' (2012) 36 Journal of Banking and Finance 136–150; Rosa Abrantes-Metz and George Judge, Sofia Villas-Boas, 'Tracking the Libor Rate' (2011) 18 Applied Economics Letters 893–899; Rosa Abrantes-Metz and Albert Metz, 'How Far Can Screens Go in Detecting Explicit Collusion? New Evidence From the Libor Setting' (2012) CPI Antitrust Chronicle, March; and Rosa Abrantes-Metz and Daniel Sokol, 'Lessons from Libor for Detection and Deterrence of Cartel Wrongdoing' (2013) 3 Harvard Business Law Review 10–16. Available at: http://www.hblr.org/2012/10/the-lessons-from-libor-for-detection-and-deterrence-of-cartel-wrongdoing/; Rosa Abrantes-Metz, 'How to Use Statistics to Seek Out Criminals' *Bloomberg* (26 February 2013) Opinion article. Available at: http://www.bloomberg.com/news/2013-02-26/how-to-use-statistics-to-seek-out-criminals.html; See also Connan Snider and Thomas Youle, 'Diagnosing the Libor: Strategic Manipulation Member Portfolio Positions' Working Paper (2009); Connan Snider and Thomas Youle, 'Does the Libor Reflect Banks' Borrowing Costs?' Working Paper (2010); Liam Vaughan and Gavin Finch, 'Currency Spikes at 4 P.M. in London Provide Rigging Clues' *Bloomberg* (27 August 2013). Available at: http://www.bloomberg.com/news/2013-08-27/currency-spikes-at-4-p-m-in-london-provide-rigging-clues.html. Abrantes-Metz's work on FX was contained in a December 2013 complaint filed in New York, which extended Bloomberg's analysis and showed further evidence of highly anomalous price spikes at key times of the day when certain benchmarks are set. See the 'CPI Cartel Column on the Uncovering of the FX Rigging' (2014) available at: https://www.competitionpolicyinternational.com/from-collusion-to-competition-15th-issue/; Rosa Abrantes-Metz, 'How to Keep Banks from Rigging Gold Prices' Opinion article *Bloomberg* (19 December 2013). Available at: http://www.bloomberg.com/news/2013-12-19/how-to-keep-banks-from-rigging-gold-prices.html; Liam Vaughan, 'Gold Fix Study Shows Signs of Decade of Bank Manipulation' *Bloomberg* (28 February 2014). Available at: http://www.bloomberg.com/news/2014-02-28/gold-fix-study-shows-signs-of-decade-of-bank-manipulation.html; Nicholas Larkin, 'London Gold Broker Says Swings in Prices No Sign of Manipulation' *Bloomberg* (5 March 2014). Available at: http://www.bloomberg.com/news/2014-03-05/london-gold-broker-says-swings-in-prices-no-sign-of-manipulation.html. See also, 'Gold lawsuit sparks concerns of market manipulation, collusion' *Fortune* (8 March 2014). Available at: https://fortune.com/2014/03/07/gold-lawsuit-sparks-concerns-of-market-manipulation-collusion/; another example is the ISDAfix benchmark for swaps, for which Abrantes-Metz's screens played an important role in supporting plausible evidence of manipulation and in uncovering previously unknown evidence consistent with collusion. See 'CPI Cartel

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These are only some examples of the very successful applications of screens to assist in the initial detection of rigging of financial benchmarks. There should be little doubt that monitoring the data through appropriately developed and implemented screens is powerful and effective in identifying potential illegal conduct.

By enhancing the volume and sources of data and other information that can be used in screens, and the complexity of models, as well as a greater ability to run multiple screens simultaneously, AI will provide additional power to screens, and assist in minimizing the likelihood of errors. As economists with a particular focus on empirical work and screening, we are excited about the potential that AI has in this area.

3.6 Machine Learning Supplements Traditional Econometric and Statistical Tools such as Screening, Enhancing Compliance

In our view, machine learning will supplement screens but not replace them, in ensuring antitrust and regulatory compliance.[36] To understand the complementary role of these two sets of tools, let's think of the following useful, if not rigorous, definition of machine learning: it is an application of minimal-structure pattern-matching algorithms to (i) infer a classification rule from a training dataset and (ii) make useful predictions on new data. Of course, one need only dip one's toes in the water to see that this grossly oversimplifies the field, but it is fair to say that the primary goal of machine learning is to predict, or really classify. For example, is this an image of a human face or not? Is it an image of John Smith or not? Based on other users, what is the most helpful item to return if one enters "machine learning" in a search engine? From past experience, should we classify the demand for ride sharing to be "high" or "low" tomorrow afternoon (note that while there is a football game scheduled, severe thunderstorms are expected)?

These algorithms can be very powerful *predictors*, and that is their purpose. It has been established both in the rich theory of machine learning and in the practice of our daily lives, where we are confronted with these applications constantly and, at this point, seamlessly. Of course, they are not perfect, nor is any tool, but very often they are very useful.

If we compare this with traditional econometrics techniques, which may be defined as the application of statistical methods to economic problems, we immediately see important similarities, but also important differences. Econometric methods have long been used for purposes of predicting outcomes. The numerical techniques associated with "linear regression" always produce what is known as the "best linear predictor" even when some of the assumptions of true regression analysis do not hold.

We are therefore not surprised to find these same numerical techniques in textbooks on machine learning. Whatever else we want to say about Big Data and its novelties, any data scientist who wants to restrict her hypothesis class to linear functions will end up doing the same numerical procedure that an econometrician would. What is typically not found in those

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Column on the ISDAfix Decision' (15 June 2016). Available at: https://www.competitionpolicyinternational.com/isdafix-decision/; 'Beyond Leniency: Empirical Methods of Cartel Detection' American Bar Association Brown Bag Series (15 December 2011). Presentations, slides, and audio available at: www.americanbar.org.

[36] Rosa Abrantes-Metz and Albert Metz, 'Can Machine Learning Aid in Cartel Detection?' (2018) CPI Antitrust Chronicle, July.

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textbooks is the discussion of the statistical and distributional theory of regression which, after all, is largely beside the point of machine learning. Yet this statistical theory, and not the value of prediction, is really the emphasis of econometrics. Under what conditions can we test a hypothesis about how an outcome Y relates to an explanatory variable X? That knowing X would allow us to form useful predictions of Y is sometimes seen as a "nice-to-have." Econometricians sometimes take pains to argue that measures of fit, like the well-known R2 statistic, are of secondary or even tertiary importance. An econometrician may declare success in his research even with a very low R2, because – quite rightly – a high fit isn't necessary for the theory to be correct. But for those interested in prediction, it is likely of primary importance. A famous aphorism among econometricians holds that if you want to predict the number of left shoes sold, get data on the number of right shoes sold. You will have a perfect prediction, but you will have explained nothing, you will have nothing to test, and in fact, the conditions necessary for regression are altogether violated! This example highlights that predicting and understanding are not necessarily the same thing. We can sometimes predict one thing from another without understanding the nature of their relationship. We can also, under the right circumstances, develop an understanding of how one thing relates to another without being in a position to form a useful prediction.

Empirical research into the existence or effectiveness of cartels is best seen as a mixture of both problems. On the one hand, it would be extremely useful to have flexible, powerful, relatively unstructured algorithms which make useful predictions or classifications of whether certain data patterns are anomalous and worthy of further investigation. We fully expect to see an increasing use of machine learning techniques as data on prices, costs, quantities, and fundamental demand and supply drivers become ever more available. The expertise and understanding of economists will be critical to avoid problems of over-fitting and reacting to spurious results.

But the second problem will also always remain: the need to formulate the right statistically testable hypothesis. We will want to be able to make statements about the likelihood of one hypothesis versus an alternative one. Here again, the expertise of the economist will prove helpful, though it may be augmented with the special skills of computational experts. Empirical analysis has long been moving away from structured assumptions, such as supposing variables have one probability distribution or another, and towards much more data-intensive methods called "non-parametric."[37] These methods' popularity has risen as the necessary data requirements are more easily satisfied.

Therefore, machine learning and screening (through traditional econometric and statistical tools) can be powerful complements, and together vastly enhance data-based antitrust and regulatory compliance.

[37] Kernel regression and isotonic regression are just a couple of examples of completely non-parametric methods which have long been in the econometrics literature.

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3.7 AI Enhances the Monitoring of Pricing Algorithms

Another important role of AI is to monitor pricing algorithms through the use of machine learning and empirical screens. The views on whether pricing algorithms enhance collusion are not settled.[38]

Pricing algorithms provide many potential procompetitive effects, enhancing both static and dynamic efficiencies. For example, they improve price transparency, facilitate the collection and organization of information, and generally enhance efficiency. By facilitating price discovery, these algorithms can help markets reach equilibrium more efficiently, which redounds to the benefit of both producers and consumers.

But, as with most conduct, the devil is in the details. A very simple pricing algorithm could be set to "determine what my competitors are charging, and set my price to be $1 lower than the lowest." But it could also be "determine what my competitors are charging, and set my price to the average." By making prices more formulaic, they become more predictable to the competition, which may allow competitors to reach a supra-competitive equilibrium more easily, whether through tacit or explicit collusion. How concerned we should we be about this and what policy makers should do about it, is not yet settled.

While there is the possibility of pricing algorithms being programmed to collude, there is also a concern that they may *learn* to "collude" without any human explicitly programming them to do so. Some time ago, AI researchers developed a poker-playing AI. They did not teach it to bluff, but it learned to bluff by itself. Suppose, in good faith we develop a pricing algorithm and it learns that wherever I set my price, my competitor moves to it: It then comes to learn that it can keep raising prices without fear of competitive reprisal until the elasticity of demand becomes large enough. That market thus reaches an equilibrium with supra-competitive prices and decreased output. Pricing algorithms of these two competitors learned to coordinate their conduct. This type of pricing pattern could place these corporations at significant risk.

As pricing algorithms become more common across many industries, the identification of patterns generated by pricing algorithms (own and competitors') can go a long way to assist in the identification of potential anticompetitive conduct and other risks in real time. AI is particularly well positioned to enhance the monitoring of pricing algorithms.

3.8 AI Helps Corporations in their Risk Assessments and in Better Complying with the Requirements of the U.S. Sentencing Guidelines for Organizations

AI will help corporations in their risk assessments and in better complying with the requirements of the U.S. Sentencing Guidelines for Organizations, which have become the benchmark for compliance programs in all areas, including antitrust.

AI will be a valuable tool to assist in the determination of the greatest areas of risk (i.e., which risks are more likely to occur) and monitor them. For many corporations, antitrust risk is one of the main such risks.

While there are several possible avenues to address these risks, a proactive policy of antitrust compliance which collects information as widely as possible, processes it, and monitors

[38] Rosa Abrantes-Metz and Albert Metz, 'Pricing Algorithms and Collusion: Is There Clarity on What Corporations May Be on the Hook For?' (2020) CPI Antitrust Chronicle, November.

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conduct with the help of AI (and screening) is a very important avenue. This is because it will more likely flag the high-risk areas of a business and allow for better targeting of audits to those areas and assist in monitoring these in a more efficient way.

AI employs techniques that can assist in determining which parts of the company merit closer scrutiny, where there should be intensive reviews, and which units may call for intensive monitoring of internal communications and other direct actions. Machine learning and empirical screens can help fulfill this role by looking at certain quantifiable red flags and applying statistical analysis to determine the priority areas for further focus, allowing for a more efficient allocation of resources.

3.9 AI can Assist in the Detection of Conduct Beyond Collusion and in the Collection of Additional Evidence

AI can be used to assist in the detection of additional types of conduct, beyond collusion. For example, by more easily and effectively monitoring communications, AI can help flag potential anticompetitive conduct such as threats to competitors and various patterns associated with monopolization. It can also monitor and flag potentially anticompetitive algorithms with features designed, at least to some extent, to foreclose competitors and price discriminate.

3.10 Direct Evidence of Anticompetitive Conduct is Getting Harder to Find, Enhancing the Need for AI in Compliance

Direct evidence in the form of communications and explicit agreements, and more generally, confessions of anticompetitive conduct, is ever harder to find. For example, once the possibility of collusion is identified, the successful prosecution of a cartel often relies on the paper trail left by its members, such as e-mails, notes, and other records documenting the intent to collude and the existence of an explicit agreement. Everyone – including the guilty – knows this. And everyone – especially the guilty – has learned their lessons from LIBOR and Foreign Exchange: that their incriminating emails and chat messages may hang them. Therefore, everyone, including the corporation, should expect cartel members to adopt new communication technologies which do not keep records, at least not as easily, and to be more cautious about leaving traces of their explicit agreements.

If anticompetitive conduct is, in fact, effective from the abusers' point of view, it will distort market outcomes and will, in principle, be detectable in the data through the appropriate screens and machine learning techniques. It may also be detectable through the monitoring of live virtual/video meetings and other surveillance, all enhanced by AI.

3.11 AI-Based Compliance Programs Will Enhance Cost Effectiveness

Of course, the extensive automation of all these processes generates efficiencies, which leads to more cost-effective programs. Yes, at the end of the day, corporations need to make a decision on the adoption of AI for compliance and how much investment to undertake. Hence, not just the benefits and incentives summarized above, but also the costs will be part of the decision making. In our view, though, there is not much of a question that corporations, particularly above a certain size, will need to adopt these tools sooner rather than later. But even for smaller corporations, there is always something that can be done, for almost any budget.

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3.12 Competition Authorities and Regulatory Agencies are Starting to Use AI, Corporations Cannot Afford to Stay Behind

Many competition authorities around the world have adopted screens for conspiracies and manipulations. Some competition and regulatory agencies are now starting to adopt larger, broader AI tools including machine learning. The reality is that corporations cannot afford to stay behind: the stakes are too high. After all, recall that in the U.S., credits are now given to effective compliance programs that actively detect potential anticompetitive conduct, and the array of anticompetitive conduct considered is very large and potentially further increasing with new regulations. And of course, with respect to collusion, there is an advantage in being the first to detect and come forward with a leniency application.

4. THE CRITICAL HUMAN ROLE AS AN INPUT IN AI-BASED COMPLIANCE AND REGULATORY PROGRAMS

The wide array of tasks that AI can potentially undertake is impressive and exciting, but should also be taken with great care. AI can do a lot, but it should not and cannot do so alone: human input and expertise are critically indispensable. Potentially almost all antitrust and regulatory compliance tasks can already be automated to a large extent, reducing the chances of human error and enhancing efficiency, but not without human expertise.

Corporations need to determine their goals, how to execute them, and how to monitor them. While AI will be a valuable tool all the way around, AI is not a panacea and requires much human expertise. At the end of the day, corporations have to take responsibility for their conduct. Regulators will be asking corporations how AI will assist in the determination of which activities to internally focus on and monitor, as well as how such monitoring is conducted. Individuals program AI and must assess its performance and ensure its reliability. Furthermore, there is a real possibility that AI may be programmed to facilitate price discrimination, collusion, and other anticompetitive conduct, as well as fraud more generally. But that is nothing new. Every tool can be used for good, or abused and misused. We cannot and should not give AI control over antitrust and regulatory compliance. AI must know "who's the boss" and that is us, humans. We must have the first and last say on decision making.

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21. The Effect of Corporate Board Gender Diversity on Compliance with EU Competition Law

Amber Scheepers

1. INTRODUCTION

In 2015, former Bundeskanzlerin Angela Merkel qualified the implementation of Germany's first gender quota laws as 'Chefsache',[1] meaning as having the utmost importance to her personally.[2] Since then, Germany has implemented the so-called First Leadership Positions Act ("FüPoG I"), and an extension of the quota in supplementary regulations for the equal participation of women in leadership positions (so-called Second Leadership Positions Act – "FüPoG II"). The implementation of the German gender quotas has brought forth substantial results. Whilst women represented 12% of board members on listed companies in Germany in 2010, this number had increased to 26% in 2015.[3] In 2021, after the first reading of the FüPoG II, 36% of German company directorships were held by women.[4] These results are impressive considering the stagnation of increased gender representation in the EU overall. From 2010 to 2015 the proportion of female members on corporate boards in Europe grew by an average rate of 2.2 percentage points per year and dropped to 1.3 percentage points after 2015.[5] According to the European Commission, this EU wide slowdown is attributable to the key drivers of progress over the earlier period having run out or being close to target and marks the limited progress that some other Member States have made.[6] As men still significantly outnumber women on corporate boards, there is a need for a new impulse.

[1] Chefsache literally means 'matter for the chef'. It is a word of German origin, which is mainly used in a political context. It indicates an issue that is so important and politically sensitive that the highest boss must speak out on it: in the most extreme case, the Chancellor.

[2] Prof. Dr. Martina Schraudner, 'Gender Equality Advancement in the German Research Landscape: An Assessment from a German Practitioner' (Fraunhofer-Center for Responsible Research and Innovation 2015).

[3] EWOB, 'Gender Diversity Index of Women on Boards and In Corporate Leadership' (European Union 2021); European Institute for Gender Equality (EIGE), 'Gender Statistics Database' (1 June 2022) https://eige.europa.eu/gender-statistics/dgs/indicator/wmidm_bus_bus__wmid_comp_compex/map accessed 7 September 2022.

[4] EIGE (n 3).

[5] EIGE statistics database. Data updated 23.05.2023. Available at Business and finance | Gender Statistics Database | European Institute for Gender Equality (https://eige.europa.eu/gender-statistics/dgs/browse/wmidm/wmidm_bus) accessed 28.05.2024.

[6] European Commission, Directorate General for Justice and Consumers, '2022 Report on Gender Equality in the EU' (Publications Office 2022) available at: https://data.europa.eu/doi/10.2838/502062 accessed 28.05.2024.

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Initially, the cause of increasing gender diversity in the boardroom was classified as an issue of anti-discrimination, equity, and equal opportunity for women in the workplace. However, since the late 1990s, female participation in the economic sphere has become increasingly associated with increased organizational efficiency and profits.[7] Such 'business case' arguments for women in economic decision-making are based on the proposition that the underrepresentation of women causes an underutilization of skills and expertise for the business sector.[8]

Whereas the literature on the benefits of gender diversity has grown significantly during recent years,[9] progress in the numerical representation of women in high-level positions has stagnated.[10] To resolve the underrepresentation of women in economic decision-making, several Member States implemented quota laws, mandating listed companies to increase the number of women holding boardroom positions.[11] Quotas have proven to be an effective tool to increase women's access to corporate boards.[12] However, the introduction of mandatory

[7] Two of the first and most influenctial studies on this topic: David A Matsa and Amalia R Miller, 'A Female Style in Corporate Leadership? Evidence from Quotas' (2013) 5 Applied Economics 136; Kenneth R Ahern and Amy K Dittmar, 'The Changing of the Boards: The Impact on Firm Valuation of Mandated Female Board Representation' (2012) 127 The Quarterly Journal of Economics 137.

[8] Cathrine Seierstad, 'Beyond the Business Case: The Need for Both Utility and Justice Rationales for Increasing the Share of Women on Boards' (2016) 24 Corporate Governance: An International Review 390; Mary Jane Lenard and others, 'Female Business Leaders and the Incidence of Fraud Litigation' (2017) 43 Managerial Finance 59; Jenny M Hoobler and others, 'The Business Case for Women Leaders: Meta-Analysis, Research Critique, and Path Forward' (2016) 44 Journal of Management 2473, available at: https://doi.org/10.1177/0149206316628643; Deborah E Arfken, Stephanie L Bellar and Marilyn M Helms, 'The Ultimate Glass Ceiling Revisited: The Presence of Women on Corporate Boards' (2004) 50(2) Journal of Business Ethics 177; Siri Terjesen, Ruth Sealy and Val Singh, 'Women Directors on Corporate Boards: A Review and Research Agenda' (2009) 17 Corporate Governance: An International Review 320; Renée B Adams, 'Women on Boards: The Superheroes of Tomorrow?' (2016) 27 The Leadership Quarterly 371.

[9] Eva María Sánchez-Teba, María Dolores Benítez-Márquez and Paloma Porras-Alcalá, 'Gender Diversity in Boards of Directors: A Bibliometric Mapping' (2021) 7 Journal of Open Innovation: Technology, Market, and Complexity 1.

[10] European Commission, '2022 Report on Gender Equality in the EU' (European Commission 2022) SWD(2022) 54 final.

[11] Council of the European Union, 'Council Conclusions on the European Pact for Gender Equality for the Period 2011–2020' (2011).

[12] Anja Kirsch, 'Women on Boards Policies in Member States and the Effects on Corporate Governance: Study Requested by the JURI Committee Policy Department for Citizens' Rights and Constitutional Affairs Directorate-General for Internal Policies' (European Parliament 2021); EIGE (n 3); Marianne Bertrand, Sandra E Black, Sissel Jensen and Adriana Lleras-Muney, 'Breaking the Glass Ceiling? The Effect of Board Quotas on Female Labor Market Outcomes in Norway' (2014) IZA Discussion Paper No. 8266. Institute for the Study of Labor (IZA). https://ftp.iza.org/dp8266.pdf; Anne Laure Humbert, Elisabeth K Kelan and Kate Clayton-Hathway, 'A Rights-Based Approach to Board Quotas and How Hard Sanctions Work for Gender Equality' (2019) 26 European Journal of Women's Studies 447, available at https://doi.org/10.1177/1350506819857125; Cathrine Seierstad, Patricia Gabaldon and Heike Mensi-Klarbach, 'The Use of Different Quota

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regulations for appointments of board members is often met with opposition from the business sector. Large companies may support the quota laws for the betterment of their social image, but it has been suggested that companies voluntarily increase the number of women in leadership positions if it provides economic benefits.[13] Therefore, there is a need for a new economic argument for diversity as an expansion of the business case.[14]

The nexus between corporate governance and compliance with competition law is a multifaceted and crucial aspect of contemporary business dynamics. Corporate governance serves as the cornerstone of an organization's internal structure and decision-making processes. It encompasses a set of principles, practices, and mechanisms that delineate the roles, responsibilities, and accountability of various stakeholders within a company, including its board of directors. In the context of competition law compliance, effective corporate governance plays a pivotal role in ensuring that a company adheres to the antitrust regulations and principles that govern competition.

The present chapter is the first to set out to find a new economic rationale for increased gender diversity with a focus on competition law compliance. The central question this study asks is: *What is the effect of corporate board gender diversity on compliance with European competition law*? This topic is highly relevant to corporate governance and business practices. Examining how companies navigate and adhere to competition laws can provide valuable insights into their commitment to legal and ethical standards. Additionally, it aligns well with the increased academic focus on gender diversity on corporate boards within the law and business department. The need for this research is twofold: new incentives for increased gender diversity are necessary to combat stagnation in overall equal gender representation on corporate boards in Europe, and new proactive compliance mechanisms need to be identified to combat anticompetitive behavior. One such proactive mechanism is increased gender diversity on corporate boards. This research aims at combining both.

Competition law is one of the building blocks of the European Union's internal market, with the European Commission as its main enforcer and watchdog. The main actors, however, are the companies conducting their business in the European market. Compliance with the rules and regulations of competition is essential for the market to function and protect its consumers. Unfortunately, it has been suggested that the deterrent effect of fines is rather low.[15] Therefore, the focus must shift from reactive punishment in the form of fines to proac-

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Regulations' in *Gender Diversity in the Boardroom, Vol 1: The Use of Different Quota Regulations* (Palgrave Macmillan 2017).

[13] Arfken, Bellar and Helms (n 8); McKinsey, 'Gender Diversity in Top Management: Moving Corporate Culture, Moving Boundaries' (McKinsey & Company 2013); Celia Huber and Sara Slayton O'Rourke, 'How to Accelerate Gender Diversity on Boards' [2017] *McKinsey Quarterly*, available at: https://www.mckinsey.com/featured-insights/leadership/how-to-accelerate-gender-diversity-on-boards accessed 12 September 2022; Philip N Cohen and Matt L Huffman, 'Working for the Woman? Female Managers and the Gender Wage Gap' (2007) 72 American Sociological Review 681; Deloitte & Alliance for Board Diversity, 'Missing Pieces Report: The Board Diversity Census of Women and Minorities on Fortune 500 Boards, 6th Edition' (2017) www.deloitte.com. accessed 16 August 2022; Alice H Eagly and Linda L Carli, 'The Female Leadership Advantage: An Evaluation of the Evidence' (2003) 14 The Leadership Quarterly 807.

[14] Hoobler and others (n 8); Seierstad (n 8).

[15] Wouter PJ Wils, 'Optimal Antitrust Fines: Theory and Practice' (2006) 29 World Competition 184. Wils has criticized this approach by stating that: "If there is no legal reason to calculate fines

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tive compliance safeguards.[16] It is for this reason that we must look at different mechanisms within the companies themselves that could potentially increase compliance with competition rules and regulations. In this chapter, one of these potential mechanisms is increased gender diversity on corporate boards. Research on the effects of increased board gender diversity (hereafter: BGD) during recent years has uncovered great potential for both financial and non-financial corporate performance. Focusing on the non-financial side, many agree that diversity of gender increases diversity of knowledge, skills, and perspectives in groups such as corporate boards. This in turn may aid boards' decision-making processes, leading to an increase in the quality of decision-making.[17] In comparison, gender homogeneity increases the probability of homogeneity of perspectives, which can jeopardize decision-making caused by one-sided and potentially under-informed decision-making.[18]

The focus on competition law in this chapter provides a new and innovative angle. Within undertakings subject to competition law, compliance is the responsibility of the board of directors as a group and as individual members. It is therefore important to ensure that their decisions are taken in the most optimal circumstances. Understanding what drives managers to breach competition laws or to comply with them must be explored to add efficiencies to the design of compliance strategies. Securing more diversity within boards may be one area that can contribute to optimal decision-making. The focus of this chapter is on gender specifically, as gender diversity encompasses both differences between male and female perspectives of individual board members and allows for analysis of diversity as an overarching characteristic of corporate governance. One way to solve the homogeneity problem is by diversifying the board's demographic by, for example, electing an equal representation of men and women to the board. Although diversity comes in many different forms such as age, ethnicity, and social and educational background, this paper will focus on gender diversity – men and women – on corporate boards.

The present study aims to explain how gender heterogeneity can benefit boards through changes in decision-making processes and board culture. These changes may lead to different economic outcomes between gender homogeneous and heterogeneous boards. Different perspectives, alternative conceptualizations of value, and the specification of underlying

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as a percentage of turnover, an economic justification is not easy to find either. To achieve effective deterrence, fines should optimally be equal to the harm caused by the infringement, or alternatively equal to the benefit gained by the violator plus some safety margin, divided by the probability of detection and punishment."

[16] Florence Thépot, T*he Interaction Between Competition Law and Corporate Governance: Opening the 'Black Box'* (Cambridge University Press 2019).

[17] Walid Ben-Amar, Millicent Chang and Philip McIlkenny, 'Board Gender Diversity and Corporate Response to Sustainability Initiatives: Evidence from the Carbon Disclosure Project' (2017) 142 Journal of Business Ethics 369. For an overview of studies relating to non-financial performance increase: Qichun Wu, Fumitaka Furuoka and Shu Chui Lau, 'Corporate Social Responsibility and Board Gender Diversity: A Meta-Analysis' (2021) 45 Management Research Review 956.

[18] Sven Horak and Jingjing Cui, 'Financial Performance and Risk Behavior of Gender-Diversified Boards in the Chinese Automotive Industry Initial Insights' (2017) 46 Personnel Review 847; Elise Perrault, 'Why Does Board Gender Diversity Matter and How Do We Get There? The Role of Shareholder Activism in Deinstitutionalizing Old Boys' Networks' (2015) 128 Journal of Business Ethics 149.

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mechanisms linking group decision-making to performance can generate changes in both the dominant ontology and the epistemology underlying this body of research.[19]

While both the EU and its individual Member States have increased their efforts to combat women's underrepresentation on boards, Germany is chosen as the main subject of interest for this chapter for several reasons. First, because the data availability of German-based companies is extensive. German law imposes transparency obligations on companies trading on the Frankfurt Stock Exchange (FSE). Second, Germany did not allow a long implementation period. The first gender quota initiative was announced in 2013[20] and implemented in 2015. After the beginning of 2016, all newly appointed directors had to adhere to the gender quota requirements. Additionally, the data included in the sample (as described below) ranges from 2010 to 2020, putting 2015 in the middle. This range allows for an equal pre- and post implementation period of 5 years, with companies having two years preparation time, and one year adjustment or grace period. As a final reason, while all EU Member States have their own national competition authorities (NCAs), the German Bundeskartellamt is one of the most active and influential NCAs. This allows for a representative analysis of the EU, and I expect it to increase the amount of data that is available.

This chapter will proceed as follows: in section 2, the theoretical explanation for gender diversity and its effects on corporate compliance is discussed. Additionally, the concept of gender diversity is explained from a linguistic and legal approach, together with its relationship with the board's decision-making process. The section builds on the idea that heterogeneity in workgroups increases the information elaboration process, which consequently improves decision-making outcome quality. Section 3 goes on to explain the technical underpinnings of the empirical analysis. I explain the German gender quota and governance system, as well as the methodology, data included, and empirical model. Section 4 will show the results of the main regression analysis as well as supplementary analyses. Section 5 discusses the limitations and areas for new research. Section 6 will provide concluding remarks.

2. GENDER DIVERSITY: DECISION-MAKING AND COMPLIANCE

Corporate boards can be analyzed as intricate social networks, where individual attributes and group cohesion hold significant sway.[21] The decision-making culture within the boardroom is markedly influenced by the independence, skills, knowledge, and expertise of its members. Scrutinizing these mechanisms as working groups provides enhanced insights to make informed decisions regarding governance sustainability and investment returns. Furthermore, the heightened legal scrutiny faced by boards and the intensifying competitiveness in the corporate control market underscore the growing interest in board cultures in recent decades.[22]

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[19] Hoobler and others (n 8).

[20] Others have adhered to the year of announcement (2013) to determine the pre and post quota period. Alexandra Fedorets, Anna Gilbert and Nora Smitt Burow, 'Gender Quotas in the Boardroom: New Evidence from Germany' (2019) DIW Berlin at p. 11.

[21] Daniel P Forbes and Frances I Milliken, 'Cognition and Corporate Governance: Understanding Boards of Directors as Strategic Decision-Making Groups' (1999) 24 Management Review 489.

[22] ibid.

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Achieving effective corporate governance hinges upon an efficient decision-making process, which can be greatly enhanced by the introduction of board heterogeneity. Homogeneous boards, by their very nature, often fail to recognize the shared internal norms and status characteristics, thus perpetuating a certain conformity.[23] Diversity provides groups with a richer pool of resources, fostering innovation. Exposure to diverse and unexpected viewpoints nurtures creativity[24] and enables thorough information elaboration through idea exchange, discussion, and integration.[25] Research indicates a positive indirect effect of increased female board representation on financial performance, tied to enhanced compliance with ethical and social standards.[26] Yet, the impact of gender diversity on competition law compliance is underexplored. The pivotal role of group processes in shaping outcomes becomes evident,[27] therefore, a potential link with competition law merits investigation[28] as the relationship between group processes and effectiveness is not static but varies with the nature of the task at hand.[29]

Despite traditional research on corporate governance efficiency adopting an economic approach, addressing conflicts of interest and value distribution, there is a lack of coherent integration of a complementary behavioral approach.[30] A behavioral theory approach to boards and corporate governance enables a more profound examination of interactions and processes within the boardroom. From a social categorization perspective, boards are social networks where shared characteristics like age, gender, or ethnicity determine group dynam-

[23] Diana Bilimoria, 'The Relationship Between Women Corporate Directors and Women Corporate Officers on JSTOR' (2006) 18 Journal of Managerial Issues 47; Terjesen, Sealy and Singh (n 8).

[24] Daan Van Knippenberg, Carsten KW De Dreu and Astrid C Homan, 'Work Group Diversity and Group Performance: An Integrative Model and Research Agenda' (2004) 89 Journal of Applied Psychology 1008; Claudia Fritz and Daan van Knippenberg, 'Gender and Leadership Aspiration – The Impact of Work–Life Initiatives' (2018) 57 Human Resource Management 855; Daan Van Knippenberg and Michaéla C Schippers, 'Work Group Diversity' (2007) 58 Annual Review of Psychology 515.

[25] Van Knippenberg, De Dreu and Homan (n 24); Daniel Ferreira, 'Board Diversity: Should We Trust Research to Inform Policy?' (2015) 23 Corporate Governance: An International Review 108; Eagly and Carli (n 13); Hoobler and others (n 8); Jane Flax, 'Postmodernism and Gender Relations in Feminist Theory' (1987) 12 Signs 621.

[26] Helena Isidro and Márcia Sobral, 'The Effects of Women on Corporate Boards on Firm Value, Financial Performance, and Ethical and Social Compliance' (2015) 132 Journal of Business Ethics 1.

[27] Sabina Nielsen and Morten Huse, 'The Contribution of Women on Boards of Directors: Going beyond the Surface' (2010) 18 Corporate Governance: An International Review 136.

[28] Ben-Amar, Chang and McIlkenny (n 17).

[29] Deborah L Gladstein, 'Groups in Context: A Model of Task Group Effectiveness' (1984) 29 Administrative Science Quarterly 499.

[30] Morten Huse, 'Accountability and Creating Accountability: A Framework for Exploring Behavioural Perspectives of Corporate Governance' (2005) 16 British Journal of Management S65; Catherine M. Daily, 'The Relationship Between Board Composition and Leadership Structure and Bankruptcy Reorganization Outcomes' (1995) 21(6) Journal of Management 1041.; Daniel P Forbes and Frances I Milliken, 'Cognition and Corporate Governance: Understanding Boards of Directors as Strategic Decision-Making Groups' (1999) 24 Management Review 489; Hans van Ees, Jonas Gabrielsson and Morten Huse, 'Toward a Behavioral Theory of Boards and Corporate Governance' (2009) 17 Corporate Governance: An International Review 307.

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ics.[31] Homogeneous groups decide quickly but may overlook critical issues, lacking diverse perspectives. Social categorization may create an "us-versus-them" mentality, disrupting information elaboration and decision quality. Gender-based social categorization can lead to intergroup bias, disrupting communication and group cohesiveness. Paradoxically, the positive effects of diversity emerge from the information perspective, emphasizing the importance of skills and perspective diversity. From an information perspective, diversity goes beyond visible traits to include education, expertise, and career paths. Diversity correlates positively with task-relevant information elaboration, improving group performance and decision quality.[32] In this context, these approaches effectively highlight disparities between the social categorization of women as a minority group and as individual board members, contributing to the disruption of the information elaboration process – a pivotal mechanism for effective decision-making and desired outcomes. To mitigate bias, fostering mutual understanding is crucial. Women, as the minority, are held to a higher standard within this framework, given their low-status group position, and as such, they must navigate additional scrutiny.[33] In the context of gender diversity, promoting women's experience in board positions challenges biases and enhances confidence.[34] This assimilation, however, may compromise the richness of women's unique perspectives and capabilities.[35] Assimilating to established norms poses a challenge for diversifying decision-making. Recognizing differences is crucial for empowering women to contribute, enhancing board decision quality.[36]

In the realm of competition law, ensuring compliance with antitrust regulations is a complex endeavor, necessitating multifaceted incentives beyond the traditional reliance on fines as the primary deterrent. Effective corporate governance wields substantial influence over a company's adherence to competition law.[37] The board must ensure strategic decisions are based on thorough risk assessments and cost-benefit analyses, including considering their impact on competition. Through effective governance, the board can identify and address anticompetitive behavior within the company, safeguarding against non-compliance risks and promoting adherence to competition laws. The specific form of the compliance scheme is not

[31] Daan Van Knippenberg, Carsten KW De Dreu and Astrid C Homan, 'Work Group Diversity and Group Performance: An Integrative Model and Research Agenda' (2004) 89 Journal of Applied Psychology 1008, 1013. The authors note tha elaborate processing of task-relevant information and perspectives requires time. Time constraints may thus put serious limits on a group's ability to elaborate.

[32] Daniel P Forbes and Frances I Milliken, 'Cognition and Corporate Governance: Understanding Boards of Directors as Strategic Decision-Making Groups' (1999) 24 Management Review 489.

[33] Rosabeth Moss Kanter, 'Some Effects of Proportions on Group Life: Skewed Sex Ratios and Responses to Token Women' (1977) 82(5) American Journal of Sociology 965–990, available at: https://www.jstor.org/stable/2777808 accessed 11 April 2019.

[34] Robin J Ely, 'The Power in Deiviography: Women's Social Constructions of Gender Identity at Work' (1995) 38 Academy of Management Journal 589.

[35] Amy Hillman, Christine Shropshire and A Cannella, 'Organizational Predictors of Women on Corporate Boards' (2007) 50 Academy of Management Journal 941, 944.

[36] Bilimoria (n 23); Terjesen, Sealy and Singh (n 8); Ely (n 34); Nielsen and Huse (n 27); Hoobler and others (n 8).

[37] Barry J Rodger, 'Competition Law Compliance Programmes: A Study of Motivations and Practice' (2005) 28 World Competition 349.

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predefined, and its nature depends on factors unique to the company.[38] Existing literature highlights three primary factors influencing competition law compliance: moral or ethical considerations, the effectiveness of corporate governance, and the apprehension of penalties and sanctions.[39] Notably, the conventional deterrent effect of fines, while an essential tool, falls short in isolation as a deterrence mechanism and has proven suboptimal and difficult to establish at an optimal level.[40] This predicament underscores the need for research to unearth novel compliance incentives, particularly those rooted in economic benefits, to safeguard the integrity of the internal market and protect consumers.

The intricate interplay between corporate governance and compliance, in a broader organizational context, has garnered scholarly attention, with the Enron scandal serving as a notable case study.[41] The implications of the Enron crisis can be linked to the absence of diversity in the perspectives of company directors. The stark homogeneity within Enron's board – comprising 16 male members out of 17 – contributed to the company's troubles, highlighting the central role that corporate boards play in ensuring compliance.[42] Literature on management teams reveals that groups composed of demographically dissimilar members possess the potential to yield innovative approaches to qualitative decision-making tasks.[43]

In summary, a growing body of evidence suggests that increased gender diversity on corporate boards can enhance decision-making processes and outcomes, thereby contributing to improved corporate compliance, including with competition law. To ascertain the veracity of these findings, it is imperative to examine board compliance dynamics in concrete contexts where gender diversity is a reality, rather than a hypothetical scenario. This necessitates a closer examination of gender quotas to facilitate women's representation in decision-making roles, an aspect that will be discussed further with a focus on Germany as the subject of empirical investigation.

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[38] Florian Wagner-von Papp, 'Managerial Liability, Managerial Duties, And Liability Within Corporate Groups: Optimal Competition Law Sanctions by Rearranging the Deckchairs Within the Undertaking?' in this Handbook.

[39] Rodger (n 38).

[40] Loet van Stekelenburg and others, 'Integrating Norms, Knowledge, and Social Ties into the Deterrence Model of Cartels: A Survey Study of Business Executives' (2023) 63 Review of Industrial Organization 275; Ane Martín, Carlos Merino and Javier García-Verdugo, 'Determinants of the Deterrence of Competition Fines in Spain (2015–2019)' (2022) 13 Journal of European Competition Law & Practice 1.

[41] Gerald Vinten, 'The Corporate Governance Lessons of Enron' (2002) 2 Corporate Governance: The International Journal of Business in Society 4.

[42] Woodrow W Clark and Istemi Demirag, 'Enron: The Failure of Corporate Governance' [2002] The Journal of Corporate Citizenship 105; Vinten (n 41); Darrell J Steffensmeier, Jennifer Schwartz and Michael Rochea, 'Gender and Twenty-First Century Corporate Crime: Female Involvement and the Gender Gap in Enron-Era Corporate Frauds' (2013) 78 Source: American Sociological Review 448.

[43] Mariateresa Torchia, Andrea Calabrò and Morten Huse, 'Women Directors on Corporate Boards: From Tokenism to Critical Mass' (2011) 102 Journal of Business Ethics 299; Huse (n 30); Van Knippenberg, De Dreu and Homan (n 24); Gladstein (n 29).

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3. EMPIRICAL STUDY ON GENDER QUOTAS

The empirical study will seek to explore the relationship between BGD and compliance with EU competition law within the German corporate landscape. By examining the impact on compliance, I aim to shed light on the complex interplay between corporate governance, gender representation, and legal adherence within the context of competition law in Germany.

The recognition of gender diversity in the corporate landscape was relatively subdued until Norway introduced gender quotas for corporate boards in 2005.[44] Subsequently, the EU adopted a tripartite policy framework to enhance women's representation on corporate boards in its Member States. These policies encompass gender quota laws, recommendations within corporate governance codes for women's representation, and obligatory disclosure of women's representation on boards.[45] This study will focus solely on gender quotas.[46]

Gender quotas are characterized by their designation of a specific proportion of board positions to be reserved for both women and men. The precise formulations of these quotas have exhibited variability across sectors and countries. The surge in prerequisites for women's participation in economic and political decision-making has been denoted as the 'gender quota revolution'.[47] Spain led the EU Member States in instituting economic gender quotas in 2007,[48] followed by Belgium, France,[49] Italy,[50] and the Netherlands in 2011.[51] Germany implemented

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[44] Mari Teigen, 'The Making of Gender Quotas for Corporate Boards in Norway' in Frederik Engelstad and Anniken Hagelund (eds), *Cooperation and Conflict the Nordic Way* (Walter de Gruyter GmbH 2016); Espen B Eckbo, Knut Nygaard and Karin S Thorburn, 'Valuation Effects of Norway's Board Gender-Quota Law Revisited' (2022) 68 Management Science 4112.

[45] European Commission, 'Women in Economic Decision-Making in the EU – Progress Report : A Europe 2020 Initiative' (Publications Office of the European Union 2012); Annick Masselot, 'The State of Gender Equality Law in the European Union' (2007) 13 European Law Journal 152; European Commission, 'Proposal for a Directive of the European Parliament and of the Council Amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as Regards Corporate Sustainability Reporting' (European Commission 2021) https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021PC0189&from=FR accessed 16 August 2022; Non-Financial Reporting Directive (NFRD) 2014 (Official Journal of the European Union).

[46] For an elaborate overview of all policies adopted in the Member States, see EIGE (n 3); Kirsch (n 12).

[47] Éléonore Lépinard and Ruth Rubio-Marín, 'Completing the Unfinished Task? Gender Quotas and the Ongoing Struggle for Women's Empowerment in Europe' in Éléonore Lépinard and Ruth Rubio-Marín (eds), *Transforming Gender Citizenship: The Irresistible Rise of Gender Quotas in Europe* (Cambridge University Press 2018) 1.

[48] Ley Organica 3/2007, de 22 de marzo, para la igualdad efectiva de mujeres y hombres. (Constitutional Act 3/2007 of 22 March for effective equality between women and men) 2007.

[49] Loi n° 2021-1774 du 24 décembre 2021 visant à accélérer l'égalité économique et professionnelle 2021 [2021–1774] extending the gender quota introduced in 2011 by Loi n°2011-103 du 27 janvier 2011.

[50] Legge 120/2011 ('Italian gender quota law', also referred to as 'quote rosa').

[51] Netherlands. Law of 6 June 2011 amending Book 2 of the Dutch Civil Code in connection with the introduction of a target figure for the male-female ratio on management and supervisory boards. Staatsblad 2011, 275.

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its quotas in 2015,[52] Austria and Portugal in 2017, and Greece in 2020. The target levels for quotas have ranged from 25% to 40% representation of both genders. Criteria for applicability, scope, and identifiability varied for each Member State.[53]

In the words of EU Commissioner Helena Dalli: "[quotas] can be a very ugly word, but also a necessary evil, in the sense we have to use quotas because otherwise we will wait another 100 years for things to change by themselves."[54] Although this may be true, it is difficult for advocates of legal requirements on gender diversity to convince the skeptics. The absence of a definitive cost-benefit analysis remains a notable challenge in the discourse.

The implementation of gender quotas in boardrooms has generated debates and raised certain concerns. Some argue that companies, in response to the new legislation, have appointed less experienced and younger female directors.[55] Consequently, this shift has led to an increase in employee numbers, reduced accounting returns, and a decrease in defenses against takeovers.[56] These factors contribute to the negative association between affirmative actions and increased gender diversity.

It is imperative to distinguish between the impact of gender *diversity* and that of gender *quotas* on corporate performance. Mandatory gender quotas often serve as a natural experiment to elucidate the causal relationship between diversified boards and various company performance indicators. This dynamic differs when examining voluntary gender diversity initiatives.

Notably, Matsa and Miller underscored the phenomenon in Norway where companies rapidly hired highly qualified women for board positions after the announcement of gender quota laws.[57] Subsequently, firms with fewer women on their boards were compelled to recruit less experienced and qualified female directors. This phenomenon may be more pronounced in sectors with a paucity of female candidates, such as Information Technology (IT) or Science, Technology, Engineering, and Mathematics (STEM). Organizations must navigate selection bias in their director appointments to foster diversity and align with evolving market dynamics. Given that corporate executives, predominantly male, often engage in homosocial reproduction, a practice where they select board members who share similar demographic

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[52] Gesetz für die gleichberechtigte Teilhabe von Frauen und Männern an Führungspositionen in der Privatwirtschaft und im öffentlichen Dienst [Law for the Equal Participation of Women and Men in Leadership Positions in the Private Sector and the Public Sector] 2015 [18–64384].

[53] For information on the specific requirements per Member State, see: Kirsch (n 12) tbl 2/3.

[54] Jennifer Rankin, 'EU Revives Plans for Mandatory Quotas of Women on Company Boards' *The Guardian* (5 March 2020) available at: https://www.theguardian.com/world/2020/mar/05/eu-revives-plans-for-mandatory-quotas-of-women-on-company-boards accessed 10 September 2022.

[55] Bertrand and others (n 12); Sonja A Kruisinga and Linda Senden, 'Gender Diversity on Corporate Boards in the Netherlands: Waiting on the World to Change' (2017) 1 Gender Diversity in the Boardroom 177; Thomas Schmid and Daniel Urban, 'Women on Corporate Boards: Good or Bad?' (University of Hong Kong, Faculty of Business and Economics & Technische Universitat Munchen, Department of Financial Management and Capital Markets 2015); Emmanuel Zenou, Isabelle Allemand and Bénédicte Brullebaut, 'Gender Diversity on French Boards: Example of a Success from a Hard Law' (2017) 1 Gender Diversity in the Boardroom 103.

[56] Renée B Adams and Daniel Ferreira, 'Women in the Boardroom and Their Impact on Governance and Performance' (2009) 94 Journal of Financial Economics 291.

[57] David A Matsa and Amalia R Miller, 'A Female Style in Corporate Leadership? Evidence from Quotas' (2013) 5 American Economic Journal: Applied Economics 136, 157.

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attributes, including age, gender, background, and experience, it is pertinent to consider terms such as 'selection bias' and 'affinity bias' to articulate this preference.[58] 'Affinity bias' denotes an unconscious prejudice that inclines individuals to favor those who exhibit shared interests, backgrounds, and physical characteristics. In organizations with a historical predominance of male leadership, there exists a natural inclination to continue hiring more men due to a sense of familiarity and confidence within this demographic. Leadership, during the organization's formative stages, significantly contributes to shaping its culture. However, as the organization matures, this culture exerts a more pronounced influence on the conduct and attitudes of its leaders.[59] Consequently, men are often chosen to perpetuate the organization's legacy because they align with the cultural norms and image of the institution. It is essential to recognize that corporate entities operate within a broader commercial landscape, an interconnected market where demographic shifts and diversification have been observed.[60] Corporations that adapt their leadership and board diversity to match the evolving composition of their potential customer and supplier network stand to enhance their market penetration and competitiveness.

The attitudes of shareholders bear significance, particularly within the context of German supervisory boards subject to co-determination. Half of the members on these boards are elected by shareholders, with the other half representing employees. Shareholders traditionally enjoyed unfettered autonomy in electing supervisory board members of their choice. The implementation of quotas, however, has curtailed this freedom, mandating gender representation. Consequently, this shift may engender aversion to female directors and perpetuate the notion that women have not earned these positions on merit, potentially resulting in stereotyping.[61]

The subsequent section will provide a detailed exposition of the 2015 gender quota for German supervisory boards under co-determination.

3.1 Gender Quota in Germany

In 2015, Germany introduced its inaugural gender quota law, which consists of a two-tiered framework contingent upon a company's size and legal status.[62] The law mandates a minimum of 30% representation of both men and women in supervisory boards, specifically for

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[58] Marilynn B Brewer, 'In-Group Bias in the Minimal Intergroup Situation: A Cognitive-Motivational Analysis' (1979) 86 Psychological Bulletin 307; Himani Oberai and Ila Mehrotra Anand, 'Unconscious Bias: Thinking without Thinking' (2018) 26 Human Resource Management International Digest 14.

[59] Richard Herrera and others, 'The Effect of Gender on Leadership and Culture' (2012) 31 Global Business and Organizational Excellence 37.

[60] Kasey Lobaugh, Jeff Simpson and Bobby Stephens, 'The Consumer Is Changing, but Perhaps Not How You Think' (*Deloitte Insights* 2019), available at: https://www2.deloitte.com/us/en/insights/industry/retail-distribution/the-consumer-is-changing.html accessed 13 September 2022.

[61] Rohini Pande and Deanna Ford, 'Gender Quotas and Female Leadership: A Review' (2009) 42 Monthly Labor Review 13 and 23.

[62] Deutscher Bundestag Gesetz für die gleichberechtigte Teilhabe von Frauen und Männern an Führungspositionen in der Privatwirtschaft und im öffentlichen Dienst [Law for the Equal Participation of Women and Men in Leadership Positions in the Private Sector and the Public Sector] (n 53).

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publicly listed companies subject to co-determination. Co-determination is a regulatory principle that applies to firms with over 2,000 employees, necessitating that half of the supervisory board members must be employee representatives.[63] The law granted companies discretion to apply the 30% representation requirement separately or jointly to employee and shareholder representatives.

To ensure compliance, companies are obligated to declare their adherence to the quota in publicly accessible annual reports. In cases of non-compliance, board appointments become void, resulting in 'open seats' that must be filled to conform to the quota requirements. Furthermore, the law mandates that listed and non-listed companies with a workforce of at least 500 employees establish self-determined targets for the representation of women. This self-determined target aligns with the current proportion of women on their boards. However, many companies have chosen to set self-imposed targets at zero, as there is no lower limit specified. Given this resistant stance of several companies, the law underwent an amendment in August 2021, introducing a minimum requirement for women's representation on management boards. This regulation exclusively pertains to companies subject to the statutory 30% quota for supervisory boards, with a minimum of four directors on their management board. In 2020, only 64 companies met this criterion. Within this subset, consisting mostly of companies with four to six members, the implied quota ranges from 16.7% to 25%.[64]

Notably, before the enactment of gender quota laws in 2015, there was limited criticism, but the journey from discussions to implementation spanned nearly 15 years in Germany.[65] Chancellor Merkel championed the implementation of gender quotas as a matter of utmost personal importance, ultimately leading to their enactment.

At the time of the first gender quota law in 2015, women held an average of more than 25% of supervisory board positions and 29% of employee representative positions. In 2022, the representation of women in these roles has risen to an average of 36.5% on supervisory boards and 40.5% in employee representative positions.[66]

The preceding discourse on gender quotas, their implementation in Germany, and their influence on board composition sets the stage for the regression analysis, which will explore the relationship between BGD and compliance with EU competition law within the German corporate landscape.

3.2 Data Description

The regression analysis adopts a natural experiment design, focusing on German listed companies subject to the Gender Quota Law of 2015. The impact of this law is contingent upon the distinct characteristics of each company as delineated by German legal standards, thereby determining whether a company falls under the influence of the gender quota. This natural

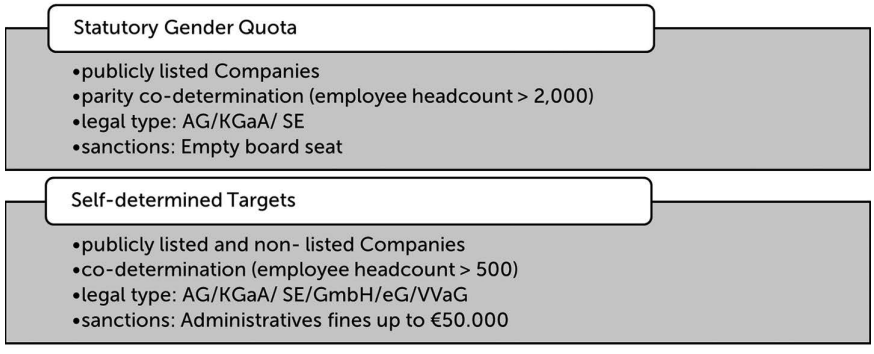
[63] Gesetz über die Mitbestimmung der Arbeitnehmer (Mitbestimmungsgesetz - MitbestG) 1976 [DEU-1976-L-13898].

[64] Virginia Sondergeld and Katharina Wrohlich, 'Mindestbeteiligung von Frauen in Vorständen: Einige Unternehmen Sind Neuem Gesetz Bereits Zuvorgekommen' (*DIW aktuell*, 2021).

[65] Sabine Lang, 'Thirty Years of Gender Quotas in Germany: Policy Adoption between Mainstreaming and Minimal Compliance' (2015) EU Working Paper 1, 12–13.

[66] EIGE (n 3).

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Source: The author.

Figure 21.1 German Gender Quota Law 2015

experiment framework facilitates the consideration of an exogenous intervention, profoundly pertinent to this study.

Specifically, the implementation of the 30% gender quota serves as an exogenous variable, providing a defined point of impact within the analysis. This distinctive feature enables the examination of two periods of interest: one preceding the introduction of the gender quota and the other following its enactment. It is noteworthy that the law came into force on April 4th, 2015, with applicability to all director appointments starting from January 1st, 2016, rendering the year 2015 as the pivotal 'shock moment' for this investigation.

Germany's selection as the jurisdiction of choice for this study is predicated on two paramount considerations. Germany's preeminent position within the European Union, particularly in the domain of EU competition, amplifies the imperative for German companies to scrupulously comply with competition law regulations. This significance extends to an investigation into the interplay between BGD and compliance with competition law in the German context, and it is notably accentuated by Germany's legislative actions regarding gender diversity in the boardroom in 2015 and in 2021 (see previous section).

The legislative landscape, characterized by these gender-related quotas, underscores the critical need to explore the impact of gender diversity on compliance with competition law. The synergy between gender diversity and competition law compliance forms a pivotal area of inquiry, and it is deeply intertwined with Germany's legal framework and societal values.

Furthermore, the importance of this inquiry is notably heightened by the fact that Germany is one of the biggest European economies, counting numerous companies whose actions inevitably impact the EU internal market.

3.2.1 Hypotheses

H1: There is a positive relationship between corporate board gender diversity on compliance with competition law.

Hypothesis H1 posits that an affirmative association exists between gender diversity within corporate boards and adherence to competition law. This hypothesis is founded on the premise that a more gender-diverse board composition may yield heightened ethical and compliance

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standards within a corporate environment. As organizations strive to adapt to evolving societal expectations and legal requirements, the extent to which gender diversity contributes to enhanced compliance with competition law becomes a pertinent subject of investigation. This hypothesis underscores the potential role of gender diversity in shaping corporate governance practices and underscores the importance of exploring this relationship within the context of contemporary business dynamics.

Compliance is the dependent variable and is measured in the following way: Whenever the Commission or Bundeskartellamt has indicated in a fining decision or commitment decision that a company was (possibly) infringing competition law, it is indicated as 'fine' in the data set. Whenever a company was not indicated to have infringed competition law in a certain year, it is indicated as 'no fine'. In sum, the term 'fine' is used to indicate that, for a given year/years, the firm has (possibly) infringed competition law.[67]

The independent variables that are considered are supervisory board gender diversity (BGD), which is calculated in the following way:

*BGD = number of female board members / total number of board members * 100*

The years in which infringements were alleged are indicated as fined (1), and where no infringements were found are indicated as no fine (0). These years are then compared in terms of their BGD by company. The complete data set consists of 30 firms with each having 11 years of observations (2010–2020), which totals to 330 data points/observations.[68]

To measure the effect of BGD on competition law compliance, I look at the difference in the probability of compliance after the quota introduction between companies with a high BGD and low BGD before quotas. For companies with a low BGD before the quotas, the probability of infringements should decrease after the implementation of the gender quota in comparison to the probability for companies which already had a high BGD, which I expect to stay relatively stable. It should remain stable as the changes in board structure are less intrusive.

To find additional support for the hypothesis, a descriptive analysis of the infringements included in the data will be conducted. The descriptive analysis explores if companies which already employed more women on their supervisory boards received fewer fines before 2015. If it shows that the companies that employed a lower BGD were the ones that were fined, this gives another indication of the relationship between BGD and competition law compliance. It may provide additional evidence of a correlation between gender diversity and compliance.

3.2.2 Data description

The data used includes information about the board composition and information on fines imposed on publicly listed companies on the DAX30 under competition law, for having engaged in anticompetitive conduct. I include decisions imposed by the Bundeskartellamt

[67] While a commitment decision is designed to resolve antitrust issues without going through a formal legal process of establishing the infringement, it does not necessarily absolve a company from the fact that it engaged in anticompetitive behavior in the past.

[68] For the company Delivery Hero SE, the years 2010 to 2013 have missing values because, during this period, they were incorporated as a GmbH and thus did not publish any reports on supervisory board members. After several attempts to obtain this data from the company in question, they have not responded, and thus these values are missing from the final data set.

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and/or the Commission for the period 2010–2020, with each year an infringement lasted counted as one indication. The decision to count each year an infringement lasted as one indication provides a temporal dimension to the study.[69] Analyzing the duration and frequency of infringements in relation to board composition allows for a nuanced exploration of how gender diversity may influence a company's adherence to competition law.

A sample of the publicly listed limited liability companies in Germany consists of the DAX30 companies. The DAX is the German blue chip stock market index, which tracks the performance of the 30 largest companies trading on the Frankfurt Stock Exchange (FSE).[70] The sample includes a large variety of companies and sectors, such as Bayer AG, a pharmaceutical company, as well as Adidas AG, which specializes in sport shoes and apparel.

The variety of sectors included in this sample is of importance to exclude the possibility that an increase or decrease in the number of fines issued is due to sectoral investigations during the period of interest.[71] By using the DAX30, this problem is resolved.

The sample includes only German companies, as German law imposes transparency obligations on companies trading on the FSE. Public limited liability companies, especially those trading on the stock market, are subject to a vast amount of transparency requirements. The DAX30 is no exception to that. Under §325 German Commercial Code (*Handelsgesetzbuch*), it is mandatory for registered companies to publish their annual reports in the Bundesanzeiger.[72] Data is gathered through annual reports posted on companies' websites and via the German Company Register (Unternehmensregister), Bureau van Dijk's database Orbis, and BoardEx. The gender of board members is determined by looking at their pronouns such as *Frau* or *Herr* (Mrs. or Mr.) or headshots included in reports. In cases where a gender-neutral pronoun is used, such as *Dr.* the full name is researched to find a CV or other relevant publications which can determine the gender.

The data in this study comprise two data sets. The first set includes information about the board composition of relevant companies, while the second set includes information on fines imposed on these companies under competition law.

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[69] In total, five companies received fines which indicated infringements that lasted several years. The cases in the dataset are: Toshiba Corporation and Others v European Commission (Case C-17/10) ECLI:EU:C:2012:72, Judgment of the Court (Grand Chamber), 14 February 2012; Siemens AG v European Commission (Case C-239/11 P) ECLI:EU:C:2014:256, Judgment of the Court (Fifth Chamber), 10 April 2014; BMW AG v European Commission (Case T-671/14) ECLI:EU:T:2017:599, Judgment of the General Court (Fifth Chamber), 12 September 2017; Daimler AG v European Commission (Case T-673/14) ECLI:EU:T:2017:604, Judgment of the General Court (Fifth Chamber), 12 September 2017; Commission Decision in Case AT.39920 – Braking Systems (Continental AG).

[70] Deutsche Börse, 'DAX-Index | Frankfurt Stock Exchange' https://www.boerse-frankfurt.de/indices/dax/constituents accessed 30 November 2022.

[71] The Bundeskartellamt conducts sectorial inspections to investigate issues within a sector. For more information, see: 'Bundeskartellamt – Sektoruntersuchungen' https://www.bundeskartellamt.de/DE/UeberUns/Publikationen/Sektoruntersuchungen/sektoruntersuchungen_node.html accessed 30 November 2022.

[72] The Bundesanzeiger is the official platform for companies to publish all the relevant information, as laid down in German laws, information on a yearly basis. This information is free for the public to access, in most cases.

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Data set 1: This data set contains quantitative data on German undertakings subject to the gender quota. Two types of companies are subject to the Gender Quota legislation:

1. Companies that are publicly listed (AG/KGaA/SE) and subject to parity codetermination (employee headcount >2,000) must comply with the statutory gender quota.
2. Companies that are subject to co-determination (employee headcount >500) and set self-determined targets (AG/KGaA/SE/GmbH).

For this study, a sample of the publicly listed limited liability companies in Germany was selected. The sample consists of the DAX30 companies, all of which are subject to the mandatory quota legislation.

Data set 2: The second data set includes data from the European Commission and the Bundeskartellamt on competition law prohibition decisions issued during the period 2010–2020. The fining decisions are linked to the subject companies. To assess whether there is any effect on competition law compliance due to the BGD increase, the fines need to be known. This sample includes any fining decision given by the Commission in the relevant period, even if the violation began before 2010. The Commission considers all the years of the violation when setting the fine. For instance, if a company violated Art. 101 or 102 TFEU from 2008 until 2013 and the Commission issued its fining decision in 2018, the fine would be calculated over the number of years the violation occurred. The sample includes the years of violation or 'fining' from 2010 to 2013.

The composition of the supervisory boards needs to be determined for the relevant period. The period in this study spans from 2010 to 2020. As the first gender quota law of 30% was implemented in 2015, the period relevant for this study starts 5 years prior to the first implementation. By starting the period in 2010, it is possible to capture a 5-year pre-implementation period. The period extends to 2020 to include a 4–5-year post-implementation period. Any violation in the relevant time is included, even if the violation started before the beginning of the selected period, 2010. The complete data set consists of 30 firms with each having 11 years of observations (2010–2020), which totals to 330 data points/observations. To conduct the analysis, a logistic regression model is used.[73]

3.2.3 Descriptive statistics

Figure 21.2 provides the summary statistics in which the most important findings are highlighted. Two periods of interest are shown in the table: the years before the introduction of the gender quota (2010–2014) and the years after the introduction (2015–2020).

First, the difference of 0.22 between the two periods of interest shows that boards did not necessarily get larger after the implementation of the gender quota, but rather replaced old members with new ones. Before the implementation of the quota, 83.4% of board members on average were men while after implementation this dropped to 69.3%.

What stands out is that throughout the years, the minimum share of men has decreased but remains around 50% of all boards, meaning there are always at least 50% males on all supervisory boards, while the women are represented at a minimum of 0%. Although the gender quota law mandates a mandatory 30% women on all supervisory boards, it is possible that not

[73] Andy Field, *Discovering Statistics Using IBM SPSS Statistics* (4th Edition, Sage 2013).

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	2010-2014	2015-2020	All Years	Observed[1]	Std.
A. General board characteristics					
Average of men	12.14	10.35	11.15	326	3.77
Minimum men	3	3	3	326	-
Maximum of men	20	17	20	326	-
Average women	2.79	4.79	3.89	326	2.39
Minimum of women	0	0	0	326	-
Maximum of women	9	10	10	326	-
Average board size	14.92	15.14	15.04	326	4.99
Number of fines	16	4	20	326	-
B. Firm characteristics					
Quota reached	17,12%	66,67%	44,48%	326	-
Quota not reached	82,88%	33,33%	55,52%	326	-
C. Firms when fined	**2010-2020**				
Average of men	82,50%		16.50	20	1.43
Minimum men	75%		15	20	-
Maximum men	95%		20	20	-
Average women	17,50%		3.50	20	1.43
Minimum of women	5%		1	20	-
Maximum of women	25%		5	20	-
Board size	-		20	20	0.00
Quota fulfilled	0%		0	20	-
D. Firms when not fined	**2010-2020**				
Average of men	75,20%		10.8	306	3.61
Minimum men	50%		3	306	-
Maximum of men	100%		20	306	-
Average women	24,80%		3.92	306	2.44
Minimum of women	0%		0	306	-
Maximum of women	50%		10	306	-
Board size	-		14.72	306	4.98
Quota fulfilled				306	-

[1] In panel A and B, the observed indicates the total number of observation (per company per year), in panels B and C the number of observations indicates years fined per company.

Source: The author.

Figure 21.2 Board, firms, and fining general statistics

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all companies follow the quota. In other words, there are instances where no women are part of the board.

In panel B, the percentage of times that the quota was reached are counted.[74] Before its introduction, the 30% gender quota was reached in only 17% of cases, while this jumped to 66% after implementation.

A couple of observations can be made by comparing companies that committed infringements each year and companies that did not. The average share of men on a supervisory board in the fining years is 82.5% while during the non-fining years, this share is smaller at 75.2%. Simultaneously, the average share of women is 17.5% during the fining years and 24.8% during the non-fining years. This could be an indication that a larger BGD relates to fewer infringements of competition law. These descriptive results suggest that there may be a relationship between the share of women on supervisory boards and the likelihood of (non-) compliance.

4. EMPIRICAL EVIDENCE

In this section, I delve into the empirical evidence, presenting the data and findings that substantiate my research hypotheses. With a specific focus on the relationship between gender diversity within corporate boards and compliance with competition law, I integrate both quantitative and qualitative methods to explore this intricate connection.

4.1 Logistic Regression

One key aspect of this analysis involves the application of logistic regression, which enables me to quantitatively assess the influence of gender diversity on corporate compliance with competition law. By considering real-world cases and utilizing statistical insights, I aim to provide a comprehensive understanding of how gender diversity impacts corporate behavior in terms of competition law compliance. This empirical evidence not only helps support the research hypotheses but also advances our comprehension of the dynamic interplay between gender diversity and legal adherence in the corporate landscape.

The first analysis test runs a logistic regression to test hypothesis 1 with 3 models. In the regression, 'fine' is the dependent variable coded as 1 for 'fine' and 0 for 'no fine'. In Figure 21.3, three independent variables are considered.

Model 1 tests whether the variable, the *percentage of women* on a board, is related to the probability of being fined. The analysis revealed that the predictor variable, the percentage of women, had a significant impact on the model. Specifically, for each one percent increase in the number of women, there was a statistically significant 4 percentage point decrease in the odds of belonging to the fining category ($p < 0.05$). Model 1 indicates that overall, as BGD increases, the odds of belonging to the 'fining' category decrease. Model 1 indicates a relationship between BGD and competition infringements. As the error bars (Figure 21.4) show, for the years in which companies were fined, the average BGD was 17.5%. This is far below the standard of 30% of the legal quota. During the years in which no violations were detected, the average BGD was 24.8%, which is still not 30% but does come much closer.

[74] The total observed is 326, as 4 years were missing for Delivery Hero SE.

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	Model #1	Model #2	Model #3
Percentage women	-.041* (.017)	.003 (.022)	-.063 (.034)
Year		-.363** (.115)	-.229 (.132)
Board size			.753** (.273)
Constant	-1.854*** (.390)	728.067** (230.700)	445.645 (264.673)
Nagelkerke (pseudo R^2)	.047	.142	.443
N	330	330	330

Note: the model shows the log odds for the different independent variables. The standard error (S.E.) is reported in the brackets below the log odds.

*Significance is measures as: *** Significance at P<.001; ** Significance at P<.01; * Significance at P<.05*

Source: The author.

Figure 21.3 Logistic Regression model showing Log Odds

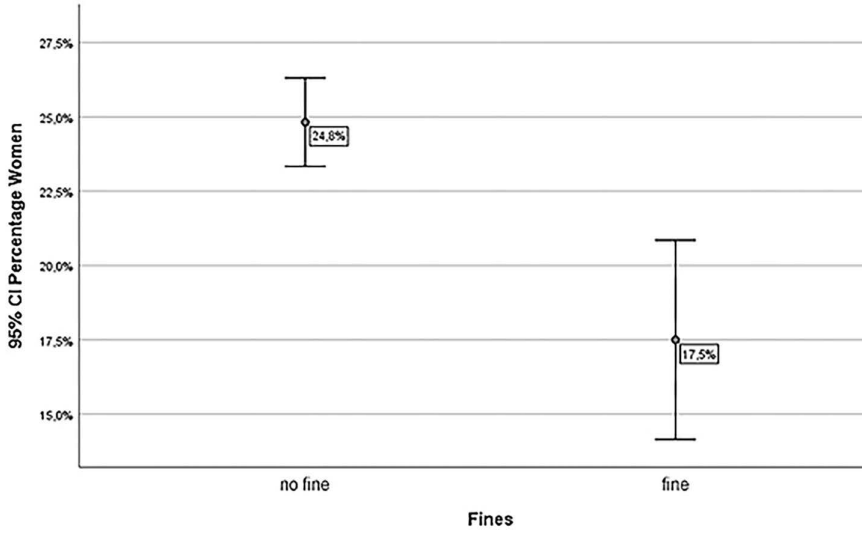
Model 2 includes the predictor variable *year.* The predictor year is important, as belonging to the fining category in one year might influence belonging to the fining category in subsequent years. The model shows that an increase in years decreases the odds of belonging to the fining category by 30.4 pp[75] at a significant level.

Notably, when we factor in the variable of 'year' as a predictor, the significance of the percentage of women as a predictor diminishes. This phenomenon can be attributed to various factors. An essential explanation lies in the fact that violations that occurred in the years following the implementation of the quota have not yet resulted in prohibition decisions. Therefore, these instances cannot be included in the sample, as it typically takes the NCA (National Competition Authority) and the Commission several years to complete their investigations. Importantly, the study's integrity remains intact because these events are still in progress. I restrict the analysis and results to the available data.

Model 3 adds the predictor variable *board size*. For board size, the nominal size is considered, meaning the absolute number of board members ranges from 3 to 23 for one company

[75] (expB = 0.696) * 100 - 100' represents a mathematical calculation in this study, where 'expB' is assigned the value 0.696. This value is then multiplied by 100, and 100 is subtracted from the result, yielding -30.4.

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Source: The author.

Figure 21.4 Average percentage of women in fining vs non-fining years

in a certain year due to uneven changes in board composition.[76] Model 3 indicates that for every increased unit of board size, the odds of belonging to the fining category increase by 112.3 pp.[77] at a significant level. Model 3 moreover indicates that the predictors *percentage of women* and *year* still account for a decrease in odds of belonging to the fining category, however, this effect is insignificant.

4.2 Supplementary Cluster Analysis

In this analysis, we look at the BGD over the years 2010–2014 for all the companies in the sample. The years 2010–2014 are considered as these are the years in which infringements are found in the data set. No fines were detected in the years after 2014, which can have several reasons. One of them being that the BGD increased after the implementation of the gender quota in 2015. However, another reason is that 2015 is too recent; it takes several years for competition authorities to detect and establish infringements and publish the prohibition decisions.

[76] During a year, the composition of a board may change due to different appointment dates and the ending of members' terms. Because in one particular case the replacement of board members happened throughout the year, all relevant members are considered to give a fair presentation of the number of women on the board.

[77] (expB = 2.123) * 100 - 100 represents a mathematical operation within the study. Here, 'expB' is a variable to which the value 2.123 is assigned. Subsequently, this value is multiplied by 100, and 100 is then subtracted from the result. The final outcome of this expression is 112.3.

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Looking at the model, overall, as the BGD grows, the odds of belonging to the fining category decrease. Now we test to see if the companies that were found to infringe competition law in the years before the mandatory quota implementation had a lower BGD than the companies that did not receive any fines. To do so, all companies are divided into 3 categories. Characteristics of category 1 are an average BGD over the period between 2010 and 2014 of 0–19%, called 'low BGD'. Category 2 consists of companies with an average BGD over the period between 2010 and 2014 of 20–25%, called 'middle BGD', and finally category 3 consists of companies with an average BGD over the period between 2010 and 2014 of 25% or more, called 'high BGD'.[78]

In 'high BGD,' only one company was fined: Deutsche Telekom AG in 2010. Deutsche Telekom AG received the fine on appeal; however, the official infringement was stated to last until December 31st, 2010.[79]

In category 'middle BGD,' again, only one company was alleged to have infringed competition law, being subject to a commitment decision by the Commission. As the Commission still found an infringement, which is admitted to by Siemens AG, one of the largest undertakings in the sample, it is taken into consideration for the analysis.

In category 'low BGD,' Daimler AG, BMW AG, and Continental AG were all found to have infringed competition law. Both Daimler AG and BMW AG were part of the same infringement decision by the Bundeskartellamt.[80] Together with Volkswagen AG, they hada fine imposed totaling approximately €100 million for anticompetitive practices in the purchase of long steel products. Representatives of the parties met twice a year to discuss prices with steel manufacturers. According to the Bundeskartellamt, competition was eliminated because of these talks to the extent that key components of the purchase price or their calculation were no longer negotiated individually. Continental AG was fined in a European Commission decision concerning collusive behavior involving braking systems sold to Daimler AG and BMW AG. The infringement lasted until approximately 2011, and the total amount of the fine was around €44 million.[81]

The analysis shows that the companies that were fined the highest and toughest, Daimler AG, BMW AG, and Continental AG, had a lower BGD in the years before the implementation of the gender quota. On average, these three had a BGD of 13.3%.[82] The other companies belonging to the same category had an average BGD of 10.68%.[83]

Most companies found to have infringed competition law belonged to the category with the lowest BGD. Companies with a higher BGD before 2015 received fewer fines. However, the

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[78] The BGD of the companies is clustered, meaning that the BGD of years 2010 to 2014 for one company is taken together and so the mean is calculated.

[79] C-280/08 P *Deutsche Telekom AG v European Commission* [2010] ECR I-9555, ECLI:EU:C:2010:603.

[80] Bundeskartellamt, 'B12-23/16, German Car Manufacturers Fined for AntiCompetitive Practices in the Purchase of Long Steel' https://www.bundeskartellamt.de/SharedDocs/Entscheidung/EN/Entscheidungen/Kartellverbot/B12-23-16.pdf?__blob=publicationFile&v=4 accessed 19 January 2021.

[81] Commission Decision of 21 February 2018, C(2018) 929 final, Case AT.39920 – *Braking Systems.*

[82] 15% (Daimler AG) +17% (BMW AG) +8% (Continental AG) /3.

[83] Delivery Hero SE is not included in the calculation as the only known observation is in 2014, which is 0%, and would give a misleading effect to the example.

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number of companies belonging to 'low BGD' is also the largest of the three categories. Out of the 20 companies belonging to this category, three were fined, making up 15%. In 'middle BGD', one company was found to have infringed competition law but was not fined. In 'high BGD', 1 out of six companies was fined, making up 16.67%. What is important for this research is that the companies that received the highest fines belonged to the group with the lowest BGD. It is important to consider the magnitude of the fines, not just the quantity, to find evidence in support of the hypothesis.

The results indicate a relationship between the share of women on supervisory boards and competition law compliance. Reported results show that an increase in BGD may decrease the odds of belonging to a fining decision, and companies with a low BGD received the highest fines.

5. DISCUSSION AND LIMITATIONS

The analysis hints at supporting the hypothesis that there is a positive relationship between BGD and infringements of competition law – the higher the gender diversity, the lower the odds of infringements. This would mean that we can reject the null hypothesis that there is no relationship between BGD and competition law infringements. Although the results show promise, it is important to consider the limitations to better interpret the results of this initial study and to improve further research.

First, as the sample is small, the number of decisions is limited. As 20 indications of a fine, for a total of five decisions, were found, imposed on five different companies, it is difficult to establish a causal relationship between BGD and competition law compliance. In a robust sample, the predictors considered in the model would be expanded. As Figure 21.4 shows, the interaction of the *percentage of women* X *year* as two independent variables is included in the regression model. The interaction *percentage of women X year* is important as it not only shows the increase of BGD due to the introduction of the gender quota but can also take company-relevant changes of BGD into account. Moreover, an interaction on a year-by-year basis with BGD would give more information on the correlation between gender diversity and gender quota on compliance.

As discussed in the descriptive analysis, there is a difference between the companies which already had a higher BGD before the quota implementation and the ones with a lower BGD. To estimate the impact of the quota on compliance, pre-quota cross-sectional variation in BGD as an exogenous instrument for the variation in BGD mandated by the quota should be used. As Ahern and Dittmar[84] assume in their study, companies which employed a lower share of women before the quota can be seen as 'treated' by the quota, while the other companies can be seen as a sort of control group, as companies which employed a higher share of women did not have to make intrusive changes in board demographics and can be seen as not treated by the quota, as the control group. It is expected then that the companies treated by the quota show a decreased probability of receiving a fine in comparison to the control group. The treatment group would show a decrease over time in terms of the probability of receiving a fine compared to the control group. By comparison, the probability of receiving a fine for the control group would remain relatively stable.

[84] Ahern and Dittmar (n 7).

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If the model then shows that the probability of belonging to the fining category would significantly decrease for the companies 'treated' by gender quota, it could add support for causality. The decrease in non-compliance may be a consequence of the increase in BGD, as the gender diversity for these treated companies was introduced exogenously.

Furthermore, an essential element to be considered is the relation between the corporate management board, BGD, and competition law compliance. The current setup, which considers only the supervisory boards in Germany, will thus not help to identify the causal relationship of BGD on management boards and compliance with competition law. However, as the management board is indeed tasked with the day-to-day functioning of the company, decisions which may infringe on competition law are taken by this board. One way is to compare the management boards of the companies fined and run a correlation analysis with the BGD on supervisory boards. This could support the relationship between BGD and competition law compliance.

Next, it needs to be examined whether the impact of gender quotas is not driven by changes in board characteristics other than BGD. To address this, interaction with dummy variables for quotas reached and other characteristics of board members after the quota enactment can be tested. One of the board characteristics that stands out in the results of this study is the size of the board, which correlates with competition law compliance. It is, however, difficult to explain why board size correlates with the probability of being fined under competition law. The correlation between board size and the probability of being fined under competition law can be attributed to several factors. A larger board typically involves more decision-makers, increasing the potential for improper choices related to anticompetitive behavior. The dispersion of information across a larger board might lead to inadequate oversight and a greater likelihood of non-compliance with competition laws. Resource allocation, corporate culture, and the ability to monitor and hold executives accountable can differ between smaller and larger boards, influencing compliance. Additionally, the industry and market context can also impact the complexity of competition law issues. It's important to remember that this correlation is influenced by a multitude of factors, and while it exists, it doesn't solely determine a company's compliance or non-compliance with competition laws.

The fact that the data only indicated fines before 2015 can also be a consequence of company conduct itself, or the deterring effect of the fines received before 2015. Companies might have learned from previous mistakes and now conduct themselves in more conformity with market and legal standards. Companies, for example, have been fined at the beginning of the timeline know that they are under the watchful eye of the Commission and Bundeskartellamt and thus act risk aversely. Another explanation to be considered is that the sample period, which ranges from 2010–2020 is too limited to draw causality. As anticompetitive behavior requires extensive investigation to be prosecuted, certain practices may not yet be detected yet.

As Model 1 shows, when BGD grows, the odds of receiving a fine decrease. This could thus be another indication that as time moves on, the introduction of the gender quota accounted for an increase in BGD and a decrease in competition law fines.

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Independent Variables	Model #1	Model #2	Model #3	Model #4	Model #5
Percentage women	-.041*	.003	15.467	36.020	-55.258
	(.017)	(.022)	(17.643)	(29.679)	(51.734)
Year		-.363**	-.186	.222	-.863
		(.115)	(.222)	(.380)	(.607)
Percentage women X Year			-.008	-.018	.027
			(.009)	(.015)	(.026)
Board size				.752**	.902**
				(.271)	(.319)
Quota reached					21.971
					(2738.139)
Constant	-1.854***	728.069**	371.308	-461.446	1694.078
	(.390)	(230.700)	(446.749)	(765.583)	(2996.368)
Nagelkerke (pseudo R^2)	.047	.142	.149	.455	.558
N	330	330	330	330	330

Note: the model shows the log odds for the different independent variables. The standard error (S.E.) is reported in the brackets below the log odds.
*Significance is measures as: *** Significance at P<.001; ** Significance at P<.01; * Significance at P<.05*

Source: The author

Figure 21.5 Logistic Regression model showing Log Odds

6. CONCLUSION

This study aimed at exploiting a natural experiment design to identify a causal relationship between supervisory board gender diversity and competition law compliance. The sample in this pilot used the introduction of the 2015 Gender Quota[85] law in Germany as the exogenous shock moment in the experimental design.

The study supports the hypothesis that increased gender diversity on corporate boards correlates with reduced competition law fines. While causation is not established, a significant positive relationship between board gender diversity and compliance is evident.

Additionally, a descriptive analysis reveals that boards with lower gender diversity received more substantial fines before mandatory gender quotas were imposed, while those with higher diversity incurred lesser fines. This reinforces the positive impact of gender diversity on competition law compliance. This research is the first to provide evidence of a connection

[85] Gesetz für die gleichberechtigte Teilhabe von Frauen und Männern an Führungspositionen in der Privatwirtschaft und im öffentlichen Dienst [Law for the Equal Participation of Women and Men in Leadership Positions in the Private Sector and the Public Sector], Deutscher Bundestag Dokumentations-und Informationssystems (DIP) website, ID: 18-64384.

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between gender diversity on corporate boards and competition dynamics in the European internal market. It carries both theoretical and practical significance, enhancing the business case for women's inclusion from a behavioral perspective.[86] This study suggests that fostering diversity in workgroups, including boards, enhances the information elaboration process, fostering innovation and creative decision-making. This, in turn, improves the overall quality of decision outcomes.

From a practical perspective, the discovery that gender-diverse boards may reduce the risk of competition law fines could incentivize businesses to intensify their diversity initiatives. It offers guidance to policymakers on implementing European diversity targets in management roles to promote greater boardroom equality. Additionally, it may encourage shareholders to appoint more female directors for enhanced corporate performance.

This work serves as a blueprint for a broader investigation into gender diversity and corporate governance. It highlights the advantages for European businesses and the internal market's efficiency.

[86] Hoobler and others (n 8).

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22. CEO Turnover and Shareholder Awareness in Cartel Cases

Catarina Marvão and Giancarlo Spagnolo

1. INTRODUCTION

Cartels are explicitly prohibited by Article 101 of the Treaty on the Functioning of the European Union and by Section 1 of the US Sherman Act. Nevertheless, they are a perennial problem and one of the main concerns of the European Commission (EC) and the US Department of Justice (DOJ). In fact, there is evidence to suggest that, among a range of competition policy features, effective anti-cartel enforcement is by far the most important determinant of positive productivity growth.[1]

Managers who enter collusive agreements are influenced by their firm's corporate governance, which determines their incentives and career concerns. The relationship between corporate governance, managerial incentives, and collusive behavior is, therefore, crucial to deter cartels, and has already been the subject of extensive theoretical analysis.[2] It recently attracted intense academic and policy attention thanks to novel empirical studies finding significant evidence of negative unilateral effects of "passive" common ownership on product market competition.[3]

[1] Paolo Buccirossi, Lorenzo Ciari, Tomaso Duso, Giancarlo Spagnolo and Cristiana Vitale, 'Competition policy and productivity growth: An empirical assessment' (2013) 4(95) Review of Economics and Statistics 1324–1336.

[2] See e.g., Giancarlo Spagnolo, 'Stock-related compensation and product-market competition' (2000) 22 The RAND Journal of Economics 22–42; Giancarlo Spagnolo, 'Debt as a (Credible) Collusive Device' (2000) SSRN Working Paper, avaiable at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=230009; Giancarlo Spagnolo, 'Managerial incentives and collusive behavior' (2005) 49(6) European Economic Review 1501–1523; Paolo Buccirossi and Giancarlo Spagnolo, 'Corporate governance and collusive behavior' (2008) in D.W. Collins (ed), *Issues in Competition Law and Policy, Vol. 2, Antitrust Section* (American Bar Association 2008) 1219, for a survey. See also more recent work by Raffaele Fiocco, Salvatore Piccolo and Giancarlo Spagnolo, 'Collusion through debt and managers' (2023) SSRN working paper 4123287; Florence Thépot, 'Interlocking directorates in Europe – An enforcement gap?' in Marco Corradi and Julian Nowag (eds), *The Intersections Between Competition Law and Corporate Law and Finance* (Cambridge University Press 2023) 190–207; Florence Thépot, *The Interaction Between Competition Law and Corporate Governance* (Cambridge University Press 2019).

[3] See e.g. José Azar, Martin Schmalz and Isabel Tecu, 'Anti-competitive effects of common ownership' (2018) 73(4) The Journal of Finance 1513–1565; Miguel Antón, Florian Ederer, Mireia Gine and Martin Schmalz, 'Common ownership, competition, and top management incentives' (2023) 131(5) Journal of Political Economy 1294–1355, and references therein; Anna Tzanaki, 'Varieties and Mechanisms of Common Ownership' (2022) 18(1) Journal of Competition Law and Economics 168–254.

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We contribute to this literature by examining the extent to which CEOs of convicted cartel members face consequences for having entered (and having been discovered in) a collusive agreement, in terms of their subsequent career paths. To do that, we discuss several characteristics of CEOs involved in sets of EU and US cartel cases, ranging from their career paths to other individual characteristics, such as their tenure as CEO, their age, or their gender. We also discuss shareholders' awareness of the CEO's misbehavior, as well as their role in terms of punishing or encouraging those managers to take part in cartels.

Firstly, this chapter feeds into the literature on the position within the firm of individuals involved in cartels, as well as the consequences (if any) of their cartel engagement. Harrington and Connor, for example, describe how, in convicted cartels in the US, decisions are typically taken by very top managers (although not necessarily CEOs) but implemented by intermediate management.[4] We add to this strand of the literature by analyzing at what level cartel decisions (in our US and EU cartel datasets) are made. Regarding consequences for individuals, González et al.[5] find little evidence that managers of convicted (listed) cartel firms in the US, between 1990 and 2014, are held accountable by either corporate governance mechanisms or the legal system. Instead, the authors find that managers of convicted cartel firms are given greater job security and receive large bonuses, while rarely facing individual prosecution. The authors also find direct involvement by the CEOs of cartel firms and, in some rare cases, by the board of directors, thus strengthening the evidence on the relationship between corporate governance and cartel formation. Understanding the career paths of the CEOs involved in convicted collusive agreements helps us further comprehend the relationship between cartel convictions and CEO turnover, and with it, the role played by career concerns in managers' decisions about whether to initiate and/or enter into a collusive agreement. We thus contribute to the literature by examining the career paths of all CEOs in convicted cartel firms, not just listed firms, as in González et al., to examine how cartel participation affects CEO tenure.

Besides, there may be individual CEO characteristics, unrelated to corporate governance, which make them more likely to initiate or enter a collusive agreement. In this sense, a CEO's past tenure may also affect cartel participation. The question of whether characteristics such as CEO tenure and a CEO's age are related to misbehavior is not a new one. Part of the literature suggests that longer CEO tenure is correlated with more stable and successful misbehavior in general (even when it is not known whether the CEO initiates or instigates the misbehavior), as it allows for better monitoring, by the CEO, of the wrongdoing.[6] This is also

[4] Joseph Harrington, 'How do cartels operate?' (2006) 2(1) Foundations and Trends in Microeconomics 1–105; John Connor, 'Problems with prison in international cartel cases' (2011) 56(2) Antitrust Bulletin 311–344.

[5] Tanja González, Markus Schmid and David Yermack, 'Does price fixing benefit corporate managers?' (2019) 65(10) Management Science 4813–4840.

[6] James Loebbecke, Martha Eining and John Willingham, 'Auditor's experience with material irregularities: Frequency, nature, and detectability' (1989) 9(1) Auditing: A Journal of Practice and Theory 1; Mark Beasley, 'An empirical analysis of the relation between the board of director composition and financial statement fraud' (1996) 71(4) The Accounting Review 443–465; Dirk Jenter, and Fadi Kanaan, 'CEO turnover and relative performance evaluation' (2015) 70(5) *T*he Journal of Finance 2155–2184; Raymond Fisman, Rakesh Khurana, Matthew Rhodes-Kropf and Soojin Yim, 'Governance and CEO turnover: Do something or do the right thing?' (2006) 60(2) Management Science 319–337.

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true for collusive activities more specifically.[7] The reasoning is that the misbehavior is often connected with "income smoothing" after a pronounced growth period, which is then followed by much poorer financial performance in a subsequent downturn. CEOs with a longer tenure period are more likely to want to smooth income and have established the knowledge and firm connections to make the misbehaviors occur. On the other hand, Han[8] shows theoretically that firms are more likely to be involved in a collusive agreement when CEO contractual tenure is low (CEO employment contracts are short-term). This is because short-term CEO appointments are only renewed if the firm hits a given profit target (similar to bonus targets in Spagnolo[9]). This contrast makes empirical assessments particularly important. We therefore discuss some old and newly collected evidence on the characteristics of CEOs involved in cartels (relating to their past tenure, and age).

Another characteristic of CEOs that has been explored is the gender of the individuals involved in the cartel cases. In an experimental setting, Hamaguchi et al.[10] examine cartel dissolution and find that women have a positive and significant impact on cartel dissolution: fewer men dissolved their cartels than women. The literature also generally agrees that women (compared to men) are less likely to participate in misbehaviors such as collusion.[11] A significant driver of this result is that men are more prone to risk than women.[12] Indeed, our data confirm that, in the EC cartel cases between 1998 and 2020, all the CEOs were male.

The importance of exploring the impact of cartel convictions on CEOs also results from the under-deterrence of antitrust fines or damages. Recent literature has provided considerable evidence in favor of introducing tougher antitrust sanctions, particularly in the EU. First, the firms' (and thereby shareholders') loss from antitrust fines appears quite small. In the event study carried out by Aguzzoni et al.,[13] the authors show that the overall antitrust sanction in

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[7] Myles Mace, *Directors: Myth and Reality* (Harvard Business School Press 1986); Arch Patton and John Baker, 'Why won't directors rock the boat?' (1987) 65(6) Harvard Business Review 10–18; Richard Vancil, *Passing the Baton: Managing the Process of CEO Succession* (Harvard Business School Press 1987) 345–356.

[8] Martijn Han, 'Short-term managerial contracts facilitate cartels' (2010) Amsterdam Center for Law and Economics. Working paper 2010–16.

[9] Giancarlo Spagnolo, 'Managerial incentives and collusive behavior' (n 2).

[10] Yasuyo Hamaguchi, Toshiji Kawagoe and Aiko Shibata, 'Group size effects on cartel formation and the enforcement power of leniency programs' (2009) 27(1) International Journal of Industrial Organization 145–165.

[11] Adora Cheung and Rey Hernández-Julian, 'Gender and Corruption: A Panel Data Analysis' (2016) available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=691468; Anand Swamy, Young Lee, Omar Azfar and Stephen Knack, 'Gender and corruption' (1999) IRIS Center Working Paper No. 232.

[12] Annika Sundén and Brian Surette, 'Gender differences in the allocation of assets in retirement savings plans' (1998) 88(2) The American Economic Review 207–211; James Byrnes, David Miller and William Schafer, 'Gender differences in risk taking: A meta-analysis' (1999) 125(3) Psychological Bulletin 367–383; Alexandra Bernasek and Stephanie Shwiff, 'Gender, risk, and retirement' (2001) 25(2) Journal of Economic Issues 345–356. See also related research on gender diversity in Amber Sheeper, 'The Effect of Corporate Board Gender Diversity on Compliance with EU Competition Law' (Chapter 21 of this Handbook).

[13] Luca Aguzzoni, Gregor Langus and Massimo Motta, 'The effect of EU antitrust investigations and fines on a firm's valuation' (2013) 61(2) Journal of Industrial Economics 290–338.

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cartel convictions (EC 1979–2009) reduced the firm's market value by less than 5%, of which fines account for less than 9% of this loss. A follow-up study by Marvão et al.[14] shows that in more recent cases (EC 1998–2020), this effect is no larger than a 1.5% loss in a convicted firm's market value. Mariuzzo et al.[15] further show that public and reputational sanctions act as substitutes (i.e., where there is a reputational penalty), increasing fines reduces the effect of the public sanction, whereas in the absence of a reputational penalty, the effect of cartel fines steps in.

Second, a recent trend of EC "leniency inflation" may be worrisome. Marvão and Spagnolo[16] describe this recent trend of EC leniency inflation, according to which the share and amount of Leniency Program (LP) reductions granted has increased between 1998 and 2020, with most convicted EC cartel members receiving a leniency reduction of the fine.[17] This trend is even more serious when coupled with the recent EU Directive on private damage actions[18] which only partially protects leniency applicants from damages and limits information available to claimants, thereby reducing the attractiveness of applying for leniency and the deterrence effects of private damage claims at the same time.[19]

In light of this debate, it is important to understand the extent to which CEOs of the firms involved do face any consequences through corporate governance tools within the firm, once collusive agreements are detected. Although mostly suggestive, the evidence we present here points to a very limited effect of convictions on the CEO's career path and more generally on corporate governance, for example, in terms of CEO removal and managerial contracts including provisions discouraging collusion (to the best of our knowledge, there is no evidence of managerial contracts explicitly including such provisions, i.e., managerial liability for antitrust violations, and if these were in place, shareholders would not have to sue for damages, as we discuss in section 6). Through a revealed preferences argument, all this in turn suggests that in most cases shareholders are not trying to prevent managers from colluding, and that corporate fines may therefore be too low to achieve deterrence given the current probability of detection. This is particularly relevant for the EU, given that even in the absence of criminal sanctions and treble damages, EU fines are still not harsher than US fines.

This chapter proceeds as follows. In section 3, we examine the position within the firm of the individuals indicted in US cartel cases (1985–2011), and of those named as being involved in EC cartel cases (1998–2020). Section 4 focuses on CEOs and investigates the career path

[14] Catarina Marvão, Valerio Poti and Giancarlo Spagnolo, 'Are banks too big to fine?' (2023) SSRN Working paper, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4441329.

[15] Franco Mariuzzo, Peter Ormosi and Zherou Majied, 'Fines and reputational sanctions: The case of cartels' (2020) 69(102584) International Journal of Industrial Organization.

[16] Catarina Marvão and Giancarlo Spagnolo, 'Should price fixers finally go to prison? – Criminalization, leniency inflation and whistleblower rewards in the EU' (2023) 63 Review of Industrial Organization 155–186.

[17] A review of the empirical and experimental evidence of the effectiveness of LPs is offered in Catarina Marvão and Giancarlo Spagnolo, 'Leniency Inflation, Cartel Damages, and Criminalization' (2023) 63 Review of Industrial Organization 155–186.

[18] Directive 2014/104/EU of the European Parliament and the Council of 26 November 2014 on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union (2014) OJ L249/1.

[19] See e.g. Paolo Buccirossi, Catarina Marvão and Giancarlo Spagnolo, 'Leniency and Damages' (2020) 49(2) The Journal of Legal Studies 335.

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of the indicted or named CEOs in EC and DOJ cases, as well as that of all CEOs of convicted EC cartel members (1998–2020). Section 5 examines some CEO characteristics such as age, gender, and recidivism. The literature suggests a significant and positive relationship between CEO age and the likelihood of cartel formation and a negative relationship with gender. The data we use in our analysis is consistent with both these claims. Finally, section 6 focuses on shareholder awareness and influence. It reviews the evidence as to whether collusion benefits shareholders, whether shareholders can influence managers to collude, whether shareholders are aware of the collusive agreements, and whether they try to punish management through legal actions after the cartel is detected. Section 7 concludes.

2. DATA

2.1 Data Sources

Data on US cartels comes from John Connor's Private International Cartels dataset.[20] The excerpt used covers the years 1984 to 2011 and contains publicly available information on 180 cartels convicted by the DOJ between 1985 and 2011, involving 470 non-anonymous individual firms.

The data on EC cartel cases were gathered from publicly available summaries and press releases associated with antitrust cases handled by the EC and accessible from the EC's website.[21] The data relate to 161 cartels (in 124 cartel cases) and 613 unique cartel members convicted between 1998 and June 1, 2020. The total sample consists of 838 observations (due to repeated or multiple offenses by some firms).

We supplement the cartel data with information on the CEOs and their post-cartel career paths. The data was obtained from Bloomberg, Who's Who in Finance and Industry, as well as the firms' own websites and reports. The data is described in more detail in Giebel et al.[22]

2.2 Case Triggers

The leniency applications by cartel members in the EC are noteworthy in that many of them have been preceded by investigations and/or fines in another jurisdiction.[23] By contrast, only 6% of EC cartel cases were fined by the EC before a conviction was obtained in the US.

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[20] Private International Cartels spreadsheet by John M. Connor, Purdue University, Indiana, USA (January 2012).

[21] Thorough descriptions of this dataset can be found in Catarina Marvão, 'The EU Leniency Programme and Recidivism' (2016) 48(1–27) Review of Industrial Organization*;* and Margaret Levenstein, Catarina Marvão and Valerie Suslow, 'Preventing cartel recidivism' (2015) 30(3) Antitrust 81.

[22] Marek Giebel, Catarina Marvão, Anja Roesner and Giancarlo Spagnolo, 'CEO overconfidence and collusion' (2023). SSRN Working Paper 5046208. Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5046208.

[23] Most investigations are triggered by a leniency application, and only 4% of the EC cartels in our sample are discovered due to a complaint by a rival firm.

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At least 25% of cartels reported to the EC by a member of the cartel were first convicted in the US. Another 20% were convicted by US and EU authorities within the same year.[24] All of these (45%) involved leniency program applications. The remaining cases (55%) were discovered due to other reasons, such as reporting by a third party (e.g., a customer or rival firm) or under the Commission's initiative.[25]

2.3 Sample Selection Bias

One concern with the data is the possibility of sample selection bias. Since cartels are prohibited by the Sherman Act and the Treaty on the Functioning of the European Union, they are secret, so the available data include only cartel members who were prosecuted and convicted. To the extent that the CEOs' career paths and shareholder awareness are different between convicted and undetected cartels, our evidence is biased. This problem of selection on the unobservables cannot be overcome, but we acknowledge its existence in the discussion of the data.

3. INDIVIDUALS NAMED IN EC AND US CARTEL CASES

It can be difficult to identify the exact individuals involved in or aware of the collusive agreement. In many cases, the individuals involved in cartel agreements go to extreme lengths to avoid the detection of the cartel and to eliminate any evidence of the agreement. For example, Kolasky[26] provides details of meetings between two competitors (and cartel partners) where one of the individuals would stage meeting the other for the first time, by exchanging business cards and being extremely formal. The investigation later discovered these two individuals socialized and played golf, as well as being engaged in price-fixing, for many years.

In this section, we discuss the position of the individuals named in the cartel cases brought by the EC and the DOJ. Using the data described in section 2 and, in more detail, in Giebel et al.,[27] we analyze at what level cartel decisions are made (according to the available case documents), based on fines for cartel violations by the EC and the US DOJ.

3.1 CEOs

Cartel agreements are frequently coordinated or allowed at a senior level within the firm (or subsidiary), often involving the CEO, but are usually implemented by intermediate managers.[28]

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[24] A further 4% of the cases were also convicted in the EU and US, but there is no clear information on the year of conviction in the US.

[25] The data from Marvão (n 21) shows that most of the cartels detected by the European Commission include both price-fixing and market-sharing. We have no reason to believe that cartels convicted in the US present a dissimilar pattern.

[26] William Kolasky, 'Antitrust Compliance Programs: The Government Perspective' (2002). DOJ's speech given to Corporate Compliance 2002 Conference, Practicing Law Institute, 12 July 2002, San Francisco.

[27] Giebel et al. (n 22).

[28] Harrington (n 4); Connor (n 4).

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One example of CEO involvement is the American Airlines cartel, convicted by the DOJ in 1982. The cartel broke down because Howard Putnam, Braniff's CEO, declined the invitation to join the cartel but recorded the conversation with Robert Crandall, the CEO of American Airlines, and made it public.[29] The transcript of the conversation involves the following:

> "Crandall: I think it's dumb as hell, for Christ's sake, all right, to sit here and pound the f*** out of each other and neither one of us is making a f*** dime.
>
> Putnam: Well...
> (…)
> Crandall: Yes, I have a suggestion for you. Raise your goddam fares 20%. I'll raise mine the next morning.
> Putnam: Robert, we...
> Crandall: You'll make more money and I will too
> Putnam: We can't talk about pricing.
> Crandall: Oh f*** Howard. We can talk about any goddam thing we want to talk about."

More recent examples can be found, although conversation transcripts appear to be a less common occurrence. In 2020, the DOJ convicted Christopher Lischenwski, the former CEO of Bumble Bee Foods LLC, for his leadership role in a price-fixing cartel involving canned tuna. He was sentenced to 40 months in jail and a $100,000 fine.[30]

Nonetheless, CEOs of convicted cartel firms are seldom indicted (5% of DOJ cases) or named as being involved (6% of EC cases) in the cartel fining decisions, as we discuss in the next subsection.

3.2 Other Individuals

Using the data described in section 2, Table 22.1 describes at what level cartel decisions are made (according to the cartel decisions), based on convictions for cartel violations by the European Commission (EC) and the US Department of Justice (DOJ).

While CEOs of convicted cartel firms are seldom indicted or named as being involved in cartels, cartel agreements are frequently coordinated and/or allowed at a senior level within the firm (or subsidiary).

Most commonly named individuals are division managers, typically sales and marketing managers (29% in EC cases and 17% in DOJ cases).

In many DOJ cases, lower-level staff are also indicted (17%, versus 3% in EC cases). Salesmen, dealers, brokers, and traders are some of the individuals who play an important role in coordinating the prices or quantities set within the cartel agreement, although they are unlikely to be responsible for the formation of the cartel.

One example of the involvement of sales directors and lower-level employees comes from another conversation transcript in a cartel sanctioned by the UK Office of Fair Trading (OFT). In 2000, toy manufacturer Hasbro organized a price-fixing cartel between retailers Argos and

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[29] *United States v American Airlines*, 743 F.2d 1114 (5th Cir. 1984). Available at: https://openjurist.org/743/f2d/1114/united-states-v-american-airlines-inc-l accessed 1/1/2023.

[30] Available at: https://www.justice.gov/opa/pr/former-bumble-bee-ceo-sentenced-prison-fixing-prices-canned-tuna accessed 1/1/2023.

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Table 22.1 Individuals indicted (US) or named as being involved (EC) in cartel convictions

Position	**EC cases 1998-6/2020 161 cartels**	**(%)**	**DOJ cases 1984-2011 180 cartels**	**(%, rounded values)**
Chairman	7	6%	10	3%
Vice-Chairman / CEO	7	6%	18	5%
President (of firm or subsidiary)	13	11%	45	12%
VP/ Senior VP / Exec.VP	8	7%	54	15%
VP of section / division	3	3%	11	3%
Directors	9	8%	53	14%
Senior executives / management	19	16%	5	1%
General manager	13	11%	41	11%
Division / region manager (or head)	34	29%	62	17%
Executive salesman	4	3%	63	17%
Outside the firm	0	0%	10	3%
total	**117**	**100%**	**372**	**100%**

Source: Authors' calculations using data from Connor (2011) and EC's website.

Littlewoods with respect to Hasbro's products. Hasbro's sales director, Mike Brighty, sent the following email to two Hasbro employees, Neil Wilson and Ian Thomson:[31]

> "'Ian ... This is a great initiative that you and Neil have instigated!!!!!!!!!
> However, a word to the wise, never ever put anything in writing, its highly illegal and it could bite you right in the arse!!!!
> Suggest you phone Lesley and tell her to trash?
> Talk to Dave. Mike."

The firm's president is named in 11–12% of US and EC cases, whereas senior VPs are named in 15% of DOJ cases but only 7% of EC cases. Instead, in EC cases, senior executives are named in 16% of the cases.

4. CAREER PATHS OF CEOS OF CONVICTED CARTEL MEMBERS

As mentioned above, in convicted cartels in the US, the literature suggests that top managers make decisions, while intermediate managers implement them.[32] Further, there is little evi-

[31] OFT (CP/0480-01), November 2003. Available at: https://assets.publishing.service.gov.uk/media/555de4d340f0b666a2000168/hasbro3.pdf accessed 1/1/2023.

[32] Harrington (n 4); Connor (n 4).

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dence that top managers of convicted (listed) cartel firms in the US are held accountable by their shareholders or the legal system.[33] Rather, managers of convicted cartel firms appear to receive large bonuses while rarely being prosecuted individually.

In this section, we examine if and how cartel convictions play a role in determining CEOs' subsequent turnover. The firm's top management, including the CEO, is ultimately responsible for making major firm decisions, such as determining the firm climate or attitudes towards (profitable) misbehavior like price-fixing, and whether a specific collusive agreement will be entered into.

We explore the career paths of CEOs who were aware (or suspicious) of the collusive agreement, based on decision reports from the EC, or who were criminally prosecuted by the DOJ following the end of the cartel.

Tables 22.2 and 22.3 describe these cases regarding EC decisions (35 cartel members) and DOJ decisions (22 cartel members). These cases of CEO awareness or suspicion represent only 4.2% of all cartel members fined by the European Commission (1998-6/2020) and 2.4% of all individuals indicted by the Department of Justice (1990–2014). However, these numbers should be interpreted as lower bounds for the true number, as enforcement agencies are likely unable to identify all the cases in which CEOs are involved in or aware of the cartel.

4.1 Named CEOs in EC Cases

Some of the EC cartel reports identify CEOs as having been aware or suspicious of the collusive agreement, although only the companies (and not the individuals) are liable for the pecuniary cartel fine in the EU. A majority (17 out of 29) of the CEOs remained in the organization either as CEOs or in another high-level position, such as chairman of the board.

After the cartel fine, the 12 remaining CEOs left the firm, although only nine left during the investigation or within a year of the fine, and mostly due to prison sentences for collusion or related offenses in the US, as described in Table 22.2a, 22.2b, 22.2c, and 22.2d. This suggests that around 3% of CEOs of convicted cartel members are individually prosecuted (although outside the EU) (3/31), and around 19% do leave the firm around the time of the investigation or fine (6/31).

4.2 Named CEOs in US DOJ Cases

The career patterns of the CEOs indicted in US cartel cases (see table 22.3) appear to be more affected by both corporate governance mechanisms and antitrust fines than those in the EU. In seven out of 19 cases (37%), we see CEOs leaving the firm during the cartel investigation or within a year of the fine.

Some of the indicted CEOs left their positions up to six years before the first cartel fine (in some cases the cartel had broken apart years before the investigation was initiated), while others remained in power for 18 years following the fine.

Robert Koehler, for example, received a personal fine of US$10 million in 1999 for his participation in the graphite electrode cartel. He remained as CEO of SGL until his retirement in 2014.

[33] González et al. (n 5).

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Table 22.2a EC cartel convictions (1998–6/2020) in which CEOs were named as having some involvement, and the CEOs remain in the firm

Case number	**EC Case name**	**Fine year**	**Cartel member**	**End term**	**Position of CEO post-cartel**
1	LCD screens	2009	LG Display Co.	current	current CEO
2	LCD screens	2009	Samsung	current	current CEO
3	LCD screens	2009	Chimei InnoLux Corp.	current	current CEO
4	Marine Hoses	2009	Trelleborg	current	current CEO
5	Calcium Carbide	2009	SKW, Arques	current	current CEO
6	TV tubes (CRT)	2012	Samsung	current	current CEO
7	TV tubes (CRT)	2012	LG Electronics	current	current CEO
8	Yen Interest Rate D.	2015	ICAP	current	current CEO
9	Citric Acid	2001	Jungbunzlauer AG.	2001	managing director
10	French beer market	2004	Heineken France	2002	resigned (personal reasons), chairman
11	Industrial bags	2005	British Polythene Ind.	2003	chairman
12	Flat Glass	2007	Saint-Gobain	2007	resigned, President
13	Fittings	2006	Comap SA	2009	term over, director
14	Graphite electrodes	2001	Carbone Graphite	2014	retired
15	Pre-stressing steel	2010	Tréfileurope	2006	promotion: CEO AM
16	TV tubes (CRT)	2012	Chunghwa Picture Tubes (CEO 2)	2011	jail (cartel), director and chairman
17	TV tubes (CRT)	2012	Philips	2011	chairman

Note: Tables a-d sorted by the position of the CEO post-cartel. "n/a" where no information was available online.
Source: Authors' calculations using data from the EC's website.

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Table 22.2b EC cartel convictions (1998–6/2020) in which CEOs were named as having some involvement – and the CEOs leave the firm during investigation or within one year of the fine

Case number	EC Case	Fine year	Cartel member	End term	Position of CEO post-cartel
18	LCD screens	2009	AU Optronics	2006	jail (cartel)
19	LCD screens	2009	Hannstar	2006	jail (cartel)
20	LCD screens	2009	Chunghwa Picture Tubes (CEO 1)	2006	jail (cartel), retired
21	Interbrew/ Alken Maes	2001	Interbrew	2002	retired (family time)
22	Bitumen Netherlands	2006	Koninklijke BAM Groep NV	2005	retired
23	Synthetic Rubber	2006	Dow Chemical Company	2004	retired
24	Fittings	2006	Sanha Kaimer	2004	term over
25	Needles	2004	Coats	2003	n/a
26	SAS + Maersk Air	2001	SAS	2001	n/a

Note: Tables a-d sorted by the position of the CEO post-cartel. "n/a" where no information was available online.
Source: Authors' calculations using data from the EC's website.

Table 22.2c EC cartel convictions (1998–6/2020) in which CEOs were named as having some involvement, and the CEOs leave the firm over one year after the fine

Case number	EC Case	Fine year	Cartel member	End term	Position of CEO post-cartel
27	Auction houses	2002	Sotheby's	2013	resigned (jail, US)
28	Speciality graphite	2002	Toyo Tanso USA	2008	resigned (illness)
29	Gas insulated switchgear	2007	AREVA	2011	fired (non-cartel)
30	French beer market	2004	Brasseries Kronenbourg	2007	term over
31	Speciality graphite	2002	Carbone of America	2009	resigned (restructuring)

Note: Tables a-d sorted by the position of the CEO post-cartel. "n/a" where no information was available online.
Source: Authors' calculations using data from the EC's website.

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Table 22.2d EC cartel convictions (1998–6/2020) in which CEOs were named as having some involvement (remaining cases with unclear or no information)

Case number	**EC Case**	**Fine year**	**Cartel member**	**End term**	**Position of CEO post-cartel**
32	Industrial/medical gases	2002	Hoek Loos	n/a	n/a
33	Italian Raw Tobacco	2005	Dimon Inc.	n/a	n/a
34	Italian Raw Tobacco	2005	Transcatab (SCC)	n/a	n/a
35	Fittings	2006	Delta / IBP	n/a	n/a

Note: Tables a-d sorted by the position of the CEO post-cartel. "n/a" where no information was available online.
Source: Authors' calculations using data from the EC's website.

Although several CEOs eventually left the firm (11 out of 19), others took on different roles within the company. In each of the cases, the severity of the individual CEO's sentence varies, ranging from pecuniary fines or hours of community service to 72 months in prison (although in the latter case, the individual was released after 36 months).

4.3 All CEOs of Convicted EC Cartel Members

Taking a closer look at the public reports of the EC's cartel decisions, we now focus on the convicted EC cartel members. When examining the career paths of all CEOs of convicted EC cartels (not just the CEOs identified in the decisions), we exclude cases where no information is available regarding the CEO (40), CEOs who were over 80 years old at the time of the fine (7), and those who left due to death (11), retirement (56), or end of term (69).

Table 22.4 provides a brief description of the career path (according to the media) of the CEOs who were in place at the time of the infringement (as per the EC conviction). Even though 66% of CEOs left their positions, only 48% left the organization, since 18% assumed a new position within the company. The position is typically that of (vice-)chairman of the board (74%). However, some became directors (9%) or members of the management board

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Table 22.3a Cartel cases by the DOJ (1984–2011) in which CEOs were indicted, and remained in the firm

Case number	**DOJ Case**	**Fine year**	**Cartel member**	**CEO Jail time**	**End term**	**Post-cartel position of CEO**
1	Stamp Auctions	2002	Earl P.L. Apfelbaum Co.	0	current	current CEO
2	Concrete, ready-mix	2005	Beaver Materials Corp.	27	current	current CEO
3	Intl. freight forwarding	2005	Pasha Group	0	current	current CEO
4	Federal Creosote Superfund	2008	Bennett Environmental Inc.	63	current	current CEO
5	Concrete, ready-mix	2005	Irving Materials, Inc.	5+5(home)	2006	Chairman [before 5y. jail]
6	Air cargo, fuel surcharge	2007	Cargolux Airlines Intl.	13	2011	SVP Global Sales
7	LCD screens	2008	Chungwha Picture Tubes (CEO 2)	9	2003	director and chairman
8	Auto parts (lights)	2011	Maxone Vehicle Lighting	6	2010	chairman

Source: Authors' calculations using data from Connor (2011).

Table 22.3b Cartel cases by the DOJ (1984–2011) in which CEOs were indicted, and left the firm during the investigation or within one year of the fine

Case number	**DOJ Case**	**Fine year**	**Cartel member**	**CEO Jail time**	**End term**	**Post-cartel position of CEO**
9	Graphite Electrodes	1998	GrafTech	17	1997	retired
10	Carbon/ Graphite Electrical	2002	Morgan Crucible Co.	18	2002	retired
11	TV tubes (CRT)	2009	Chunghwa Picture Tubes (CEO 1)	7	2006	retired
12	Nigeria liquid natural gas	2010	M. W. Kellogg	30	2003	retired
13	Shipping, Parcel Tankers	2003	Odfjell Seachem	4	2004	CEO new firm
14	Auction houses	2000	Sotheby's	0 (1000h c.s.)	2000	n/a
15	Tomatoes, processed	2008	SK Foods Group	72 (out at 36)	2008	n/a

Source: Authors' calculations using data from Connor (2011)

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Table 22.3c Cartel cases by the DOJ (1984–2011) in which CEOs were indicted, and left the firm over one year after the fine (or before investigation)

Case number	**DOJ Case**	**Fine year**	**Cartel member**	**CEO Jail time**	**End term**	**Post-cartel position of CEO**
16	Plastic dinnerware	1994	Dispoz-o Plastics	21	2009	retired
17	Graphite Electrodes	1998	SGL Carbon	0	2013	retired
18	Construction Wastewater	2002	American Int. Contractors	36	1996	retired
19	E-Rate Internet program	2003	Multimedia Communication S.	60	2009	retired

Source: Authors' calculations using data from Connor (2011).

Table 22.3d Cartel cases by the DOJ (1984–2011) in which CEOs were indicted (remaining cases, with unclear or no information)

Case number	**DOJ Case**	**Fine year**	**Cartel member**	**CEO Jail time**	**End term**	**Post-cartel position of CEO**
20	Military bandages	1998	Fraass Survival Systems Inc.	5	n/a	n/a
21	Cable-stayed bridges	1999	Dywidag-Systems Intl. USA	0	n/a	n/a

Source: Authors' calculations using data from Connor (2011).

(6%), and some were even promoted to head of the group or president (8%). Interestingly, only 4% of CEOs were publicly forced to leave explicitly because of the cartel.

The figures in Table 22.4 illustrate that 32% of the CEOs resigned for reasons (allegedly) unrelated to cartels, such as becoming political figures or establishing their own companies, while another 7% left since the company changed its structure or declared bankruptcy. In addition, only 1% of the cases involved CEOs leaving as a result of other misconduct, such as embezzlement and fraud.

We find that most CEOs do not immediately step down following a cartel investigation or a fine: 85% of CEOs are still in place one year after the start of an investigation, and 45% remain in place one year after the fine. The CEOs of convicted cartel members who remain in

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power after the investigation or the fine, on average, continue to be in power for 6.1 years after the investigation or 2.2 years after the fine.

In general, there appears to exist a positive correlation between longer CEO tenure and (discovered) cartel participation. The average tenure of a CEO of a convicted EC cartel firm is approximately 13.6 years (including the cartel years) and can range from 1 to 60 years. In comparison, WRDS Compustat Executive Compensation reports the average CEO tenure for S&P 500 companies between 2000 and 2015 to be 6 years (much lower than in the EC cases examined – although there may be several non-antitrust related reasons for this) and ranging from 0 to 51 years.

5. CEO AGE AND RECIDIVISM

5.1 Age

The literature suggests a significant and positive relationship between CEO age and the likelihood of cartel formation. There are several reasons for this finding. First, firms with older

Table 22.4 CEO career path after the cartel fine. EC fines, 1998–6/2020

-	-	**If in place at investigation**	**If in place at investigation**	**If in place at fine**	**If in place at fine**
CEO career path	Career path detail	**Frequency**	**%**	**Frequency**	**%**
Current CEO	-	120	34%	120	54%
New internal position	-	65	18%	35	16%
Left due to:	Bankruptcy	4	1%	2	1%
	Prison – cartel	4	1%	1	0%
	(other jurisdictions)	2	1%	2	1%
	Prison – non-cartel	23	6%	10	5%
	M&A; restructuring				
Resigned	Cartel	8	2%	3	1%
	New firm as CEO	18	5%	5	2%
	Political position	5	1%	2	1%
	Others	92	26%	45	20%
Fired	Cartel-related	3	1%	0	0
	Other reasons	10	3%	6	3%
Total	**-**	**354**	**100%**	**222**	**100%**

Source: Authors' calculations using data from the EC's website.

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CEOs are less likely to engage in strategic change.[34] Second, older CEOs are likely to be more conservative, which often improves firm performance[35] but they may be more likely to commit fraudulent behaviors.[36] Third, older CEOs are likely to be more experienced and understand how the market structure may lead to collusion. They also have established or stronger social networks to sustain collusive agreements.[37] Finally, older CEOs, close to retirement age, may use the remaining time to ensure personal benefits through collusive agreements while also having low reputation concerns.[38]

In our data, CEOs named in the EC cases ranged in age from 20 to 63 years old when they assumed their positions and from 36 to 74 years old when the fine was imposed. When we examine all EC cartel cases, at the start of their tenure, the average age of CEOs of companies involved in a convicted EC cartel is 48 years (ranging from 17 to 71). However, at the time of the cartel fine, the average age of the CEOs was 59 (ranging from 35 to 85). In comparison, Navaretti et al.[39] report that the average age of a CEO in the EU, in 2009, was 45 years.

In the US, the CEOs named in the DOJ cases became CEOs between the ages of 18 and 64 and were between the ages of 44 and 75 at the time of the fine. In contrast, the WRDS Compustat Executive Compensation reports that the average CEO age for S&P 500 firms in 2000–2015 is 56 years (ranging between 27 and 89), while Statista (2022) reports that the average age of US CEOs has been increasing over time, from 45.9 years in 2005 to 54.1 years in 2018. These figures are summarized in Table 22.5.[40]

Overall, CEOs of cartel firms appear to be older than average, which is in line with the current literature. Considering such a high number of CEOs are close to retirement age, it is likely that director disqualification (for example, in the UK) and disqualification from public contracts (for example, in Spain) may not be as effective personal sanctions as expected.

5.2 CEOs as Multiple Offenders

Giebel et al.[41] report that CEOs are involved in more than one cartel agreement in 18% of EC cartel cases. In 9% of cases, CEOs are involved in two cartels, but in some cases, CEOs are involved in eight to ten cartels. This should be interpreted as a lower bound of the number of cartels firms take part in, as Ormosi[42] suggests that only around 10% of all cartels are detected (and convicted).

For example, Franz Humer was the CEO of F. Hoffman-La Roche during the period in which the company was involved in ten cartels (all convicted within one EC case). This was

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[34] Han (n 8).

[35] Ibid.

[36] John Stevens, Janice Beyer and Harrison Trice, 'Assessing personal, role, and organizational predictors of managerial commitment' (1978) 23(2) Academy of Management Journal 380–396.

[37] Beasley (n 6).

[38] Lucian Bebchuk and Yaniv Grinstein, 'The growth of executive pay' (2005) 21(2) Oxford Review of Economic Policy 283–303.

[39] Giorgio Navaretti, Davide Castellani and Fabio Pieri, 'CEO age, shareholder monitoring, and the organic growth of European firms' (2022) 59 Small Business Economics 361–382.

[40] Ibid.

[41] Giebel et al. (n 22).

[42] Peter Ormosi, 'A tip of the iceberg? The probability of catching cartels' (2014) 29 Journal of Applied Econometrics 361–382.

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Table 22.5 CEO age data

Sample:	Average age when becoming CEO	Average age of CEO at time of the fine
EC cases – Named CEOs [this paper]	44 Range: 20–63	62 Range: 36–74
EC cases – all CEOs [this paper]	48 Range: 17–71	59 Range: 35–85
Navaretti et al. EU sample in 2009	45	n/a
US cases – Indicted CEOs [this paper]	40 Range: 18–64	56 Range: 44–75
S&P 500 CEOs 2000–2015	56 Range: 27–89	n/a
Statista US sample (2005) Statista US sample (2018)	45.9 54.1	n/a

Source: Authors' calculations using data from Connor (2011) and EC's website.

not only the case with the CEO, as many senior executives of the company continued to collude in the vitamins cartel while pleading guilty in the citric acid cartel. As Spratling[43] suggests:

> Incredibly, some senior executives of this multinational firm knew about the firm's participation in international cartels in two industries. When the firm's illegal activities were uncovered in one industry, and the firm had to plead guilty and pay millions of dollars in fines, those executives could have and should have terminated the firm's cartel activities in the second (and larger) industry. Instead, those executives orchestrated false statements to enforcement authorities, took steps to further conceal the firm's illegal activities, and continued to lead the world's other vitamin producers in a global cartel – actions which will end up costing the firm billions of dollars in fines and damages.

In another example, Thierry Desmarest was the CEO of Arkema France during the period in which the company was involved in eight cartels (in seven EC cases). There is also one (convicted) case where the same individual was (non-contemporaneously) the CEO of different firms during the time of a cartel (based on the length of the cartel for which the fine was imposed): Jurgen Dormann served as Hoechst AG's CEO (1994–1999) during its collusion period (1978–1996) and later served as ABB's CEO. During his tenure as CEO (2002–2004), ABB participated in three cartels (1988–2004, 1999–2003, and 2000–2008).

[43] Gary Spratling, 'International Cartels: The Intersection between FCPA violations and Antitrust violations' (1999) DOJ's speech at American Conference Institute, 9 December 1999, Washington, D.C.

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6. SHAREHOLDER AWARENESS AND INFLUENCE

Sections 4 and 5 above discuss how (convicted) cartels are formed or operated by managers. An individual manager participating in a cartel may have a number of personal objectives, such as maximizing their salary or career advancements. Conversely, shareholders seek to maximize shareholder value while potentially also serving a wide range of stakeholders' interests in terms of corporate social responsibility, such as promoting public health, reducing climate change, or ensuring fair trade.[44] Consequently, managers' and shareholders' motivations may not be aligned fully.[45]

6.1 Is Collusion Beneficial for Shareholders?

Collusion can benefit shareholders depending on their discount factors (i.e., how they value present versus future value), the antitrust enforcement environment, and the overall economic conditions. While collusion is widely acknowledged to benefit managers, several studies have explored whether shareholders also benefit from corporate misconduct.[46]

Due to the increased profits generated during the cartel period, collusion can also be beneficial to shareholders, provided expected negative consequences from a conviction are limited. If these expected negative consequences, which may include large monetary fines, damages actions, and reputational loss, outweigh the expected benefits of collusion, then collusion will not be beneficial for shareholders.[47] Often, a reputational loss can be more significant than a fine.[48] As shareholders are expected to anticipate the potential loss caused by the monetary

[44] Oliver Hart and Luigi Zingales, 'Companies should maximize shareholder welfare not market value' (2017) 2 Journal of Law, Finance, and Accounting 247–274; Oliver Hart and Luigi Zingales, 'Serving shareholders doesn't mean putting profit above all else' *Harvard Business Review* (12 October 2017), available at: https://hbr.org/2017/10/serving-shareholders-doesnt-mean-putting-profit-above-all-else.

[45] Michael Jensen and William Meckling, 'Theory of the firm: Managerial behavior, agency costs and ownership structure' (1976) 3(4) Journal of Financial Economics 305–360; Bo Sun, 'Executive compensation and earnings management under moral hazard' (2014) 41 Journal of Economic Dynamics & Control 276–290; Raffaele Fiocco, Salvatore Piccolo and Giancarlo Spagnolo, 'Collusion through debt and managers' (2023) SSRN working paper 4123287; Frederick Oh and Kyung Park, 'Corporate governance structure and product market competition' (2016) 48(14) Applied Economics 1281–1292.

[46] Sanaj Bhagat, John Bizjak and Jeffrey Coles, 'The shareholder wealth implications of corporate lawsuits' (1998) 27(4) Financial Management 5–27; John Bizjak and Jeffrey Coles, 'The effect of private antitrust litigation on the stock-market valuation of the firm' (1995) 85(3) The American Economic Review 436–461; Paul Griffin, Joseph Grundfest and Michael Perino, 'Stock price response to news of securities fraud litigation: An analysis of sequential and conditional information' (2004) 40(1) Abacus 21–48; Samuel Tibbs, Deborah Harrell and Ronald Shrieves, 'Do shareholders benefit from corporate misconduct? A long-run analysis' (2011) 8(3) Journal of Empirical Legal Studies 449–476.

[47] Anup Agrawal and Gershon Mandelker, 'Managerial Incentives and Corporate Investment and Financing Decisions' (1987) 42(4) Journal of Finance 823–837.

[48] John Armour, Colin Mayer and Andrea Polo, 'Regulatory sanctions and reputational damage in financial markets' (2017) 52(4) Journal of Financial and Quantitative Analysis 1429–1448.

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fine, damages awards, reputational costs and legal costs, the initial public announcement of a misconduct such as collusion typically has a negative impact on the stock price of their company.[49] Despite this, the net effect of a cartel conviction on shareholders appears to be negligible,[50] confirming Ginsburg and Wright's view: "(a)s matters now stand, neither shareholders nor directors and officers have an incentive to prevent price-fixing as long as it remains profitable for the corporation."[51]

Diantini[52] concludes that cartel engagement benefits shareholders also in the United States (1990–2013), not only in terms of portfolio investment decisions, but also in terms of risk management.

6.2 Can Shareholders Influence Cartel Decisions?

The literature also suggests that shareholders do influence management decision-making and that managers know their largest shareholders and their incentives.[53] Aubert[54] and Ha et al.[55] suggest that cartel decisions are made either managers or by shareholders who encourage the managers to collude, for example, by providing stock-based reward incentives.[56] Large shareholders who explicitly request CEOs to collude may face criminal liability under US antitrust laws and may be exposed to (collective) civil liability under European competition law. Importantly, in the EU, shareholders may bear the negative consequences of antitrust fines, as owners of an infringing firm or more broadly whenever they form part of the 'undertaking' within which the responsible CEOs operate. That is, unlike in the US, also in cases where they had no direct involvement in the violation or for infringements of other affiliate companies within the same economic group. For instance, a parent company (and hence its shareholders) is presumed to be liable for violations of a wholly owned or controlled subsidiary in which the CEO operates.[57] Hence, as stressed by Ha et al.,[58] shareholders do not give "direct instructions to collude and thus have plausible deniability that the incentives schemes do not reflect this particular product market strategy to maximize profits. In this way, they are not subject

[49] Aguzzoni et al. (n 13); Bruce Haslem, 'Managerial opportunism during corporate litigation' (2005) 60(4) The Journal of Finance 2013–2041.

[50] See e.g. Aguzzoni et al. (n 13); Mariuzzo et al. (n 15); Marvão et al. (n 14).

[51] Douglas Ginsburg and Joshua Wright, 'Antitrust Sanctions' (2010) 6(2) Competition Policy International 3.

[52] Ni Diantini, 'Does Price-Fixing increase firm value?' (2021) Ph.D. thesis, Chapter 2, The University of West Australia.

[53] See e.g. Antón et al. (n 3); Alex Edmans, 'Blockholders and corporate governance' (2014) 6(1) Annual Review of Financial Economics 23–50; Andrei Shleifer and Robert Vishny, 'A survey of corporate governance' (1997) 52(2) Journal of Finance 737–783.

[54] Cecile Aubert, 'Managerial Effort Incentives and Market Collusion' (2022), Toulouse School of Economics working paper 09-127.

[55] Sangeun Ha, Fangyuan Ma and Alminas Zaldokas, 'Motivating collusion' (2024) Journal of Financial Economics (forthcoming).

[56] See Spagnolo, 'Stock-related compensation and product-market competition' (n 2).

[57] For more details, see Stephen Daly and Alison Jones, 'The Undertaking and Single Entity Doctrine in EU and UK Competition Law: Proposals for a Refined Approach' (Chapter 7 in this Handbook).

[58] See Ha et al. (n 55).

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to the personal antitrust liability". Although it is worth noting that, in the EU, shareholders may not be able to avoid the negative consequences of fines based on strict liability for violations of companies they control. In this light, shareholders who wish managers to collude can simply choose the appropriate (and most commonly observed) incentives for their managers, as shown in Spagnolo,[59] and thus, avoid clauses that penalize unlawful but profitable behavior like cartel participation.

6.3 Are Shareholders Aware of Collusive Agreements?

As one could expect, the evidence regarding whether shareholders are aware of collusive agreements, and whether they facilitate or even induce them, is highly mixed. Below, we discuss four cases in which shareholders were also involved in the cartel, along with some examples of cartel penalties imposed on them. Contrastingly, we then present examples where shareholders did not appear informed about the cartel as they sued managers and/or directors for their mismanagement leading to the cartel.[60]

The following are some examples of penalties that shareholders have been subjected to. It is worth noting that the two latter cases relate to the legal presumption of "decisive influence" of the parent over the subsidiary.

1. In the US DOJ cartel between Sotheby and Christie's, convicted in 2001, the CEO of Sotheby's, Diana Brooks, implicated one of their shareholders, Alfred Taubman. He was fined US$7.5 million and imprisoned for 10 months.
2. In the EC MCAA cartel fined in 2005, "[t]he Commission consider[ed] the 98% shareholding of Elf Aquitaine in Atofina [wa]s sufficient in itself to impute liability to Elf Aquitaine." In this case, the controlling shareholder was another firm (and not an individual).
3. In the EC International Removal Services cartel fined in 2008, the Commission notes that: "In the light of the case law referred to in paragraph (386) and given the shareholder relationship between Sirva and Allied Arthur Pierre during the period indicated, the Commission takes the view that Sirva can be presumed to have exercised a decisive influence over Allied Arthur Pierre's commercial policy." As in the previous point, the controlling shareholder was another firm (Sirva).

[59] See Spagnolo, 'Stock-related compensation and product-market competition' (n 2); Spagnolo, 'Managerial incentives and collusive behavior' (n 2).

[60] In the previous UK OFT (the predecessor of the current CMA) guidelines, the involvement of shareholders was also a factor that mitigated fines against management. The guidelines stated that a fine reduction shall be granted if "the director was himself or herself under severe internal pressure such as from controlling shareholders of the company or directors of a parent company (…) to be involved in the breach or to allow it to occur," as discussed in: Maher Dabbah, *EC and UK Competition Law: Commentary, Cases and Materials* (Cambridge University Press 2004).

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Members of cartels sometimes attempt to consolidate their position within the cartel by becoming shareholders of peer cartel companies.[61] This behavior can be seen in the following example:

4. The pre-insulated pipe cartel was fined by the EC in 1998. It involved several members including ABB and Løgstør. The decision notes that: "ABB believed that its situation [in the cartel] could be consolidated by its taking a shareholding of up to 10% in Løgstør, in return for which it would secure an increased quota for Løgstør within the cartel. (This idea never in fact became a reality)."[62]

Although it is not uncommon for cartel peers' shareholders to hold shares in another cartel member's company, it is uncommon that these are fined. In Table 22.6, we present a list of the cases in which EC cartel reports (between 1998 and 2020) mention significant shareholders who were also implicated in the collusive agreement. The table also includes some cases of legal presumption of "decisive influence" of the parent over the subsidiary's conduct. In these cases, the parent company is often an addressee of the EC decision.

However, in many cases, shareholders may not be aware of the collusive agreements. The low visibility of managerial actions to shareholders, especially those that are dispersed, may also be exploited by managers. In this case, in some jurisdictions such as the US, Germany[63] and Japan, shareholders can seek damages from managers and/or directors on behalf of a firm where it is alleged that they failed to prevent a breach of competition law. Some examples are listed below.

1. In 2019, shareholders sued Micron Inc. for allegedly failing to disclose, first, the price-fixing agreements of Dynamic Random Access Memory (DRAM) sold to manufacturers of personal computers and, second, the public investigation for price-fixing.
2. In the US DOJ lysine cartel (1999), shareholders sued Archer Daniels Midland (a cartel member) for mismanagement, for a total of US$38 million.
3. The US DOJ cartel between Sotheby and Christie's was fined in 2001. Although one of Sotheby's main shareholders was indicted and fined for its involvement in the cartel, other Sotheby's shareholders in the US filed a civil antitrust suit against the board of directors.

Another piece of evidence suggesting that shareholders may often be unaware of collusive agreements is provided by González et al.[64] The authors investigate shareholder litigation against cartel firms for securities fraud. They find that several convicted cartel members are sued for securities fraud (44 out of 224 firms in the sample). This proportion is significantly larger for (convicted) cartel members than otherwise. This large number is due to shareholders suing because of misleading financial reporting connected to the cartel, or because cartel

[61] See, e.g., Christopher Leslie, 'Trust, Distrust, and Antitrust' (2004) 82 Texas Law Review 515–680.

[62] Commission decision of 21 October 1998 relating to a proceeding under Article 85 of the EC Treaty (Case No. IV/35.691/E-4: — Pre-Insulated Pipe Cartel), para. 46.

[63] See for more details: Jens-Uwe Frank and Till Seyer, 'Management Liability for Companies' Antitrust Fines' (Chapter 24 in this Handbook).

[64] González et al. (n 5).

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Table 22.6a EC cartel cases where shareholders of a cartel member were also implicated in the cartel

Case	Firm	Shareholder as cartel partner	Shareholding percentage
Pre-insulated pipes (1998)	Løgstør Rør A/S	ABB Asea Brown Boveri Ltd	10% (demanded by ABB but did not happen)
Extra d'alliage (1998)	Acciai Speciali Terni SpA	Krupp Thyssen Nirosta GmbH	Moved from 50% to 75% during cartel
Austrian banks — Lombard Club (2002)	Österreichische Postsparkasse Aktiengesellschaft	Bank für Arbeit und Wirtschaft Aktiengesellschaft	n/a
Plasterboard (2002)	Gyproc Benelux NV	BPB	46%
Plasterboard (2002)	Gyproc Benelux NV	Etex (Eternit)	54%
Plasterboard (2002)	Gyproc AB, Nordic	BPB	25%
Needles (2004)	Entaco Group Ltd	Prym Consumer	10.1%
Gas insulated switchgear (2007)	VA TECH Schneider High Voltage GmbH	Schneider Electric SA	40%
Gas insulated switchgear (2007)	TM T&D Corporation	Toshiba	50%
Gas insulated switchgear (2007)	TM T&D Corporation	Melco	50%

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Table 22.6b EC cartel cases where shareholders of a cartel member were also implicated in the cartel

Case	Firm	Shareholder with Parental liability	Shareholding percentage
MCAA (2005)	Atofina SA	Elf Aquitaine SA	98%
Pre-stressing steel (2010)	AFT Aldé Filo Srl (formerly TRACOFIL Srl)	Acciaierie e Ferriere Lombarde Falck SpA	30%
Pre-stressing steel (2010)	AFT Aldé Filo Srl (formerly TRACOFIL Srl)	Aldé Filo SpA	23.07%
Pre-stressing steel (2010)	AFT Aldé Filo Srl (formerly TRACOFIL Srl)	Tréfileurope	46%
Pre-stressing steel (2010)	Tréfileurope	Usinor Sacilor SA	88.02%
Pre-stressing steel (2010)	Tréfileurope	Unimétal	3.51%
Pre-stressing steel (2010)	Tréfileurope	ARBED SA	8.32%
International Removal Services (2008)	Allied Arthur Pierre	Exel Investments Limited	-
International Removal Services (2008)	Gosselin Group NV	Stichting Administratiekantoor Portielje	92%
Graphite electrodes (2001)	UCAR International Inc.	Mitsubishi	n/a
Austrian banks — 'Lombard Club (2002)	Österreichische Volksbanken AG	Credit Union Grouping	n/a
Sodium Gluconate (2004)	Glucona B.V.	Akzo Chemie B.V.	50%
Sodium Gluconate (2004)	Glucona B.V.	Avebe B.A.	50%
Reinforcing steel bars (2002)	Acciaieria Megara S.p.A.	Alfa Acciai S.R.L.	49.7%
Reinforcing steel bars (2002)	Alfa Acciai S.R.L.	Siderurgica Investimenti S.R.L.	67.875%
Copper plumbing tubes (2004)	Societa Metallurgica Italiana S.p.A	KME-group	largest
Bitumen Spain (2007)	Petronor	Repsol S.A	85.98%

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Case	Firm	Shareholder with Parental liability	Shareholding percentage
Bitumen Spain (2007)	Asfalnor	Petronor S.A.	60%
Bitumen Spain (2007)	Asfalnor	Repsol Petróleo S.A.	40%
Gas insulated switchgear (2007)	Japan AE Power Systems Corporation	Hitachi Ltd	50%
Gas insulated switchgear (2007)	Japan AE Power Systems Corporation	Fuji Electric Holding Co. Ltd	30%
TV and computer monitor tubes (2012)	Shuguang LG Electronics Co., Ltd.	LG Electronics Inc.	<55%
TV and computer monitor tubes (2012)	LG.Philips LCD Co. Ltd.	Philips Electronics N.V.	32.87%
TV and computer monitor tubes (2012)	Matsushita Toshiba Picture Display Co. Ltd.	MT Picture Display Co. Ltd	35–40%
TV and computer monitor tubes (2012)	Matsushita Toshiba Picture Display Co. Ltd.	Toshiba	60–65%
Smart card chips (2014)	Renesas Technology Corp	Hitachi	7.66%
Smart card chips (2014)	Renesas Technology Corp	Melco	6.27%
Polyurethane foam (2014)	Eurofoam	Recticel N.V.	50%
Polyurethane foam (2014)	Eurofoam	Greiner Holding AG	50%
Rechargeable batteries (2016)	Sanyo	Panasonic	50.2% (acquired post-cartel)
Optical disc drives (2015)	Philips BenQ Digital Storage (now Philips-Lite-On)	BenQ (later with Lite-On)	49%
Optical disc drives (2015)	Hitachi-LG Data Storage Inc.	LG Electronics Inc.	49%
Optical disc drives (2015)	Sony Optiarc	NEC Corporation	45%
Trucks (2017)	Scania	Volkswagen	45.66%(largest)
Maritime car carriers (2018)	EUKOR Car Carriers Inc.	Wallenius Logistics AB	40%
Maritime car carriers (2018)	EUKOR Car Carriers Inc.	Wilhelmsen Ships Holding Malta Limited	40%
Maritime car carriers (2018)	Wallenius Wilhelmsen Logistics ASA	Wilhelmsen Ships Holding Malta Limited	50%

Source: Authors' calculations using data from the EC's website.

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members tend to also not comply with regulations related to securities filings and other laws. Although mostly suggestive, this evidence adds to the very limited effect of convictions on corporate governance. Through a revealed preferences argument, this may in turn suggest that in most cases shareholders are not trying to prevent managers from colluding, and that corporate fines may therefore be too low to achieve deterrence given the current probability of detection.

7. CONCLUSION

We find little evidence of competition law enforcement affecting firms' corporate governance, such as convictions inducing CEO removal by shareholders, particularly in the EU. Furthermore, in some cases, shareholders may have had a role in detecting sanctioned cartels or they may have also been shareholders of peer cartel companies. More positively, there have been some cases in which shareholders have sought compensation for damages from directors and/or managers. However, these seem to be rare.

Overall, the evidence presented or reviewed suggests that (the majority of) shareholders do not try to deter managers from colluding. Thus, it appears that the expected consequences of convictions are still too mild to deter collusion through changes in corporate governance. This is either due to low fines or a low likelihood of detection, or both and is particularly important for the EU because EC fines are generally less severe than those in the US, even in the absence of criminal sanctions. Accordingly, studies such as Allain et al.,[65] who suggest that 50% to 80% of fines are over-deterrent, may have relied on overly optimistic assumptions about the probability of cartel detection and other parameters of the model.

In convicted cartel firms, CEO tenure appears to be longer than average, and CEOs are often close to retirement age at the time of the fine. In these cases, disqualification from management positions is also unlikely to have a strong deterrent effect.

An important example that summarizes our key points in this chapter is from the Euro Interest Rate Derivative (EIRD) cartel. The CEO of Barclays Bank, who reported the cartel to the European Commission and applied for the Leniency Program, Bob Diamond, was forced to resign a week after the bank was fined (in July 2012). The CEOs of the non-reporting banks, instead, either remained in place or stepped down at the end of their terms with large severance packages. This example illustrates the large gap between the current scenario, where colluding managers that do not self-report are rewarded, and one with optimal enforcement, where leniency applicants should be rewarded, and other firms' managers should be punished by shareholders. Taken together, this evidence points to a need for policy changes that can make antitrust intervention sufficiently robust to generate a deterrent effect that could be visible through its effects on firms' corporate governance.

[65] Marie-Laure Allain, Marcel Boyer, Rachidi Kotchoni and Jean Ponssard, 'Are cartel fines optimal? Theory and evidence from the European Union' (2013) CIRANO-Scientific Publications 2013s-24.

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23. Managerial Liability, Managerial Duties, and Liability Within Corporate Groups: Optimal Competition Law Sanctions by Rearranging the Deckchairs Within the Undertaking?

Florian Wagner-von Papp

1. OVERVIEW[1]

This chapter analyses the incentive effects of competition law sanctions when the sanction is shifted between various constituent elements within the infringing undertaking, be it to managers or be it to other corporate entities within a corporate group.

Corporate governance considerations will influence the choice of sanctions.[2] Corporate[3] sanctions[4] by themselves will not necessarily create the right incentives for the individual

[1] I have mulled over the topics for this contribution, in particular the topic of indemnification, for some 15 years, and I have presented on various occasions and received helpful feedback. I should thank everyone at each of these events; a complete list is impossible (both for reasons of space and for reasons of memory). I first presented on 'suing the suits' in March 2009 at the Amsterdam Centre for Law & Economics, with comments by Maarten Pieter Schinkel being particularly memorable; in May 2009, at the UCL/IMEDIPA Competition Law Research Workshop on the Limits of Competition Law in Santorini, and comments by Bill Kovacic, Ioannis Lianos, Andreas Stephan, D Daniel Sokol and Wouter Wils are particularly vivid in my memory (there were many more comments, although the most memorable and commented on parts were arguably not my intellectual contributions – if any – but the pictures of my then four-week old son I had used in my presentation); and in December 2009 at the Centre for Competition Law at the UEA in Norwich, where helpful comments came, again, from Andreas Stephan as well as from Bruce Lyons and Morten Hviid. Much more recently, I benefited from the comments at the workshop at the ZEW in Mannheim in March 2023, especially from Jens-Uwe Franck, Catarina Marvão, Giorgio Monti, Anne Riley, and, of course, the editors of the book, Florence Thépot and Anna Tzanaki; Florence and Anna have also substantially improved the chapter during the editing process by giving extremely helpful feedback and making excellent suggestions. I should also thank several generations of LL.M. students in the Competition Law Enforcement in Europe module during my time at UCL, where we covered all the topics of this contribution. I am sure I have forgotten to mention many who made relevant comments. My excuse is that I am now based in Hamburg, where memory lapses are kind of a tradition. I would also like to thank my colleagues Tim-Erik Held, Karsten Kamps and Paul Voges for diligent proof-reading and editing.

[2] Florence Thépot, *The Interaction Between Competition Law and Corporate Governance – Opening the 'Black Box'* (Cambridge University Press 2019) 133ff.

[3] I will use 'corporate sanctions' as a shorthand for sanctions that are imposed on the undertaking or its constituent parts. In principle, natural persons (or unincorporated entities) can be undertakings as well.

[4] From the perspective of optimal sanctions theory, private enforcement of pecuniary claims against the infringer may to some extent be a substitute to public fines. In particular, both fines and private

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decision-makers within the firm, for whom corporate sanctions are negative externalities – unless the undertaking internalizes the displeasure (inflicted by corporate sanctions in the form of fines or damages) with the individuals through internal sanctioning mechanisms. The indifference of the individual to corporate sanctions as such may result in a principal-agent problem, which is considered by many (including myself) to be an argument for the use of individual sanctions,[5] such as individual administrative fines, director disqualification orders (DDO), individual criminal sanctions, or direct private claims of those harmed by infringing conduct against the culpable individuals.[6] Others argue, however, that it is sufficient to impose public sanctions exclusively on the undertaking, provided the undertaking, in a second step,

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enforcement may seek to deprive the infringer of the illegal gains and have a deterrent effect (cf Case C-882/19 *Sumal SL v Mercedes Benz Trucks España SL* EU:C:2021:800, para 35). For much of this chapter, fines and private pecuniary claims will therefore be treated as interchangeable. However, such private claims are not perfectly interchangeable with public sanctions (Section 3).

[5] Gregory J Werden and Marilyn J Simon, 'Why Price-Fixers Should Go to Prison' (1987) 32 Antitrust Bulletin 917, 930ff; Wouter PJ Wils, 'Does the Effective Enforcement of Articles 81 and 82 EC Require Not Only Fines on Undertakings, But also Individual Penalties, and in Particular Imprisonment?' in Claus-Dieter Ehlermann and Isabela Atanasiu (eds), *European Competition Law Annual 2001: Effective Private Enforcement of EC Antitrust Law* (Hart Publishing 2003) 411, 415ff; Wouter PJ Wils, *Efficiency and Justice in European Antitrust Enforcement* (Hart Publishing 2008) §§ 547ff, § 559; William H Page, 'Optimal Antitrust Penalties' in Roger D Blair and D Daniel Sokol, *The Oxford Handbook of International Antitrust Economics* Vol I (OUP 2015) 254, 262–263; Florian Wagner-von Papp, 'Compliance and Individual Sanctions in the Enforcement of Competition Law' in Johannes Paha (ed), *Competition Law Compliance Programmes – An Interdisciplinary Approach* (Springer 2016) 135; Florian Wagner-von Papp, 'Introduction' in Florian Wagner-von Papp, David Viros, Daniel Zimmer, William E. Kovacic and Andreas Stephan, 'Individual Sanctions for Competition Law Infringements: Pros, Cons and Challenges' (2016) 14(2) Concurrences 21; Samet Caliskan, 'Individual Behaviour, Regulatory Liability, and a Company's Exposure to Risk: The Deterrent Effect of Individual Sanctions in UK Competition Law' (2019) 10 Journal of European Competition Law & Practice 386; Kristina M Stomper, *Kriminalisierung von hardcore-Kartellrechtsverstößen* (Nomos 2021) 142ff, esp. 151ff; Catarina Marvão and Giancarlo Spagnolo, 'Leniency Inflation, Cartel Damages, and Criminalization' (2023) 63 Review of Industrial Organization 155; Terry Calvani and Rory Jones, 'Why do countries with criminal antitrust sanctions fail to incarcerate price fixers?' (2024) 12 Journal of Antitrust Enforcement, https://doi.org/10.1093/jaenfo/jnad050; see also Kurt Stockmann, 'Zur Sanktionierung schwerer Kartellverstöße natürlicher Personen' in Juliane Kokott, Petra Pohlmann and Romina Polley (eds), *Europäisches, Deutsches und Internationales Kartellrecht – FS Dirk Schroeder* (Otto Schmidt 2018) 811; Emmanuel Combe and Constance Monnier-Schlumberger 'Cartel et Comportement des Managers: Détecter, Sanctionner et … Prévenir' in Emmanuel Combe, Constance Monnier-Schlumberger, Philippe Coen, Marie-Pascale Heusse, Chloé Le Coq, Cantarina Marvão, Andreas Stephan and David Viros, 'Managerial Behaviour and Competition Law', (2020) 2(4) Concurrences 4–5, and, in the same Dossier, David Viros 'Staff and Management's Implication in Anticompetitive Practices: Lifting the Corporate Veil' (2020) 2(4) Concurrences 34. Further references for the 'principal-agent argument' can be found in Florian Wagner-von Papp, 'What if all Bid Riggers Went to Prison and Nobody Noticed? Criminal Antitrust Law Enforcement in Germany' in Caron Beaton-Wells and Ariel Ezrachi, *Criminalising Cartels* (Hart Publishing 2011) 157, 173 in n 100.

[6] These types of individual sanctions all address the principal-agent problem. However, they each have their advantages and disadvantages, which will be discussed in the course of this chapter.

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internalizes the displeasure with the individual decision-maker, usually directors or officers ('managers'), through 'indirect individual sanctions', such as (1) seeking redress from the individual for fines paid to the state and/or damages paid to any individual harmed by the infringement from culpable individuals, (2) clawing back bonuses or (3) other disciplinary actions up to termination of employment.[7] Do we still need public sanctions for individuals when private liability for fines and damages is – directly[8] or indirectly[9] – borne by (some of) the culpable individuals?

Managerial liability has the prerequisite that managerial duties were breached. Liability for competition law infringements therefore may depend on the scope of duties imposed by corporate law. Is there a managerial duty to introduce compliance schemes?[10] Is there a duty

[7] These authors argue at least against criminalization and possibly even for abolishing individual fines, inter alia, on the basis that liability for damages is sufficient, see Konrad Ost, 'From Regulation 1 to Regulation 2: National Enforcement of EU Cartel Prohibition and the Need for Further Convergence' (2014) 5 Journal of European Competition Law & Practice 125, 134–135; Markus Twele, *Die Haftung des Vorstands für Kartellrechtsverstöße* (Nomos 2013) 232 (see also 233–274 for some of the internal sanctions against directors apart from private liability); against criminalization pointing to the substitute of private liability, but not against individual fines, see Meinrad Dreher, 'Wider die Kriminalisierung des Kartellrechts' (2011) 61 Wirtschaft und Wettbewerb 232, 242–243. Against these arguments that internal sanctions make criminal sanctions unnecessary, see Wils, Does the Effective Enforcement of Articles 81 and 82 EC (n 5) 427ff; Wagner-von Papp, Compliance and Individual Sanctions (n 5) 138–140.

[8] In Germany, managers who have caused or facilitated the infringement are personally (jointly and severally with the undertaking) liable for damages for the harm done to third-party victims directly to them under the so-called *Dornbracht* case law (OLG Düsseldorf, 13 November 2013, VI-U (Kart) 11/13 paras 147ff, (2014) 64 Wirtschaft und Wettbewerb 317, 327–28 = WuW/E DE-R 4117, 4127–28 – *Badarmaturen* (Dornbracht); Eike Eden, 'Haften Geschäftsführer persönlich gegenüber Kartellgeschädigten auf Schadensersatz?' (2014) 64 Wirtschaft und Wettbewerb 792, 802); see Meinrad Dreher, 'Die persönliche Außenhaftung von Geschäftsleitern auf Schadensersatz bei Kartellrechtsverstößen' (2009) 59 Wirtschaft und Wettbewerb 133, and the in-depth analysis in Eike Eden, *Persönliche Schadensersatzhaftung von Managern gegenüber Kartellgeschädigten* (Nomos 2013); see also Twele (n 7) 95–107.

[9] Whether companies may seek indemnification from directors, officers or employees is hotly debated, and will be discussed at length in Section 4 below, as well as in Jens-Uwe Franck and Till Seyer, 'Management Liability for Companies' Antitrust Fines', Chapter 24 in this Handbook, 535. See, e.g., Stefanie Leclerc, *Der Kartellgeldbußregress* (Mohr Siebeck 2022); Twele (n 7) 108–211. The discussion to what extent undertakings should be able to seek indemnification to recover fines and/or damages from individuals distinguishes between the recovery of fines on the one hand and recovery of damages paid to third parties on the other. See Section 4; see also Konrad Ost, '"Einer trage des andern Last…"? – Die Unternehmenssanktion zwischen gesellschaftsrechtlichem Organregress und kartellrechtem Sanktionszweck' in Kokott, Pohlmann and Polley (n 5) 589, 591ff, 598.

[10] A compliance scheme may be defined, in the abstract, as a set of procedures that seeks to reduce infringements by steering employees' behaviour towards a culture of competition and compliance by informing, screening, and monitoring employees and management. In addition to compliance training, a compliance scheme may include an internal sanctioning mechanism, but also an internal leniency mechanism to incentivize early and truthful reporting. Compliance schemes come in many different shades, some 'light touch' but effective in fostering a culture of competition (which may even be achieved without any compliance scheme), some very elaborate

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to apply for leniency to minimize corporate fines once an infringement is detected – perhaps through a compliance scheme? Here, there is again an interplay between corporate governance and competition law sanctions: the manager's duty may depend on the corporate cost-benefit ratio, and this ratio in turn depends on the way competition authorities react to the existence of compliance schemes: Should there be additional liability for the failure to set up an effective compliance scheme, or should there be a discount on – or even immunity from – a fine where a compliance scheme was introduced even if it failed in the individual case, or should the sanction be indifferent to the existence or introduction of a compliance scheme?[11]

The choice of competition sanctions will influence how corporate governance mechanisms are employed. To the extent undertakings may seek indemnification for fines or damages from their managers, the questions arise whether there is a duty on management to initiate such actions for indemnification, and if management does not comply, whether such a duty could be enforced by shareholders.[12]

Where sanctions are imposed on, or damages are awarded against,[13] the undertaking, which potentially comprises several legal entities,[14] the questions arise whether this de facto piercing of the corporate veil between separate legal entities[15] is justified, and whether it results in

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and heavy-handed but ineffective, and some in between these extremes. For the purposes of this chapter, it is not necessary to go deeper into the definition or details of compliance schemes, because their effectiveness is too context-dependent to allow an abstract assessment. For details see the literature in n 11 below, and the discussion in Sections 5–7.

[11] Wouter PJ Wils, 'Antitrust Compliance Programmes and Optimal Antitrust Enforcement' (2013) 1(1) Journal of Antitrust Enforcement 52; Damien Geradin, 'Antitrust Compliance Programmes and Optimal Antitrust Enforcement: A Reply to Wouter PJ Wils' (2013) 1(2) Journal of Antitrust Enforcement 325; Anne Riley and D Daniel Sokol, 'Rethinking Compliance' (2015) 3(1) Journal of Antitrust Enforcement 31; Rosa M. Abrantes-Metz and D. Daniel Sokol, 'Antitrust Corporate Governance and Compliance' in Roger D Blair and D Daniel Sokol (eds), *The Oxford Handbook of International Antitrust Economics* Vol. 2 (OUP 2015) 586, 591ff; Thépot (n 2) 196ff; Hauke Brettel and Stefan Thomas, *Compliance und Unternehmensverantwortlichkeit im Kartellrecht* (Mohr Siebeck 2016); Johannes Dittrich and Petra Linsmeier, 'Compliance-Defence im Kartellrecht' (2014) 2 Neue Zeitschrift für Kartellrecht 485–492. See Sections 5, 6 and 7.

[12] See Section 4.4.

[13] For the proposition that the claim is against the undertaking as a single economic unit, see Case C-724/17 *Vantaan kaupunki v Skanska Industrial Solutions Oy and others* EU:C:2019:204; *Sumal* (n 4) para 38; but see Melanie Moser, *Konzernhaftung bei Kartellrechtsverstößen* (Nomos 2017), rejecting civil liability of the undertaking as a single entity.

[14] For the boundaries of the undertaking as an element of opening the black box, see Thépot (n 2) 33ff, and Stephen Daly and Alison Jones, 'The Undertaking and Single Entity Doctrine in EU and UK Competition Law: Proposals for a Refined Approach', Chapter 7 in this Handbook, 128; Thomas K. Cheng, 'The Single Economic Entity Doctrine', Chapter 8 in this Handbook, 152; Marcos Araujo Boyd, 'Undertakings and Legal Entities as Addressees of Articles 101 and 102 TFEU', Chapter 9 in this Handbook, 170; Carsten Koenig, 'Enforcement of EU Competition Law Against Groups of Companies: The Calculation of Fines', Chapter 10 in this Handbook, 193; Mariana Pargendler, Maria Luiza Mesquita e Silva and Lucas Víspico, 'Family Ties and the Boundaries of the Firm in Antitrust Law', Chapter 11 in this Handbook, 218.

[15] See Carsten Koenig, 'An Economic Analysis of the Single Economic Entity Doctrine in EU Competition Law' (2017) 13 Journal of Competition Law & Economics 281; Mark Leddy, 'Piercing the Corporate Veil in Competition Cases' in Kokott, Pohlmann and Polley (n 5) 501.

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changes to the structure and governance of corporate groups – and if this is not the case, this may even lead us to reconsider the approach to (lateral) piercing or enterprise liability more generally.[16]

This chapter will proceed as follows. Section 2 will outline the problem of designing a system of optimal sanctions for both undertakings and individuals in an environment where it is unclear whether corporate sanctions are optimal, so that the interests of these players diverge because the undertaking would like to avoid infringements while the individual may have private interests that would be furthered by infringing competition law, or, alternatively, corporate sanctions are suboptimal, so that the interests of undertakings and individuals are generally aligned because both have an interest in infringing competition law.

Section 3 takes a very brief look at how private damages actions – either against the undertaking or against individuals (directors and officers) – contribute to the deterrent effect similarly to public enforcement. It also discusses why there are differences between public and private enforcement, and why one should be careful not to over-rely on private actions to ensure that overall sanctions are deterrent.

Section 4 looks at the interactions between the undertaking and its agents, both for the scenario that corporate sanctions are suboptimal and for the scenario where they are optimal, so that a principal-agent problem exists. In the latter case, the question is raised whether the undertaking may resolve the principal-agent problem internally by seeking indemnification from its agents for corporate fines and/or damages paid to third parties, a discussion that is currently raging fiercely in Germany (and is still smouldering in the UK). To the extent such indemnification for damages or fines is possible, the question arises whether the management of a company has an obligation to seek indemnification, and whether it can be forced to do so, if necessary, by derivative shareholder actions.

Section 5 turns to the question of whether management has a duty to introduce compliance schemes. Section 6 asks whether management has a duty to apply for leniency. Section 7 addresses whether the existence of a compliance scheme should result in a reduction of the fine. Section 8 turns to the concept of undertaking as a single economic unit and the corporate-law paradigm of limited liability of separate legal persons.

Section 9 summarizes the conclusions of the chapter and provides an outlook to the future.

This chapter faces a certain presentational problem. While competition law is, to the greatest extent, harmonized EU law (and one which is sufficiently close to competition laws outside the EU to be comprehensible globally), corporate law is, predominantly, national law. To the extent it is necessary to refer to corporate law, it would, theoretically, be necessary to investigate the various national corporate laws. I will confine myself to German law (and perhaps the occasional reference to English or US law), mostly because this is the jurisdiction with which I am most familiar, but also because there have recently been particularly interesting developments in this jurisdiction in relation to whether companies may seek indemnification from directors, officers and employees (Section 4). I trust this Teutonic slant of the chapter will not deter the reader; it should be sufficiently easy for the reader to substitute the German statutes with those in which the reader is interested.

[16] See Section 8.

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2. OPTIMAL SANCTIONS AND CORPORATE LAW

The goal of the theory of optimal competition sanctions and enforcement is to minimize the total cost of competition law infringements, type I errors, type II errors, and administrative costs.[17]

At least initially, much of the discussion focused on optimal corporate fines.[18] These pecuniary sanctions on undertakings are still (nearly) the only sanction available at the EU level,[19] although many EU Member States and jurisdictions outside the EU have opted for individual – criminal or administrative – sanctions in addition to corporate fines.[20]

Let us assume, for the moment,[21] that sanctions on the undertaking have reached an optimal level, that is, the *ex ante* expectation of sanctions is at least equal to the net harm inflicted on actors other than the infringer or at least equal to the expected gains. However, optimal enforcement theory in economic terms works predominantly by optimizing *deterrence*, and when asking when 'an undertaking' is deterred, it is obvious that one has to open the 'black box' of the undertaking to get to the actual decision-makers – only they can feel the 'terror' of sanctions and therefore be 'de-terred'.[22] This is where corporate governance theory supplies its recognition that the interests and incentives of 'the undertaking' (and its owners as the principal) and those of the individual decision-makers (which may be the board as the first-degree agent for the owners, or managers as second-degree agents) may diverge. From the vantage point of corporate governance, this seems to be a standard principal-agent problem,[23] which one should be able to address by the standard approaches of screening the agents, monitoring the agents, or aligning their incentives.

Screening for agents that are likely (not) to break the law is arguably difficult. This leaves monitoring and aligning the incentives by ensuring that sanctions guide individuals in the same direction as undertakings. Monitoring the agents is sufficiently easy where the agent openly induces the undertaking to engage in conduct that infringes competition law, for example, in abuse-of-dominance (monopolization) cases, and those horizontal cooperation or vertical agreements that may constitute an effects restriction (EU) or rule-of-reason violation

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[17] See generally Jonathan B Baker, 'Taking the Error Out of "Error Cost" Analysis: What's Wrong with Antitrust's Right' (2015) 80 Antitrust Law Journal 1; for early contributions see Paul L Joskow and Alvin K Klevorick, 'A Framework for Analyzing Predatory Pricing Policy' (1979) 89 Yale Law Journal 213, 222ff; Frank H Easterbrook, 'The Limits of Antitrust' (1984) 63 Texas Law Review 1.

[18] Wouter PJ Wils, 'Optimal Antitrust Fines' (2006) 29(2) World Competition 183, 184.

[19] There are some indirect sanctions, such as the optional exclusion from bidding in procurement law (e.g., Article 57 of Directive 2014/24/EU). Damages awards against undertakings have increased substantially, but they can, in a first approximation, be treated similarly to corporate fines from the perspective of optimal sanctioning (but see Section 3).

[20] For an overview see the Dossier by Wagner-von Papp and others, 'Individual Sanctions for Competition Law Infringements' (n 5) 14ff; Wagner-von Papp, Compliance and Individual Sanctions (n 5) 143–161.

[21] See Sections 4.1 and 4.2, differentiating between the two scenarios of optimal corporate sanctions and suboptimal corporate sanctions.

[22] See, in particular, Thépot (n 2); see also Wagner-von Papp, Compliance and Individual Sanctions (n 5) 137ff.

[23] See n 5 above.

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(US).[24] For this type of infringement, where the agent's actions are revealed to, and openly implemented by the undertaking, monitoring of the agent should be sufficient to prevent a serious principal-agent problem from arising. Corporate fines in this area are arguably sufficient. The same is not true to the same extent, however, for clandestine conduct, that is, where the agent may be able and have an incentive to conceal the infringing conduct from the owners of the undertaking, in particular when it comes to horizontal cartels that constitute object restrictions (EU) or per-se prohibited conduct (US).[25] For this type of clandestine conduct, effective monitoring may be too costly. Accordingly, for clandestine conduct neither screening nor monitoring are effective, and the agent's incentives need to be aligned with those of the principal (who, by assumption, is interested in avoiding infringements because corporate sanctions are for now assumed to be optimal).

Sanctions should therefore, in the case of clandestine conduct, internalize the harm with the individual decision-makers, either directly or indirectly. Sanctions reaching the individual *directly* include individual administrative sanctions (such as administrative fines or director disqualifications) and criminal sanctions (such as criminal fines or prison sentences) imposed on individuals. Making the individual directly liable for damages vis-à-vis those harmed by an infringement may serve a similar function.[26] *Indirect* forms of sanctions on individuals are mediated by the undertaking. This intermediation can take various forms, such as the legal person recovering fines it has paid to the state – or damages it has paid to harmed individuals – by seeking indemnification from culpable individuals, be it by direct action initiated by the management or by derivative actions initiated by shareholders to bypass management. Alternatively, or cumulatively, the undertaking could punish individuals involved in competition law infringements internally by clawing back their bonuses, withholding their promotions or demoting them, or terminating their employment – always provided the culpable individuals are still employed at the undertaking at the time the infringement is detected and sanctioned.[27] If sanctions were optimal, the undertaking would have a strong incentive to discipline its managers by enforcing such indirect sanctions.[28]

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[24] See Page (n 5) 263 and 264.

[25] Page (n 5) 263 and 264–265. Even when it comes to vertical or dominance cases, however, there may be room for clandestine conduct, e.g., where a publicized non-infringing company policy is complemented by a clandestine agreement that turns the arrangement into an infringing one.

[26] But see the qualifications in Section 3. In particular, it is far from certain that a person harmed by, e.g., a cartel would choose to include as defendants in an action for damages not only the undertaking but also the culpable individual(s). Their liability depends on additional elements (such as individual culpability, possibly the question to what extent any given individual's actions or omissions caused harm) which may be more difficult to prove than the undertaking's liability, with the additional downside that in most cases the undertaking will be the solvent defendant, whereas de facto recovery of any judgment against an individual would very likely only be partial.

[27] The limits to undertakings sanctioning their employees have already been highlighted by Wils, Does the Effective Enforcement of Articles 81 and 82 EC (n 5) 428ff; see also the chapter by Catarina Marvão and Giancarlo Spagnolo, 'CEO Turnover and Shareholder Awareness in Cartel Cases', Chapter 22 in this Handbook, 449, noting that many have left the firm, or are close to retirement at the time the infringement is sanctioned. Termination or demotion in these cases would be an ineffective sanction; retrospectively clawing back bonuses might still be possible but may face legal or de facto constraints.

[28] Combe and Monnier-Schlumberger (n 5) 2 para 7.

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The discussion about 'optimal' competition sanctions and enforcement, however, is fraught with difficulties because there is no clarity regarding even the most basic theoretical or factual elements of the analysis.

2.1 What is the Goal of Optimal Sanctions?

Not even the theoretical starting point is entirely clear: when we are considering competition law infringements where procompetitive effects or efficiencies are a realistic possibility, our goal is presumably to internalize the net harm to persons other than the infringer,[29] so as to avoid overdeterrence. However, in particular when we are talking about hardcore cartels,[30] we may not feel the same qualms about overdeterrence, prefer to impose 'sanctions' instead of merely assigning 'prices', and prefer to make sure that the infringer does not retain any gains made from the infringement.[31] In the case of hardcore cartels, overdeterrence is only a problem in so far as there is a danger of (1) type I errors, (2) a chilling effect on legitimate conduct, or (3) marginal deterrence being impaired. The significance of the question whether to aim only for the internalization of net harm or for depriving the infringer of all gains, however, pales in comparison to a number of other uncertainties, which are discussed in the following paragraphs.

2.2 Is There Really a Misalignment (at least Initially) Between the Undertaking's and the Agent's Incentives – Are Corporate Fines Optimal Yet?

The most basic question is whether there is a misalignment between the interests of the principal (the shareholders) and those of the agents (board, management and employees) in the first place.

The misalignment that is usually posited in the literature on the corporate governance of competition law sanctions is that antitrust fines and/or damages in private competition law enforcement have made cartels and other competition law infringements unprofitable for undertakings, but that individual agents may have persisting incentives to enter into cartels or to infringe competition law. This is, for example, because they are hoping to increase the undertaking's (or a division's) profits, in order to raise the value of stock options they have, get bonuses or promotions, or conversely to avoid demotions or termination of employment.

In other words, the starting point of the analysis is usually that antitrust fines on undertakings are already optimal in that the expected (marginal) sanction is at least equal to the infringer's expected (marginal) gains from the infringement. If this assumption is correct, undertakings have no incentive to infringe antitrust law, and all infringements are down to 'rogue managers' or 'unfaithful agents'. If, on the other hand, corporate sanctions are still suboptimal, that is, the expected sanction is lower than the expected gains to be made from

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[29] William M Landes, 'Optimal Sanctions for Antitrust Violations' (1983) 50 University of Chicago Law Review 652, 656.

[30] These are the cases where individual sanctions are particularly important, see text accompanying n 25 above.

[31] Wils, 'Optimal Antitrust Fines' (n 18) 191–192; Wils, *Efficiency and Justice* (n 5) §§ 185ff. The 'prices and sanctions' terminology stems from Robert Cooter, 'Prices and Sanctions' (1984) 84 Columbia Law Review 1523.

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an infringement, then both the undertaking and the agent may have a shared interest in the infringement – at least from an *ex ante* perspective, that is, before getting caught.

It is often claimed that we have reached the point of raising sanctions on undertakings to an optimal level. This has certainly not always been the case. A distinguished German competition lawyer tells the anecdote that decades ago he lost a case and the client incurred a (by the standards of the time) huge fine. When leaving the courtroom, the client reassured the contrite lawyer: 'Don't worry – it was still worth it!'.

Possibly, these times are gone. At least with regard to cases that have been detected, that is, from an *ex post* perspective, one could doubt that after fines and damages claims there are many cases where a cartel is 'still worth it'. It is far more difficult to say, however, if sanctions have become so high that infringements are 'not worth it' from an *ex ante* perspective, where detection of the cartel is just a, perhaps distant, possibility.

There has certainly been a tremendous increase in the amount of fines imposed for competition law infringements over the last decades.[32] There have been three events in the EU, each resulting in a steep increase in corporate fines. First, there was the *Musique diffusion française* judgment with its explicit statement that the Commission's determination of the fine must take into account 'the necessary deterrent effect' (confirming the Commission's first fines exceeding 2% of the total turnover, namely fines between 2 and 4%).[33] Second, the 1998 Fining Guidelines with their new methodology for setting fines led to an increase in the level of fines.[34] Third, the 2006 Fining Guidelines resulted in another steep rise, mainly because the duration of the infringement now results in a multiplication of the basic amount by the number of years, and not merely an increase of up to approximately 10% per year of duration, as had been the case under the 1998 Guidelines.[35]

In addition, the probability of detection likely increased substantially when effective leniency regimes were introduced, raising the expected sanction – being a product of probability of detection and the sanction imposed in the case of detection – even further.

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[32] For details see the Commission's regularly updated statistics on cartel cases, https://competition-policy.ec.europa.eu/cartels/statistics_en accessed 23 April 2025; see also Wagner-von Papp, Compliance and Individual Sanctions (n 5) 137–138.

[33] Joined Cases 100 to 103/80 *SA Musique Diffusion française and others v Commission* EU:C:1983:158 [1983] ECR 1825, paras 103, 106.

[34] See Guidelines on the method of setting fines imposed pursuant to Article 15(2) of Regulation No. 17 and Article 65(5) of the ECSC Treaty [1998] OJ C9/3 (the '1998 Guidelines'); and the Court of Justice's discussion in 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 Rorindustri and others v Commission* EU:C:2005:408 [2005] ECR I-5425, para 155ff (where, inter alia, the appellants claimed that previously fines had not exceeded 10% of the *relevant* turnover).

[35] Contrast the Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003, [2006] OJ C210/2 (the '2006 Guidelines') [24] with the 1998 Guidelines (n 34) Section 1.B. For a comprehensive analysis of the 2006 Guidelines, and a comparison to the 1998 Guidelines, see Wils, *Efficiency and Justice* (n 5) §§ 244ff who, at § 281, also singles out the approach to the duration as the main difference between the 1998 and the 2006 Guidelines; see also ibid, § 287 fn 82 (higher percentage of the value of sales can be taken into account) and §§ 297ff (recidivism; although it should be noted that, in practice, the Commission and Court do not seem inclined to make full use of the power to impose a 100% uplift for each previous 'similar' infringement).

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Moreover, the rise of private damages actions has served as a further boost to moving the overall 'price' of an infringement towards an optimal level (and therefore a true 'sanction'). In the US, treble damages actions have always been a large part of the deterrent effect. In the EU, the increase in private enforcement in the form of damages actions is more recent, triggered by the *Courage v Crehan* case law since the beginning of the millennium,[36] the subsequent increase of private actions in the Member States, and the consolidation of private enforcement in the EU through the implementation of the Damages Directive and the associated case law.[37]

Additionally, reputational costs for the undertaking on capital markets may need to be considered, as well as litigation costs. However, in comparison to the amounts payable for fines and damages, these costs are arguably minor considerations.

While there is no denying that fines and damages claims have increased by orders of magnitude over the past decades, it is difficult to say whether this makes the current level of sanctions optimal. Cartels continue to be formed, which could be an indication that sanctions are still suboptimal. However, as explained above, an alternative explanation for this continued formation of cartels would be that sanctions against undertakings are optimal already so that undertakings have no desire to enter into cartels, and that they are the hapless victims of rogue employees as their unfaithful agents who enter into cartels purely for the agents' own personal benefit.

It is very difficult to determine empirically which of these alternative explanations is correct. However, there are some anecdotal, but in their totality convincing indications that corporate fines may, from an *ex ante* perspective, not yet be sufficiently deterrent, at least not in all circumstances. For example, where entrepreneurs (without recourse to limited liability and whose private incentives are therefore perfectly aligned with those of the undertaking) enter into a cartel, this indicates that corporate fines are not yet optimal.[38] Similarly, there is anecdotal evidence that in some cases undertakings have not punished, but, on the contrary, rewarded managers who had entered into cartels,[39] and the widespread use of profit-based incentive schemes – despite the recognition that the singular focus on profits may incentivize

[36] Case C-453/99 *Courage v Crehan* EU:C:2001:465 [2001] ECR I-6297; see also Cases C-295/04 to 298/04 *Manfredi v Lloyd Adriatico Assicurazioni and others* EU:C:2006:461 [2006] ECR I-6619.

[37] Directive 2014/104/EU of the European Parliament and of the Council of 26 November 2014 on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union [2014] OJ L349/1. For some of the national case law that has resulted in quantified damages awards see, e.g., (for Germany) the awards included in the table in Tilman Makatsch, 'Was lange fährt…' (2023) 73 Wirtschaft und Wettbewerb 641–642, and (for Spain) Helmut Brokelmann, 'First Rulings of the Spanish Supreme Court in the Trucks Damages Litigation' (2023) 73 Wirtschaft und Wettbewerb 590. Note that many cases precede the temporal applicability of the Damages Directive. For the deterrent effect of private actions in the EU, see, e.g., *Sumal* (n 4) para 35.

[38] Also cf the participant in the *Pre-insulated pipes* cartel case who narrowly escaped being personally classified as an undertaking, whose undertaking was fined some 5m EUR, and who immediately went on to establish a bid-rigging cartel on the national level (for which he was sentenced to 34 months in prison and a fine of 100,000 EUR); see the description and references in Wagner-von Papp, What if all Bid Riggers Went to Prison and Nobody Noticed? (n 5) 169–170.

[39] See in particular the contribution by Catarina Marvão and Giancarlo Spagnolo, 'CEO Turnover and Shareholder Awareness in Cartel Cases', Chapter 22 in this Handbook, 449.

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competition infringements – also indicates that corporate fines may not yet be optimal. The frequent participation of senior management in cartels is another indication that fines may still be suboptimal,[40] and the often hierarchical division of labour in the formation and execution of cartels – with top-level approval for the formation, followed by lower-level execution of the details[41] – indicates that the 'rogue-agent' explanation is not particularly convincing.[42] In addition, there is, to my knowledge, no evidence of undertakings systematically and publicly doling out internal punishments to managers in Europe, except in isolated cases,[43] although it has been speculated that internal punishment in the form of indemnification may be under-reported because the parties resort to arbitration or settlements in order to avoid publicity.[44]

Nor is it possible to calculate the optimal fine at the drawing board in order to compare it to the fines actually imposed.[45] We would need to calculate the discounted present value of

[40] See Table 1 in Andreas Stephan and Ali Nikpay, 'Leniency Decision-Making from a Corporate Perspective: Complex Realities' in Caron Beaton-Wells and Christopher Tran (eds), *Anti-Cartel Enforcement in a Contemporary Age – Leniency Religion* (Hart 2015) 139, 145–146. Moreover, in a recent analysis of 15 German cartels, Haucap and Heldman found that of the 158 individuals involved in the cartels and identified in the proceedings, 120 belonged to senior management, 32 to middle management, and on 6 no information was available (Justus Haucap and Christina Heldman, 'On the sociology of cartels' (2023) 56 European Journal of Law and Economics 289). For empirical evidence on the involvement of senior management in cartels, see also Wils, 'Antitrust Compliance Programmes' (n 11) 56–57 with further references. There is probably some selection bias: of those individuals involved in the infringement, the competition authorities will likely focus on those in the upper echelons where possible. Also, where management is involved, it may still be difficult to disentangle the purely private motivations of the managers from their acting in the (perceived or real) interests of the undertaking (in other words, even senior management may act as a rogue agent of the owners as principal). However, given that frequently several individuals from each undertaking are involved in the formation and execution of cartels, there is a certain cross-check on the pursuit of purely private aims. Similarly rejecting the 'purely private incentives' argument: Wils, 'Antitrust Compliance Programmes' (n 11) 57–58. See also the facts underlying some of the German indemnification actions at section 6.2.4.

[41] See Haucap and Heldman (n 40) 310–311.

[42] Similarly rejecting the 'rogue agent' hypothesis, e.g., Wils, 'Antitrust Compliance Programmes' (n 11) 56–57; Wouter PJ Wils, 'EU Antitrust Fines and Managerial Liability – A Legal and Economic Analysis' (2023) 73 Wirtschaft und Wettbewerb 583; Andreas Stephan, 'Why managers form cartels and why it is hard to stop them' in Combe and others (n 5), para 1 and 29 para 16. Combe and Monnier-Schlumberger (n 5) 3 paras 13, 16 and 4 paras 18ff, 21, similarly consider corporate sanctions to be suboptimal and the most frequent case to be the one where undertakings' and managers' interests in infringing competition law converge.

[43] The *Safeway v Twiggers* case in the UK and the *ThyssenKrupp* case in Germany remain the prime examples so far. See the discussion of further cases in Section 4.2.4. It is possible that the more recent *steel cartel* case (OLG Düsseldorf, 27 July 2023, VI-6 U 1/22 (Kart), DE:OLGD:2023:0727.6U1.22KART.00 (an abbreviated version is reprinted in (2023) 73 Wirtschaft und Wettbewerb 505)), and the European Court of Justice's decision to the preliminary reference made by the BGH the highest German court in cartel cases, following the appeal (BGH, 11 February 2025, KZR 74/23) will bring clarity to the legal treatment of such recovery actions, and that this will lead to an increase in such actions in the future.

[44] Leclerc, *Kartellbußgeldregress* (n 9) 9–10.

[45] Wils, 'Optimal Antitrust Fines' (n 18) 206–208; Wils, *Efficiency and Justice* (n 5) §§ 237ff, 285.

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the expected sanctions and compare it with the discounted present value of the expected gains from the infringement.[46] For that, we would need to know several factors, each shrouded in mystery.

Firstly, we would need to know the gains from (or the net harm of) the infringement. The difficulties in establishing the quantum of damages in private enforcement actions show that this is far from trivial. Rough approximations are possible but costly.

Secondly, we would need to know the probability of detection. Even the *objective* detection probability is unknown. Two figures are often assumed to be an estimate: 'one in six cartels' or 'one in three cartels' is said to be detected. Both figures, however, are not much more than glorified guesswork. There is an empirical foundation to the one-in-six figure: Bryant and Eckard looked at a sample of detected cartel cases from the US (indicted in the date range from 1961 to 1988) and their duration, and calculated that in this sample of *detected* cartel cases, the probability of the cartel being detected in any given year of its existence was approximately one in six.[47] From this, they argued – convincingly – that they could extrapolate the finding to the detection probability of the entire cartel population (detected plus undetected) in so far as it was very unlikely that the annual detection probability was any higher than one-sixth. They added, however, that there were very good reasons to suspect that the detection probability was, on the contrary, *lower*, possibly far lower, when looking at the population including undetected cartels, because it is not unlikely that cartels that are detected have features that made them easier to detect than those that were not detected. This last point is crucial: the one-in-six figure was never meant to be an estimate for the detection probability for the entire cartel population; it was only meant to be an upper bound to the detection probability in any given year.[48] Combe, Monnier and Legal reached a similar result, an annual detection probability of approximately 13%, based on a European sample of detected cartels (with a date range from 1969 to February 2007), again with the proviso that this is an upper bound and not an estimate for the entire cartel population.[49] Ivaldi, Khimich and Jenny find – using Combe et al's methodology – an annual detection rate (again: upper bound) of 24% in a sample of cartels detected

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[46] Wils, *Efficiency and Justice* (n 5) §§ 163ff.

[47] Peter G Bryant and E Woodrow Eckard, 'Price Fixing: The Probability of Getting Caught' (1991) 73 The Review of Economics and Statistics 531.

[48] Additionally, it has to be considered that the estimate was for the *annual* detection rate. If the detection rate in any given year is 1/6, and the cartel lasts for five years, the probability of the cartel being detected would be higher than 1/6. If the probabilities of a cartel being detected (or not) in any given year of its existence were independent of each other, i.e., not correlated at all, the detection probability would be equal to approximately 60%. However, it is likely that these probabilities are not independent of each other, so that the detection probability is likely to be lower than 60%. Again, it has to be emphasized that this result is based on the subpopulation of detected cartels, and that the detection probability in the overall population is likely to be much lower. Peter L Ormosi, 'A Tip of the Iceberg? The Probability of Catching Cartels' (2014) 29 Journal of Applied Econometrics 549, 553, points out, however, that strictly speaking the Bryant and Eckard detection rate is not necessarily an upper bound because cartels can end for reasons other than detection.

[49] Emmanuel Combe, Constance Monnier and Renaud Legal, 'Cartels: The Probability of getting Caught in the European Union', Bruges European Economic Research Papers N° 12 (March 2008).

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in developing countries.[50] Ormosi, applying a 'Capture-Recapture' model to recidivists finds that the detection rate in any given year is generally below 20%.[51] The detection rate of 'one in three cartels', which is sometimes mentioned instead, is no more than a guesstimate building on the studies just described. This guesstimate takes the 'one-in-six' probability as a starting point but argues that leniency programmes have substantially increased the detection probability of cartels in the time period since the Bryant and Eckard study was conducted, and that if the detection probability was previously one-in-six, a doubling of the detection probability could be a reasonable (maximum) modification.[52] Given that even the one-in-six figure is not an estimate but only an upper bound to the estimate, the additional somewhat arbitrary working hypothesis that leniency programmes have doubled the detection probability (which may be too high, too low, or just right) decreases the accuracy of the estimate.

Thirdly, we would need to know the undertaking's risk attitude. Here, it seems at first glance that we can rely on an estimation that undertakings should behave as if risk neutral because (and to the extent) its owners can diversify their investments.[53]

Fourthly, calculating the optimal sanction further requires knowledge of the undertaking's discount rate. Sanctions are imposed *ex pos*t, usually years if not decades after the fact, while gains from the cartel accrue earlier. Especially undertakings that are on the verge of insolvency may put a high value on instant gains and discount possible future sanctions.[54]

Fifthly, even though we are interested only in the optimal corporate sanction here (and therefore do not yet consider the principal-agent problem of unfaithful agents), the calculation of the optimal corporate sanction has to take into account that undertakings act through agents, and that it is not necessarily the objective facts but the agents' beliefs about these facts that have to be entered into the calculation. This concerns in particular the agents' beliefs about (1) the detection probability, (2) the profits from the cartel, and (3) the undertaking's risk attitude. Even if we knew the objective detection probability of cartels, this would not allow us to calculate the optimal fine. We would need to know what the acting agent's subjective estimate of the detection probability is.[55] We would also need to know what the agent's subjective estimate of the cartel profits is. If the participants underestimate the detection probability or overestimate the gains from the cartel relative to the true values, then optimal sanctions need to be higher than those calculated on the basis of the 'objectively' true values. Given that

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[50] Marc Ivaldi, Aleksandra Khimich and Frédéric Jenny, 'Measuring the Economic Effects of Cartels in Developing Countries', Final Report, UNCTAD/DITC/CLP/Misc/2014/2 (6 February 2015). They speculate that this higher rate may have to do (1) with the European sample including very old cases, and (2) with international cartels operating in developing countries being investigated in several jurisdictions, so that investigations in one jurisdiction may trigger investigations in others.

[51] Ormosi (n 48) 560.

[52] Wouter PJ Wils, 'Is criminalization of EU competition law the answer?' in Katalin J Cseres, Maarten Pieter Schinkel and Floris OW Vogelaar (eds), *Criminalization of Competition Law Enforcement – Economic and Legal Implications for the EU Member States* (Edward Elgar 2006) 60, 79–80. Combe, Monnier and Legal (n 49) mention the possibility that leniency programmes had a positive effect on the detection rate but cannot, on the basis of their data, isolate this effect.

[53] However, see the qualification under 'fifthly' below.

[54] On the other hand, once they have entered into a cartel, the same myopic tendency may lead them to cheat on the cartel agreement.

[55] Wils, *Efficiency and Justice* (n 5) §§ 194–198.

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defendants in private actions argue on a regular basis that the cartel in question actually did not produce any profits or harm whatsoever (despite the cartelists' revealed assumption that the cartel would be profitable at the time of formation), and provided we treat this argument at face value, it would seem to follow that cartelists are quite often overoptimistic with regard to the possible gains from the cartel. It would, in turn, follow that fines need to be increased to counteract this misconception. With regard to risk attitudes, a faithful agent should in principle mirror the principal's risk attitude. To the extent an agent recognizes that the undertaking most likely is risk neutral and that the agent's own risk attitude deviates from this benchmark, we can disregard differences in the risk attitude when we consider only faithful agents. There is, however, also the possibility that even a faithful agent acts in a risk-prone or risk-averse way unintentionally.

It is true that, as Wouter Wils has convincingly argued, the European Commission's 2006 Fining Guidelines can be read to be an attempt at approximating several of the factors of this analysis on an abstract level. Yet, even if the values hypothesized by the Guidelines should be half-way realistic approximations of the optimal fine *on average* (and, given what we have seen above, even that would be a miraculous coincidence), this would still not give an answer to the question whether there are undertakings for whom infringing competition law is or appears profitable from an *ex ante* perspective. This could be because the profits from the cartel are higher than average or the level of detection is lower than average (for example, because of sector- or market-specific peculiarities) or because the agents (wrongly) anticipate higher profits or a lower detection probability than the Guidelines assume.

3. PRIVATE DAMAGES ACTIONS – AGAINST THE UNDERTAKING AND AGAINST INDIVIDUALS

The increase of private damages actions in the EU has arguably added to the overall deterrent effect.[56] These damages actions will usually be brought against the undertaking or its constituent entities, and in that sense add to the 'corporate sanctions'.

At least under German case law, however, it is also possible for those harmed by the infringement to file a claim directly against individuals who culpably cause the infringement.[57] Where this is the case, this is akin to an individual sanction, albeit a merely pecuniary one, and therefore shares not only the advantages, but also the disadvantages of other pecuniary individual sanctions like individual administrative fines: in particular, they can be compensated, *ex ante* or *ex post*, by the infringing undertaking and even be insured by direc-

[56] *Sumal* (n 4) para 35. There is a separate discussion on whether private damages actions have also *reduced* the deterrent effect by negatively impacting leniency programmes. See, on the one hand, Monopolkommission, *Wettbewerb 2022 – Hauptgutachten XXIV,* 2023, §§ 296ff (for the summary conclusion in English, see point K10 of https://monopolkommission.de/images/HG24/HGXXIV_Summary.pdf accessed 23 April 2025), and, on the other hand, the criticism by Wouter PJ Wils, 'Should the EU Competition Damages Directive be revised to grant companies that have received immunity from fines under the competition authorities' leniency programmes also immunity from damages?' (2023) 73 Wirtschaft und Wettbewerb 365. However, this is a separate discussion, because it seems likely that the overall net deterrent effect of private actions remains positive.

[57] See *Dornbracht* (n 8) above.

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tors and officers (D&O) insurance. In addition, the probability that those harmed by the cartel initiate an action specifically against the culpable individuals, instead of or in addition to the undertaking, is arguably low.[58]

For the most part, there is no reason to treat 'corporate fines' and 'corporate damages' differently for the purposes of optimal deterrence; both can be seen as a form of a corporate sanction in the broader sense. Similarly, both individual fines and damages awards against individuals will have comparable deterrent effects on the infringing individuals.

For some purposes, however, there may be substantial differences between fines and damages claims. Most importantly, private damages actions are more uncertain to follow. While nearly every detected hardcore cartel is nowadays followed by some form of private action, this need not include all involved undertakings as defendants, and certainly not all individuals. Also, some victims may choose to forgo their damages claims, either because they passed on the overcharge to a (possibly fragmented) downstream market and the passing-on defence therefore prevents recovery by the direct purchasers, while the lack of effective tools for collective damages actions makes actions by indirect purchasers unlikely, or because the victim is in a supplier-customer relationship of economic dependency with the cartelists and prefers not to damage this relationship.[59] Furthermore, the success of private actions depends on sufficient proof of causation and the quantum of damages, and different courts have different views on what level of proof is sufficient. Where the action is directed against individuals, the causation of their conduct would additionally have to be proven. All this makes success uncertain, and correspondingly may prevent potential claimants from seeking recourse. More generally, the enforcement of private damages claims is completely discretionary for the potential claimants: whether they bring the claim, whether they settle it, abandon it, or see it through to judgment, lies completely in the hands of the potential claimants; and their private interests need not be identical or even aligned with the public interest.

Moreover, there is the argument that when it comes to indemnification, the purpose of corporate fines and their full effectiveness would be impaired if the fined undertaking were allowed to recover the amount of the fine from someone else, whereas arguably no such limitation applies where the undertaking or individual seeks to recover the amount of damages paid to a person harmed by the infringement from those who have culpably caused the infringement.[60] Lastly, and related to the previous point, while insurance may cover private damages claims (albeit with exclusions for wilful conduct), there are or should be general limits or prohibitions with regard to insuring against fines.

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[58] For some of the reasons, see n 26 above.

[59] See also Maarten Pieter Schinkel, Jan Tuinstra and Jakob Rüggeberg, 'Illinois Walls: how barring indirect purchaser suits facilitates collusion' (2008) 39 The Rand Journal of Economics 683 (discussing the possibility for the infringer to bribe direct customers, who are the only plaintiffs with standing under the alternative Illinois Brick rule in the US, which precludes indirect purchasers from initiating damages actions; while in the EU indirect purchasers are, in contrast to the US position considered by Schinkel et al., not barred de iure from seeking damages, in many Member States there is no effective collective redress mechanism for dispersed-harm cases so that the indirect purchasers may be excluded de facto while defendants may invoke the passing-on defence against direct purchasers).

[60] See Section 4.2.1 and the cases discussed in Sections 4.2.3 and 4.2.4, e.g., OLG Düsseldorf (n 43); Wils, 'EU Antitrust Fines and Managerial Liability' (n 42); previously, e.g., Ost (n 9).

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4. INTERACTIONS BETWEEN THE UNDERTAKING AND THE AGENT

Section 2 showed that there may or may not be a misalignment between the incentives of the undertaking and its agents initially. This section first addresses the situation that corporate sanctions are suboptimal, so that the undertaking has an incentive to motivate the (willing or unwilling) agent to infringe competition law (4.1). It then deals with the scenario that corporate sanctions are optimal but rogue agents nevertheless infringe competition law to further their own goals (4.2).

4.1 Scenario 1: Both the Undertaking and the Agent see the Infringement as Profitable

It may be that both the undertaking and the agent perceive benefits from entering into a cartel – consider the various cartels ADM entered into in the 1990s, where it was firm policy that 'our competitors are our friends, our customers are the enemy'.[61] To be sure, even in those cases the agent's incentives may be different from the undertaking's; for example, where the agent has (redeemable) stock options, there may be a greater incentive for the agent to pursue policies that result in a high volatility of the stock values, even where the undertaking may be interested only in higher profits.[62] Nevertheless, if both the undertaking and the agent see an *ex ante* profit in entering into a cartel, the undertaking is unlikely to disincentivize its agents from infringing competition law; on the contrary, the undertaking may provide incentives for its agents to infringe competition law, and to turn a blind eye if they do. Such incentives need not take the crude form of directly steering the agent towards infringing conduct. Subtler forms may include structuring the remuneration scheme such that the incentives are geared towards seeking profit at all cost.[63]

In such a scenario, even the existence of a compliance scheme is not necessarily evidence to the contrary. It is perfectly possible to establish a compliance scheme and nevertheless provide incentives to managers to enter into cartels and to turn a blind eye to infringements. Where the corporate climate encourages profit-maximization at all cost, a compliance scheme may either be an ineffective façade or, worse, a training exercise in how to escape detection.

The policy reaction to this scenario of suboptimal corporate fines should be two-fold.

Firstly, corporate sanctions should be raised to the optimal level, so that this scenario is shifted into the second category.[64] Before this shift is complete, we cannot rely on the undertaking motivating its agents to act in conformity with the law; quite the opposite is true.

Secondly, individual sanctions should be introduced in order to provide an incentive for the agent to resist any inducements provided by the undertaking to the agent incentivizing the infringement of competition law – be it in the form of carrots or sticks, explicitly or

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[61] Of course, even the fairly extreme case of ADM is not necessarily conclusive proof that sanctions were suboptimal, because the management may itself have been an unfaithful agent of the shareholders.

[62] Indeed, in the ADM case, one agent, Mark Whiteacre, both acted in unison with firm policy in entering into the Lysine cartel, and proved to be an unfaithful agent when embezzling money.

[63] Wils, 'Antitrust Compliance Programmes' (n 11) 58 with further references.

[64] Section 4.2.

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implicitly.[65] At least in this scenario, pecuniary sanctions in the form of administrative fines or private damages payments to third parties[66] imposed on the individual are unlikely to be sufficient, because the undertaking may be minded to compensate the individual for these pecuniary sanctions, either *ex ante* (a profit-based bonus or a promotion as a risk premium that allows the agent to pay any pecuniary sanctions) or *ex post* (by indemnifying the agent, again either directly or indirectly, for example, by promotions or pay rises). It is therefore necessary, in this scenario, to introduce non-pecuniary (non-compensable) individual sanctions alongside increased corporate sanctions, in particular criminal sanctions.

4.2 Scenario 2: Corporate Sanctions are Optimal but Rogue Agents Infringe the Law

The second scenario represents the principal-agent problem outlined at the beginning of the chapter: corporate sanctions are optimal but faithless agents pursue their private benefit contrary to the principal's (the undertaking's) interests. In my view, this is the less likely scenario.[67]

In this scenario, we would expect to see the undertaking invest into avoiding any infringements of competition law, for example, invest into effective compliance schemes, in particular into creating a corporate culture that makes it clear that profit-maximization efforts are constrained by legal and ethical considerations. One would also expect the undertaking to attempt an alignment of the incentives of principal and agent by internalizing what is for the agent otherwise an externality. This could include stated policies on internal sanctions for those

[65] Werden and Simon (n 5) 931 (noting that '[t]heir resistance will, at the very least, make price-fixing more costly for corporations').

[66] It does not matter in principle whether the private damages result from a direct claim of the victims against the individual (see n 8) or from an indemnification claim by the undertaking trying to recover a fine paid to the authorities or damages paid to third parties (see Section 4.2). However, in this scenario, it is even less likely that the undertaking seeks indemnification from individuals (or: from the directly involved individuals), as this may have an *ex ante* disincentivizing effect on the individual to enter into a cartel. Nevertheless, it is not impossible that even in this situation the undertaking seeks indemnification. It could be, for example, that the detection of the infringement results in external pressure on the undertaking to be seen to be doing something against infringements (possibly also the duty to enforce valid claims, in Germany under *ARAG/Garmenbeck*, BGH, 21 April 1997, II ZR 175/95, BGHZ 135, 244, see text accompanying n 161 below); or the undertaking is willing to throw the individual under the bus; or only the first (now detected) infringement is seen as *ex ante* profitable, whereas the expected *malus* for recidivism would make the second infringement *ex ante* unprofitable, so that it does not matter that the faithful agent is thrown under the bus. Note, however, that the reluctance in making full use of the recidivism multiplier in practice makes this last-mentioned scenario somewhat unlikely, except if the undertaking also updates its expectations regarding the probability of detection, for example, because the authority is more likely to pay attention to the undertaking's conduct in the future. A particularly problematic tendency, not unlikely for reasons discussed below (esp related to D&O insurance), is that the undertaking could seek indemnification precisely from persons who may have supervised negligently, but have not been directly involved in the infringement. This appears to have been the case in *ThyssenKrupp*, where the defendant was a director who had, even according to the claimant's assertions, asked for the cartel activities to be terminated.

[67] See n 42 above.

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responsible for an infringement, such as demotions or termination of employment – with clear exemptions for those who uncover infringements, so as not to give an additional incentive to cover up infringements or to impede leniency applications. It could also include the attempt to seek indemnification from the culpable individuals for fines or damages the undertaking paid to third parties. The next section addresses policy considerations relating to indemnification for fines (4.2.1), followed by a section on policy considerations relating to indemnification for third-party damages (4.2.2), a brief description of the practice on indemnification in the UK (4.2.3), and a longer description about the case practice in Germany (4.2.4), before the conclusions are summarized (4.2.5).

4.2.1 Legal and policy considerations regarding indemnification by individuals for corporate fines

The question is whether it is permissible at all for the undertaking to seek indemnification from its managers, in particular for antitrust fines. The starting point is that infringing conduct by a director or an employee has caused harm to the company: due to the individual's infringing conduct, the company has to pay a fine and/or damages. In principle, it would seem that the company has a claim for indemnification against the individual.[68]

There are several factors to be considered that may e xclude or put limits to an indemnification claim for corporate fines.

First, there is the question whether indemnification is prevented by the fact that the competition rules are exclusively addressed to undertakings, so that the infringer would seek indemnification from a non-infringer. In England, the majority of the Court of Appeal in *Safeway v Twigger* argued that the *ex turpi causa non oritur actio* maxim prevented the company from recovering the fine imposed by the OFT from the company's former directors. This confuses

[68] The relevant cause of action and basis for the claim will, of course, differ depending on the jurisdiction and on the status of the individual from whom recovery is sought (for claims against the executive board of Aktiengesellschaften primarily § 93(2) Aktienngesetz (an English translation of which can be found at https://www.gesetze-im-internet.de/englisch_aktg/englisch_aktg.html#p0533 accessed 22 November 2023), for claims against directors of GmbH primarily § 43(2) GmbHG). Stefan Thomas, 'Bußgeldregress, Übelszufügung und D&O-Versicherung' (2015) Neue Zeitschrift für Gesellschaftsrecht 1409, 1410, and Leclerc, *Kartellbußgeldregress* (n 9) 135ff, with further references in n 15 on p. 138, doubt that there is any indemnifiable harm in the first place. This is more of a semantic problem: it is clear that the company suffered a pecuniary detriment caused by the culpable actions of the individual in the form of fines or obligations to pay damages. *Generally*, this would constitute cognizable harm for which indemnification could be sought. See Christian Kersting, 'Organhaftung für Kartellbußen' (2016) Zeitschrift für Wirtschaftsrecht (ZIP) 1266, 1272ff; this is conceded by Stefanie Leclerc, 'Kartellgeldbußen als Schaden?' (2021) Neue Zeitschrift für Kartellrecht (NZKart) 220, 221. The question is, however, whether there are exceptional, normative reasons for preventing indemnification. This is also the main argument in Thomas's article, with which I agree; Leclerc, *Kartellbußgeldregress* (n 9) 219ff and Leclerc, 'Kartellgeldbußen als Schaden?' (n 67) 221ff puts the emphasis on the non-existence of (normatively cognizable) harm, which leads to the same outcome, but, in her view, makes it unnecessary to rely on an exception to the general rule of compensation. Doctrinally, this may be interesting, but it hardly matters whether the normative reasons for limiting liability are integrated into the concept of cognizable harm, or whether harm is defined factually in a first step and normative limitations are added in a subsequent step.

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the undertaking's undoubted *external* responsibility with the question of the allocation of responsibility in the internal relationship between undertaking and the individual. While good reasons argue against the indemnification even in the internal relationship (see below), one should not formalistically deny that a decision as to the internal (re-)allocation of the burden has to be taken on normative grounds.

Secondly, one could ask whether the balance of the statutory fining scheme in countries that provide for both individual and corporate fines (such as Germany) would be undermined if the company could recoup corporate fines by way of indemnification from the individual. Again, however, the statutory fining scheme determines the external relationship between the state on the one hand and the undertaking or the individual on the other hand; it does not *necessarily* predetermine the eventual allocation of the burden in the internal relationship between the undertaking and the individual.

Thirdly, it has been argued that the fine also serves the purpose of depriving the undertaking of the profits, and that indemnification would undermine this purpose.[69] Proponents of indemnification accept that it needs to be ensured that the undertaking does not eventually keep profits from the infringement, but argue that this can be taken into account even if one allows indemnification in principle.[70] Three arguments could potentially be made to deny indemnification in so far as it would lead to unjust enrichment of the undertaking: One could argue that where the infringement was net profitable, the individual did not even breach any duty, because the individual acted in the undertaking's interest;[71] one could deny that the breach of duty caused harm to the undertaking because of the net positive effect; or, and this is the most convincing of the three options, one could acknowledge that the resulting fines and damages obligations constitute harm, but that the profits resulting from the infringement have to be taken into account in mitigation (or, in Germany, as *Vorteilsausgleichung*).[72] A

[69] Thomas (n 68) 1412–1413; Wils, 'EU Antitrust Fines and Managerial Liability' (n 42) 587f.

[70] Kersting (n 68) 1268–1269, 1273–1275; Christian Kersting and Manuel May, 'Der Bußgeldregress gegenüber Organmitgliedern' (2024) 74 Wirtschaft und Wettbewerb (WuW) 313, 318.

[71] In Germany, this argument would not be successful, at least not in the case of directors of companies, because they have a 'duty of legality', so that they cannot argue that an infringement of the law is not a breach just because it is profitable (this is the nearly unanimous view, see BGH, 27 August 2010, 2 StR 111/09, BGHSt 55, 266, (2010) Neue Juristische Wochenschrift 3458, 3460, para 29 with further references, Meinrad Dreher and Leon Burkhart, 'Beendigung einer Kartellbeteiligung durch Geheimhaltung vs. kartell- und gesellschaftsrechtlich gebotene Beendingungsmaßnahmen mit Publizität' (2023) Die Aktiengesellschaft 457, 460, and below n 136; but see Leclerc, *Kartellgeldbußgeldregress* (n 9) 22ff, 79ff, who considers the duty of legality to be doctrinally unsound and therefore denies a breach of duty where the conduct is net profitable). Even outside Germany, the argument would arguably be incompatible with the EU Member States' duty of sincere cooperation, given that accepting the argument that profitable infringements are not a breach of duty would fail to condemn competition law infringements.

[72] Thomas (n 68) 1414–1415 correctly points out, however, that mitigation/*Vorteilsausgleichung* would require not an isolated comparison between the profits drawn from the infringement and the amount of the fine, but that all benefits and costs would have to be compared (to the extent there is a sufficiently close connection between benefits and costs); in particular, under this heading, the undertaking could argue that its profits from the infringement amounted to less than the fine combined with damages paid (or owed) to third parties.

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practically important issue is where the burden of proof lies for the undertaking's resulting gains. Being a question of mitigation, the burden would usually lie with the individual relying on mitigation. However, the argument has been made that, due to the information asymmetry regarding the undertaking's profits, the burden of proof (or at least the burden of production) should be borne by the undertaking.[73]

Fourthly, there is the obvious problem: corporate fines in competition cases are, for the most part, ruinously high when applied to individuals. To be sure, this need not always be the case. There are infringements that attract moderate fines, especially for undertakings with a low relevant turnover, and there are some very rich individuals who may be able to pay even high fines. In general, however, corporate fines in competition cases are so high that if the undertaking were to recover them, in full, from one or more individuals, this would arguably drive these individuals into insolvency. To which the first answer might be: so what? In the case of managers who enter into cartels, one may well consider it appropriate that they have to file for insolvency.[74] One might start to hesitate, however, when it comes to mere negligence, for example, where a manager does not enter into the cartel herself but 'merely' fails to exercise due diligence and consequently overlooks that a junior manager entered into a cartel. Some German commentators have argued for a cap on the recoverable amounts, either based on an analogy to the maximum individual fine of 1 million EUR, or based on a supposed duty of the undertaking, as the employer, towards their directors, officers, and employees.[75]

However, even in general tort law the tortfeasor is liable for damages regardless of their quantum even where there is mere negligence. Accordingly, when it comes to an individual's liability for private damages claimed directly by cartel victims, the *Dornbracht* case law in Germany does not hesitate to impose liability despite the high quantum of damages;[76] and when it comes to indemnification for *damages* paid by the undertaking to third parties, German courts also do not hesitate to hold managers liable regardless of the quantum of damages. The mere fact that damages claims may be enormous is not a reason to deny or reduce claims for recovery.

In any event, two factors may alleviate the mere 'big numbers' problem just described. To the extent that the fine was calculated to disgorge illegal gains, the undertaking had previously received a corresponding benefit, and – as mentioned above – this benefit arguably reduces the liability of the individual.[77] The second point is that D&O insurance may step in, at least where the individual in question did not act wilfully (or intentionally, depending on the phrasing of the exclusion in the D&O insurance contract).[78]

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[73] Kersting (n 68) 1273–1275, arguing for assigning the burden of proof to the undertaking; but see Thomas (n 68) 1415, arguing that a prima facie presumption would hardly help the individual, given that the individual would need to argue convincingly that the profits exceeded the sum of fine and damages owed or paid to third parties.

[74] Kersting (n 68) 1270.

[75] Against these proposals, see convincingly Kersting (n 68) 1269–1271.

[76] See n 8 above.

[77] Under German law, this is caught under the doctrine of *Vorteilsausgleichung*. Under English law, one could arguably invoke the doctrine of mitigation (cf *British Westinghouse Electric and Manufacturing Company Limited v Underground Electric Railways Company of London Ltd* [1912] AC 673).

[78] For a discussion of the coverage by D&O insurance for indemnification claims in principle, see Thomas (n 68) 1416–1419.

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This, however, brings us to the second set of reasons why courts may hesitate to allow undertakings to seek recovery from individuals for fines. We started this section by assuming that we are in the scenario where fines are optimal, so that the undertaking has no incentive to infringe competition law. If the undertaking could recover the entire (or at least substantial parts of the) fine from one or more individuals, however, we would be back to the scenario of suboptimal fines described above. The undertaking, anticipating recovery from individuals or their insurance company, might behave as if fines were suboptimal and therefore not take the necessary precautions, or even incentivize their managers and employees to infringe competition law.[79]

If one allowed indemnification and the fines recovered from the individual or individuals should be covered substantially in full by D&O insurance, *neither* the undertaking *nor* the individual may be incentivized to avoid infringements.[80] The undertaking, having infringed competition law intentionally, could even choose to recover the fine from managers who acted merely negligently (instead of those individuals who intentionally infringed competition law) in order to launder wilful infringements into liability for negligence, so as to circumvent the exclusion of D&O insurance policies.[81]

In very large-scale cartel cases, where fines go into the hundreds of millions, it is perhaps not very likely that the undertaking could recover the entirety of a fine from one individual or even several individuals (even accounting for the mitigation in the case of fines disgorging illegal gains, and perhaps even accounting for D&O insurance where the coverage is sometimes insufficient – although sometimes, such as in the *stainless steel* cartel, the coverage has a limit of more than 10% of the turnover of the undertaking). The limits to recovery, the messiness of real life, might therefore provide a certain shield against the effect of recovery from individuals transforming optimal fines into suboptimal ones even if one did not put legal limits on the recoverability.[82] It seems unsatisfactory, however, that this question should turn on the vagaries of the individual case, and it is accordingly understandable that courts search for ways to limit recovery on a systematic basis. Also, even where the entire fine cannot be recovered by the undertaking, even a partial recovery may be sufficient to turn an optimal fine into a suboptimal one.

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[79] One might think that this would be compensated by the increased incentives for the potentially liable individuals to avoid liability. However, these incentives would at least be reduced (1) where liability is sought from some but not all culpable individuals (provided it can be predicted which individuals will and which will not be held liable) and (2) where insurance is available.

[80] Thomas (n 68) 1419 and OLG Düsseldorf (n 43) (referencing Thomas).

[81] Thomas (n 68) 1419; OLG Düsseldorf (n 43); *contra* LG Dortmund, 14 August 2023, 8 O 5/22 (Kart), (2023) Wirtschaft und Wettbewerb 573.

[82] In favour of indemnifiability, inter alia with this reasoning, Kersting (n 68) 1267; see also Kersting and May (n 70); Artur Robert Fabisch, 'Managerhaftung für Kartellrechtsverstöße' (2013) ZWeR 91–119; Walter Bayer, 'Legalitätspflicht der Unternehmensleitung, nützliche Gesetzesverstöße und Regress bei verhängten Sanktionen' in Georg Bitter and others (eds), *Festschrift für Karsten Schmidt* (Verlag Dr Otto Schmidt 2009) 85, 95–97 (arguing for indemnifiability, but for a limitation to an 'adequate' amount based on the company's duties towards the directors and officers).

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This brings us to the final and most convincing argument, namely that the statutory scheme of the corporate fine requires that a deterrent sanction remains with the undertaking,[83] at least to the extent that the sanction does not lose its full effectiveness and dissuasiveness.[84]

This argument (the 'full effectiveness' argument) is related, but not identical, to the consideration described above that corresponding gains which the undertaking received through the infringement have to be taken into account, and that it may be necessary to shift the burden of proof or substantiation to the undertaking (the 'mitigation approach'). Where, for example, the undertaking can show that they made cartel profits in the amount of (no more than) X, the mitigation approach would ensure that the undertaking could only seek recovery for the amount of the fine exceeding X. However, this would still not ensure the full effectiveness and dissuasiveness of the sanction. It is true that the undertaking in the specific case would be deprived of all of its cartel gains even if the amount exceeding X were transferred to the individual. However, this is only true from an *ex post* perspective: only those undertakings whose infringements are eventually discovered and sanctioned would be deprived of all their cartel gains. This would not ensure that sanctions remain optimal, because the optimal sanction must take the detection probability into account; the optimal sanction is the expected cartel gains multiplied by the inverse probability of detection. In other words, contrary to the mitigation approach, it is not sufficient to show by how much the fine exceeds the profits actually drawn from the infringement; it would be necessary to show that the fine (possibly in combination with damages claims of third parties or other sanctions[85]) exceeds the *opti-*

[83] Meinrad Dreher, 'Die kartellrechtliche Bußgeldverantwortlichkeit von Vorstandsmitgliedern' in Barbara Dauner-Lieb and others (eds), *Festschrift für Horst Konzen* (Mohr Siebeck 2006) 85, 104–105 (correctly emphasizing the *effet utile* of the fine as a requirement based on EU law); Thomas (n 68) 1410ff; similarly Florian von Schreitter and Anne-Kathrin Lauer, 'Organhaftung für Kartellrechtsverstöße' (2023) Der Betrieb 2035, 2039.

[84] Wils, 'EU Antitrust Fines and Managerial Liability' (n 42) 588. See also Franck and Seyer (n 9), who (in section 3.3) agree that the principle of effectiveness is to be taken into account, but who (in section 4) consider the plus in individual deterrence to compensate sufficiently for the minus in corporate deterrence, and who also consider the problems with D&O insurance (in section 5), but assess them to be less weighty than I do; similarly Kersting and May (n 70) 314–319. My deeper scepticism is founded on the remarks in German judgments discussed below, which seem to indicate that D&O insurance would cover much or all of the managers' liability, and on the assumption that undertakings can choose to seek indemnification from those who acted only negligently (so that the exclusion for wilful conduct rightly considered by Franck and Seyer can be, is, and will be, circumvented even in hardcore cartel cases; moreover, even recklessness is covered by D&O insurance in Germany, see LG Frankfurt/M, 20 January 2023, 2-08 O 313/20, ECLI:DE:LGFFM:2023:0120.2.08O313.20.00). Whether this moral hazard will ultimately lead to a market for lemons and the breakdown of the D&O insurance market, or at least to the exclusion of or limitation for such antitrust liability risks, is a separate question (rightly raised by Franck and Seyer (n 9)); currently, however, these exclusions and limitations are not in place, and rumour has it that insurance companies are willing to continue to offer D&O insurance to managers on very favourable terms because generosity towards managers will induce them to conclude more insurance contracts on behalf of the undertaking over the course of their tenure; the D&O insurance is said to be the 'entrance fee' for future business.

[85] The optimal sanctions literature often looks at various forms of consequences for the infringement in isolation (e.g., calculating the optimal fine without taking into account other consequences). More precisely, one would have to look at the consequences in their entirety. In

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mal sanction. To the extent the fine exceeds the optimal fine, indemnification would indeed not harm the full effectiveness and dissuasiveness of the fine. Proving, however, that the fine exceeds the optimal fine will likely be a *probatio diabolica*. In practice, therefore, the 'full effectiveness' approach, that is, the obligation to maintain the full effectiveness and dissuasiveness of the fine, will de facto preclude the undertaking from recovering the amount of the fine, or substantial parts thereof, from individuals.

It has been argued against the 'full effectiveness argument' that this reduction in deterrent effect for the undertaking is balanced or outweighed by the deterrent effect on the (rogue) agent: as long as the agents are deterred, it no longer matters that the sanctions on the undertaking are suboptimal.[86] However, first, this counterargument certainly does not apply where – and to the extent – the claim is covered by D&O insurance.[87] Secondly, even where the individual cannot rely (fully or substantially) on D&O insurance, compensating the undertaking so that the corporate fine is no longer optimal would incentivize the undertaking to encourage competition law infringements by its agents and to cover up these infringements.[88] While it may be more difficult to motivate individuals to engage in these infringements if they themselves need to fear being liable, a pervasive climate conducive to competition law infringements – fostered, e.g., by purely profit-oriented remuneration schemes and an absence of effective compliance measures – may result in risk-seeking individuals infringing competition law, while indemnification is sought from others.[89] Indeed, a merely negligent individual may well be the more attractive defendant. This is certainly the case where D&O insurance is available for these negligent individuals. Even where this is not the case, a board member who negligently did not supervise properly may have deeper pockets than the sales manager who

practice, however, this is exceedingly difficult, because the competition authority will have no power over the extent to which, for example, private claims are enforced, especially where the market conditions result in the harm eventually being dispersed.

[86] Kersting (n 68) 1268; Franck and Seyer (n 9); LG Dortmund (n 81).

[87] Cf OLG Düsseldorf (n 43) (described in more detail in Section 4.2.4.3 below), para 180: the D&O insurance in that case was said to cover damages in the order of magnitude of 10 per cent of the undertaking's turnover and would therefore have covered the fine in full.

[88] For a flabbergasting series of the compliance failings, see the ThyssenKrupp case (described in more detail in Section 4.2.4.1 below). See ArbG Essen, 19 December 2013, 1 Ca 657/13, DE:ARBGE:2013:1219.1CA657.13.00, para 76 describing that the defendant's predecessor was found guilty of bribery and merely transferred to another division, apparently without any detailed investigation into his other dealings; and paras 117, 141 describing that the compliance inquiry, initiated in the knowledge of earlier cartel conduct and based on suspicions of further cartel conduct, did not follow up on reported competition law infringements including quota cartels.

[89] This appears to have been the case in ThyssenKrupp (see Section 4.2.4.1 below), where the director for sales 'C.' (name redacted) and the defendant's predecessor 'R.' (name redacted) appear to have been more intimately involved in the price and quota cartel than the defendant from whom indemnification was sought and who, according to the first-instance court, which interpreted the facts perhaps a little too generously, did not even breach his duty of supervision (although this is difficult to square with the facts as reported by the court). See the first-instance labour and employment court's judgment, ArbG Essen, 19 December 2013, 1 Ca 657/13, DE:ARBGE:2013:1219.1CA657.13.00, paras 124–135, 140–142. Even taking the pleadings by the claimant as true, the defendant was the one who asked for the cartel to be terminated while 'C.' and 'R.' argued for its continuation, ibid, para 31.

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felt justified increasing profits by infringing competition law. Moreover, if the undertaking no longer had an incentive to implement effective compliance measures, the resulting lack of information about competition law standards could lead to inadvertent infringements of competition law. While explicit hardcore price-fixing or quota cartels will not usually come about inadvertently, it is possible that individuals ignorant of competition law start, for example, to exchange confidential information or pressure customers to adhere to recommended resale prices. Additionally, the de facto reduction of the corporate sanction where an individual indemnifies the undertaking may reduce the incentives to make use of leniency programmes.[90]

4.2.2 Legal and policy considerations regarding indemnification by individuals for damages paid to third parties

When it comes to the indemnification for damages paid to third parties, questions arise that are similar to the ones discussed above for the indemnification for fines, albeit with some important differences.

If one considers the undertaking to be prevented from recovering fines based on the *ex turpi causa non oritur actio* principle, then recovery of damages is excluded by the same principle. I have indicated above that I do not consider the *ex turpi causa* exclusion to apply.

The disturbance of the balance of the statutory fining scheme for undertakings and individuals, even if one considered it to be an argument against the recovery of fines, is not an argument when it comes to the recovery of private damages paid by the undertaking to third parties.

A more difficult question is whether the argument that optimal sanctions need to remain with the undertaking also prevents the indemnification for damages paid to third parties. The German Regional Court and Higher Regional Court in Düsseldorf, which considered this to be a problem *with regard to the fine*, allowed the indemnification *for damages paid to third parties* without limitations. At first glance, this seems unremarkable: the reason why indemnification for fines is problematic is the conflict with the public policy of deterrence; and damages claims, as private claims, do not generally pursue a public policy but rather the interests of individuals: *publicum ius est quod ad statum rei romanae spectat, privatum quod ad singulorum utilitatem pertinet*.[91]

However, private *competition* law claims could be different. The Court of Justice emphasizes regularly that private competition law enforcement, besides providing compensation to the claimants, also serves a deterrent (preventative, dissuasive) function.[92] As mentioned above, the introduction and proliferation of private damages actions likely contributed substantially to the deterrent effect and an approximation of optimal sanctioning levels. This

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[90] See, e.g., Leclerc, *Kartellgeldbußregress* (n 9) 227–228; von Schreitter and Lauer (n 83) 2040 text accompanying and in n 51.

[91] Inst 1,1,4, derived from Ulpian D 1, 1, 1, 2.

[92] See, in particular, *Sumal* (n 4) para 36: 'Beyond the compensation itself for the harm alleged, the establishment of such an entitlement [scil: to private compensation] contributes to the objective of dissuasion, which is at the heart of [the] task of the Commission, which is under a duty to pursue a general policy designed to apply, in competition matters, the principles laid down by the FEU Treaty and to guide the conduct of undertakings in the light of those principles'; see also Case C-312/21 *Tráficos Manuel Ferrer SL v Daimler AG* EU:C:2023:99, para 42; Case C-163/21 *AD v PACCAR* EU:C:2022:863, para 56.

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could lead to the conclusion that the considerations with regard to the indemnification for fines should be transferred to damages paid to third parties: if it were possible for the undertaking to seek indemnification for damages from individuals, the overall sanction on the undertaking could sink below the optimal level.[93]

Even though private enforcement does indeed serve an important deterrent function and it is not unlikely in practice that only the combination of a fine plus damages payments to third parties allows the overall sanction to approach the optimal level, it is still true that private damages claims primarily serve the interests of private actors ('*utilitas singulorum*'). Private actors decide whether to claim damages at all, as well as if, when, and how to settle the case. Their considerations are guided by their own idiosyncratic private interests, and these are not usually constrained or motivated by public policy considerations. Accordingly, one should not rely on these claims to protect public policy considerations such as the full effectiveness of the sanctions deterring competition law infringements. To the extent private claims are brought and thus contribute to the aim of deterrence, they have the welcome side-effect of boosting the public policy aim of deterrence – this is the effect recognized by the Court of Justice. One should not, however, outsource in full or even partially the public policy function to private actors who pursue their own interests.[94] If public policy considerations cannot force those harmed by infringements to initiate and see through damages actions, these public policy considerations cannot be so compelling as to prevent the undertaking from seeking indemnification from individuals.

In Germany, there is the additional consideration that those harmed by competition law infringements are permitted to claim directly from individuals under the *Dornbracht* case law, because culpable individuals are considered jointly and severally liable.[95] This does not necessarily mean that the individual has to bear the entirety of the burden in the internal relationship between the undertaking and the individual. The allocation of the burden between two jointly and severally liable parties – here: the undertaking and the individual – is determined under § 426 of the German Civil Code (BGB). Whatever the individual's share of this allocation is, this share has to be borne by the individual regardless of whether the third-party victim initially recovers damages from the undertaking or from the individual. In other words, the eventual allocation of the losses between undertaking and individual should not depend on whom the victims sue first.

Therefore, in contrast to the situation regarding fines, undertakings should be allowed to seek indemnification from individuals for damages paid to third parties, and not only in the highly theoretical case that the optimal sanction is exceeded. In cases where the undertaking seeks indemnification for damages, it is still possible for the individual to argue that the undertaking had corresponding profit gains due to the infringement (the 'mitigation approach'). The question remains who should bear the burden of proof for such mitigating profits. As mentioned before, in principle the individual bears the burden of proof for the existence and

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[93] von Schreitter and Lauer (n 83) 2040.

[94] This has happened to some extent in the United States, where private enforcement has traditionally been much more prevalent, but even there private enforcement has always been complemented by public enforcement by federal and state authorities. Also, for various reasons private enforcement in the United States has been and continues to be more effective (e.g., pre-trial discovery, treble damages, unilateral cost-shifting, opt-out class actions).

[95] See n 8 above.

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amount of mitigating profits. However, there are good reasons either to reverse the burden of proof, or, alternatively, to require the undertaking to argue in detail why there were no (or a lower level of) profits resulting from the infringement. First, in the case of cartels, there is a presumption that the infringement has resulted in profits. Second, in the case of indemnification for damages, the third party will have proven (or have to prove in the future) that it sustained a certain amount of loss caused by the infringement. While not all infringements will allow the inference that the infringing undertaking will have made corresponding profits, for many infringements – in particular for cartels where the third party claims the overcharge – this inference is not far-fetched. Third, while the undertaking is in a good position to assess the existence and quantum of such profits, the individual will not generally have any insights into the accounting; there is an asymmetry of information.[96] There are, therefore, good reasons to require the undertaking to demonstrate with detailed evidence that the profits they made from the infringement were lower than the damages they had to pay to third parties.[97]

4.2.3 Practice in the UK: *Safeway v Twigger, Jetivia v Bilta*

In the UK, in the first attempt to seek such an action to recover fines imposed by the OFT (as it then was), the High Court did not strike out the action.[98] However, the Court of Appeal allowed the appeal, with the majority reasoning that the *ex turpi causa non oritur actio* maxim prevented recovery.[99] In contrast, Pill LJ, while agreeing with the result, based his judgment on the reasoning that the 'policy of the statute would be undermined if undertakings were able to pass on the liability to their employees, or the employee's D&O insurers. Only if the undertaking itself bears the responsibilities […] are the public protected'.[100] The Court of Appeal's majority controversially rejected the argument that the undertaking was the victim of the fiduciary with the formalistic counterargument that it had been the undertaking that had breached the statutory duty.[101] This seemed to settle the question for English law.

However, '[t]he decision in *Safeway* has not avoided criticism'.[102] In *Les Laboratoires Servier v Apotex*, the UK Supreme Court remarked that 'this is not a case in which any question arises as to the correctness or otherwise of a decision such as that of the Court of Appeal in [*Safeway v Twigger*]'.[103]

In *Jetivia v Bilta*, the UK Supreme Court held in a fraud case, as summarized by Lord Neuberger, that '[w]here a company has been the victim of wrong-doing by its directors, or

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[96] Such asymmetries of information can, of course, be addressed in different ways. An alternative to the reversal of the burden of proof described here is a decent system of disclosure of evidence; in Germany, however, courts have generally opted for a system of alternating obligations to provide substantiated evidence to address information asymmetries. See Florian Wagner-von Papp, 'Access to Evidence and Leniency Materials' (February 18, 2016), available at https://ssrn.com/abstract=2733973 accessed 22 November 2023.

[97] Note that it would not be sufficient for the undertaking to show that they made a loss from the combination of fine and damages paid (or to be paid) to third parties.

[98] *Safeway Stores Ltd v Simon John Twigger* [2010] EWHC 11 (Comm).

[99] *Safeway Stores Ltd v Simon John Twigger* [2010] EWCA Civ 1472, [16]–[27] (per Longmore LJ) and [35]–[38] (per Lloyd LJ, agreeing with Longmore LJ).

[100] *Safeway v Twigger* (n 99), [44].

[101] *Safeway v Twigger* (n 99), [28]–[31] (per Longmore LJ, with whom Lloyd LJ agreed).

[102] *Re Mobigo Ltd* [2022] EWHC 1349 (Ch), [39].

[103] *Les Laboratoires Servier v Apotex Inc* [2014] UKSC 55, [2015] A.C. 430, 451, [45].

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of which its directors had notice, then the wrong-doing, or knowledge, of the directors cannot be attributed to the company as a defence to a claim brought against the directors by the company's liquidator, in the name of the company and/or on behalf of its creditors, for the loss suffered by the company as a result of the wrong-doing, even where the directors were the only directors and shareholders of the company, and even though the wrong-doing or knowledge of the directors may be attributed to the company in many other types of proceedings.'[104] The thrust of the arguments shared by all Justices would appear to stand in contrast to the decision in *Safeway v Twigger*. This is clearest in the opinions of Lord Toulson and Lord Hodge, who explicitly discuss *Safeway v Twigger* and conclude that they 'disagree with the reasoning' in the Court of Appeal's decision that it was determinative that the liability for the competition law infringement was a 'personal' liability of the company so that its claim against the directors and employees was barred by the doctrine of illegality.[105] Following *Watts*' assessment,[106] Lord Hodge and Lord Toulson reject the claim that it follows logically from the fact that the principal becomes liable based on an agent's acts that the principal cannot hold the agent liable for an infringement of a separate and legal contract.[107] Lord Mance tended to agree with this assessment of *Safeway v Twigger*, but preferred to leave the decision for another day.[108] Lord Sumption considered *Safeway v Twigger* to have been decided correctly on the basis that under the statutory scheme of the Competition Act 1998, exclusively the undertaking was capable of committing the offence.[109] Lord Neuberger stated that he 'would take a great deal of persuading that the Court of Appeal did not arrive at the correct conclusion in that case'; however, he preferred not to decide the issue at this time, and explicitly left open whether, if *Safeway v Twigger* was rightly decided, he would prefer the reasoning of the majority or that of Pill LJ.[110]

This decision calls the Court of Appeal's decision in *Safeway v Twigger* into question.[111] This is not to say that *the result* in *Safeway v Twigger* was incorrect: the reasoning underlying the judgment by Lord Justice Pill, namely that the indemnification for the fine would be incompatible with maintaining the full effectiveness of the fine is, for the reasons outlined above, sound and convincing, and it is independent of the (in isolation unconvincing) *ex turpi causa* argument.

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104 *Jetivia SA and another v Bilta (UK) Ltd and others* [2015] UKSC 23, [7].

105 Ibid, [156ff], [159].

106 Peter Watts, 'Illegality and agency law: authorising illegal action' [2011] JBL 213.

107 *Jetivia v Bilta* (n 104), [159]–[161].

108 *Jetivia v Bilta* (n 104), [33], [52].

109 *Jetivia v Bilta* (n 104), [83].

110 *Jetivia v Bilta* (n 104), [31]. To the extent this paragraph of the judgment can be interpreted to show a preference, it is arguably one for upholding *Safeway v Twigger* on the basis of Pill LJ's reasoning (see text accompanying n 100 above).

111 Mark Brealey and Kyla George, *Competition Litigation – UK Practice and Procedure* (2nd edn, OUP 2019) 562 in n 25.

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4.2.4 Practice in Germany

4.2.4.1 ThyssenKrupp GfT Gleistechnik GmbH

In Germany, one of the many facets of the rail tracks cartel (*Schienenkartell*) was that ThyssenKrupp initiated an action against a former director (and, at other times, employee), seeking to recover the sum of two fines of 191m EUR imposed by the Bundeskartellamt for a non-exempted exclusive distribution arrangement[112] and, more importantly, a quota and price cartel that had been implemented between 2001 and 2011.[113] At a later stage of the proceedings, ThyssenKrupp also demanded damages in the amount of 100m EUR paid to victims of the cartel. This led to a lengthy journey through the German court system.

The first-instance Labour Court (ArbG)[114] considered the defendant – in contrast to his predecessor 'R.' and his co-director 'C.' – not to have been directly involved in the cartel conduct himself.[115] The Court acknowledged that as a co-director of the company, he had a duty to supervise even with regard to matters that fell formally into his co-directors' purview; nevertheless, the Court considered him to have discharged this duty by informing the compliance officer in an enquiry (even though it was soon obvious that no consequences followed).[116] While this assessment of the facts seems to be overly generous to the defendant, the Court added that, in any case, it considered the undertaking to have contributed to the infringement and that it would be an abuse of rights if the undertaking were indemnified for the full corporate fine; instead, the Court argued that the statutory maximum fine for individuals was set at 1m EUR, that a higher fine was reserved for corporate fines, and that transferring the corporate fine to the individual by way of indemnification would contravene the statutory purpose of setting the individual fine at a level that did not destroy the individual's economic existence.[117]

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[112] With the TSTG Schienen Technik GmbH, part of the voestalpine group.

[113] See Bundeskartellamt, Fallbericht, 6 September 2013, B12 – 16/12, B12 – 19/12, https://www.bundeskartellamt.de/SharedDocs/Entscheidung/DE/Fallberichte/Kartellverbot/2013/B12-16-11_B12-19-12.pdf?__blob=publicationFile&v=7 accessed 22 November 2023.

[114] ArbG Essen (n 88); see also the judgment in the parallel proceedings ArbG Essen, 19 December 2013, 1Ca 658/13, DE:ARBGE:2013:1219.1CA658.13.00 ('ArbG Essen II'), in which the parent undertaking sought redress from the same defendant.

[115] ArbG Essen (n 88), paras 99–137. The court's generous assessment is sometimes difficult to find believable (at para 104, the bar for evidence required for an agreement in the sense of competition law seems set too high; at para 78 believing that the defendant obtained 'neutral mobile phones', which were eventually used to facilitate clandestine communications, without knowing their intended purpose; also there were allegations that the defendant had participated in a few cartel meetings, at para 128). See also ArbG Essen II (n 114), paras 112–116, 136–139, 157.

[116] ArbG Essen (n 88), paras 138–141; ArbG Essen II (n 114), paras 117–132 (re exclusivity agreement) and 142–143, 148–149.

[117] ArbG Essen (n 88), paras 142–145. This approach – at least when not accompanied by additional considerations – was (rightly) criticized in the literature, given that liability for private damages is unrelated to any administrative fines due for the same conduct: when I do not clear the sidewalk of snow and ice, and someone slips and breaks her leg, my liability for damages is not limited to the amount of the administrative fine due for not clearing the sidewalk. Cf Kersting (n 68) 1270; Bayer (n 82) 97 (but advocating for a reduction to an 'adequate' amount based on the company's duty of care towards its directors and officers); but see Dreher (n 83) 105, who rejects

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On appeal, the second-instance employment and labour court (LAG) considered that, in principle, a director breaching the duty of legality is liable for the resulting loss to the company, and that the fine at first glance constituted a loss in this sense. However, the LAG held that there was no such liability for competition fines. In contrast to the first-instance labour court, the LAG did not primarily argue that limitations resulted from a need to protect individuals from ruinously high damages payments as such, although it did not categorically reject the first-instance court's approach of limiting the recovery to the maximum individual fine.[118] Instead, the LAG reasoned that the statutory scheme of imposing separate fines on the undertaking and on the individual precluded the undertaking from recovering its corporate fine from individuals, especially where the corporate fine included an element of the disgorgement of gains.[119] The LAG rejected the argument that the decision to impose separate fines did not also intend to determine where the burden should eventually lie: the imposition of the corporate fine on the undertaking was, in the Court's view, a deliberate choice in order to incentivize the undertaking's owners to take effective measures and controls to avoid infringements of competition law.[120] In particular where the fine had as one of its objectives the disgorgement of cartel profits, any recovery from third parties would mean that the infringing undertaking could continue to benefit from the infringement.[121] The Court saw the possibility of the defendant's mitigation defence, which would in principle avoid the problem of the undertaking retaining cartel profits, but reasoned that this defence would often be de facto worthless because the defendant bears the burden of proof and would often not be able to discharge this burden.[122] The LAG further argued that the differentiated system of maximum fines for undertakings and individuals would be undermined if the undertaking were indemnified by the individual, and that the factors considered in setting the corporate fine were specifically tailored to the undertaking's liability.[123]

Regarding the claimant's separate claim for damages and a declaratory judgment in relation to future third-party damages claims, the LAG did not decide on the substance and instead suspended the proceedings to allow an appeal.[124]

Given that the issue of indemnification had not previously been decided in German law, the decision by the third-instance, highest employment and labour court (BAG) was keenly anticipated. However, the BAG decided in 2017 on purely jurisdictional grounds that the

indemnification for fines for the reasons mentioned above, but would, in the alternative, consider the individual maximum fine to be a limit for the indemnification for corporate fines.

[118] LAG Düsseldorf, 20 January 2015, 16 Sa 459/14, DE:LAGD:2015:0120:16SA459.14.00, paras 154–156.

[119] LAG Düsseldorf (n 118), paras 157–174. See also in the parallel case (by the company's parent) LAG Düsseldorf, 20 January 2015, 16 Sa 460/14, DE:LAGD:2015:0120.16SA460.14.00, paras 166, 167.

[120] LAG Düsseldorf (n 118), paras 158–168.

[121] LAG Düsseldorf (n 118), paras 169–171.

[122] LAG Düsseldorf (n 118), para 170; but see Kersting (n 68) 1273–1275, arguing for an exceptional allocation of the burden of proof to the undertaking (or at least reversal of the burden of proof) based on the particularities in competition law cases.

[123] LAG Düsseldorf (n 118), paras 172, 173.

[124] LAG Düsseldorf (n 118), para 146.

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competition-related questions meant that it was not the labour courts at all, but instead the courts in competition matters that were competent to adjudicate the case.[125]

Accordingly, the case was transferred to the competition court, the LG Dortmund. There, the parties settled the case, reportedly for a consideration of between 10m and 30m EUR, an amount which was said to be covered in its entirety by the D&O insurance.[126] In terms of legal certainty about the recoverability of fines, which had seemed so close with the appeal to the BAG, this result was a set-back.

4.2.4.2 Villeroy & Boch

The Austrian subsidiary of Villeroy & Boch AG had, between 1994 and 2004, participated in the bathroom ceramics cartel and was fined by the European Commission in 2010 (upheld by the Court in 2013 and 2017).[127] Villeroy & Boch sought (partial[128]) indemnification, on behalf of the Austrian subsidiary, for the fine, for third-party claims, and for legal expenses from its former Chairman of the board under § 93(2) Aktiengesetz, arguing that he had failed to introduce an effective compliance scheme and to supervise the subsidiary effectively.

In 2020, the Regional Court Saarbrücken dismissed the action, primarily on the ground that the claims were time-barred.[129] In the alternative, however, the Court argued that the (European Union law) principle of effectiveness prevented indemnification because otherwise the full effectiveness of the fine would no longer be ensured.[130] In addition, the Court mentioned the danger of the fine being shifted to D&O liability insurers.[131] The Court considered the 'obvious' possibility of a preliminary reference to the European Court of Justice, in order to seek clarification on the issue whether indemnification conflicts with the principle of *effet utile*, but discarded the option as impermissible because the lapse of the limitation period meant that the question was not determinative for the outcome of the case.[132]

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[125] BAG, 29 June 2017, 8 AZR 189/15, DE:BAG:2017:290617.U.8AZR189.15.0.

[126] Volker Votsmeier and Martin Murphy, 'Thyssen-Krupp gibt im Streit um Schäden aus dem Schienenkartell klein bei', *Handelsblatt online* (Düsseldorf, 31 January 2022), https://www.handelsblatt.com/unternehmen/industrie/stahlhersteller-thyssen-krupp-gibt-im-streit-um-schaeden-aus-dem-schienenkartell-klein-bei/28024290.html accessed 23 April 2025.

[127] *Bathroom Fittings and Fixtures* (COMP/39092) Commission Decision [2011] OJ C348/12; Cases T-373/10, T-374/10, T-382/10 and T-402/10 *Villeroy & Boch Austria and Others* v *Commission* EU:T:2013:455 (the General Court largely dismissed the appeal except for a reduction of the duration of the cartel participation by the Villeroy & Boch AG); Case C-625/13 P *Villeroy & Boch AG v Commission* EU:C:2017:52 (the Court of Justice dismissed the further appeal).

[128] The defendant had not been in office for the entire time of the cartel (only from 1994 to 1997), so that recovery was sought only for slightly more than a third of the fine. In addition, the company sought a declaratory judgment for the indemnification for all future third-party claims.

[129] LG Saarbrücken, 15 September 2020, 7 HK O 6/16, BeckRS 2020, 32440, paras 70-121, https://beck-online.beck.de/Bcid/Y-300-Z-BECKRS-B-2020-N-32440 accessed 23 April 2025 , partially reprinted in (2021) Neue Zeitschrift für Kartellrecht (NZKart) 64-65.

[130] LG Saarbrücken (n 129), paras 122-123.

[131] LG Saarbrücken (n 129), para 123.

[132] LG Saarbrücken (n 129), para 124.

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4.2.4.3 Stainless steel

In a series of decisions between 2018 and 2021, the Bundeskartellamt fined 10 undertakings, two associations of undertakings and 17 individuals in the stainless-steel sector a total of some 355m EUR for a price-fixing and information-exchange cartel.[133] The cartel had a hierarchical organization, with both high-level and low-level management participation. One of the companies, which had been fined 4.1m EUR for its participation, had expenses for its legal defence of some 1.14m EUR, and fearing third-party damages claims by those harmed by the cartel, initiated an action for indemnification against one of its former directors, who had attended cartel meetings between 2002 and 2015.

The Regional Court (LG) Düsseldorf considered well-founded the claim for a declaration that the director is liable for the indemnification for damages claims by third parties.[134] However, it rejected the claim for indemnification for the fine and the legal expenses associated with the fine.[135]

With regard to the indemnification for third-party damages claims, the Court reasoned that under § 43(2) of the GmbHG a director of a limited liability company is liable for the company's loss resulting from breaches of duties against the company. Directors have a duty to act in conformity with the law (*Legalitätspflicht*) and the argument that the breach of the law was profitable is not an acceptable defence.[136] The defendant breached this duty at least negligently; even if, as he claimed, he was not aware of the illegality of his actions because of the alleged 'grey area', he at a minimum neglected to seek legal advice in time.[137] Any potential knowledge about the infringement on the part of other directors would be irrelevant for the defendant's liability vis-à-vis the company because of the directors' joint liability.[138] Also irrelevant was the fact that the shareholders had formally approved the board's actions at the shareholder meeting (*Entlastung*) because at the time of approval the shareholders had not been informed of the potential liability.[139] The Court also rejected a potential mitigation (*Vorteilsausgleich*) argument at this time, albeit with reasoning which was wrongly imported from pass-on cases: it was not 'at first sight … obvious that the cartel damage had been passed on in full'.[140] Accordingly, any question of mitigation did not prevent the issuing of the declaratory judgment that the defendant is in principle liable for the indemnification of third-party

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[133] Bundeskartellamt, Fallbericht, 28 September 2021, Cases B12-22/15 and B12-21/17.

[134] LG Düsseldorf, 10 December 2021, 37 O 66/20 [Kart] DE:LGD:2021:1210.37O66.20K art.00, paras 62–83; affirmed, OLG Düsseldorf (n 43), paras 72–142.

[135] LG Düsseldorf (n 134), paras 85–98; affirmed, OLG Düsseldorf (n 43), paras 143–192.

[136] LG Düsseldorf (n 134), para 64, following BGH (n 71) para 29; affirmed, OLG Düsseldorf (n 43), paras 83–87.

[137] LG Düsseldorf (n 134), paras 65–69; affirmed, OLG Düsseldorf (n 43), paras 88–123, but the Higher Regional Court confidently considers the conduct to have been an intentional, not merely a negligent, breach; the Higher Regional Court discusses extensively that (1) the defendant was likely not in doubt about the illegality of his actions at all, paras 102–111, and (2) if he was unaware of the illegality, the error in law was not unavoidable, paras 112–123.

[138] LG Düsseldorf (n 134), paras 70, 71.

[139] LG Düsseldorf (n 134), paras 72–77.

[140] LG Düsseldorf (n 134), para 80. In reality, the question would have to have been whether it could be predicted that future third-party damages claims would be no higher than the corresponding profits the undertaking had received based on the infringement.

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damages claims, but will have to be addressed in the future when the company claims specific damages based on the declaratory judgment.

In contrast, the Regional Court rejected indemnification for fines and the associated legal fees. The Court considered indemnification to conflict with the purpose of the sanctioning rules under German law, and therefore considered the indemnification provision inapplicable under a purposive approach.[141] In order to deter infringements and to influence the undertaking's future conduct, and in particular to incentivize effective compliance measures, the sanction needed to be imposed on the undertaking, and indemnification would remove the incentive effect.[142] It explicitly rejected the argument that indemnification would increase deterrence by influencing the individual who could otherwise profit, via variable compensation elements, from the infringement; the Court reasoned that the possibility under German law to impose a fine on individuals of up to 1m EUR was sufficient deterrence to prevent them from becoming unfaithful agents.[143] The Court also considered indemnification for fines incompatible with the different maximum sanctions for undertakings and individuals, respectively. If the undertaking could recover the fine, whose amount is determined by the undertaking's turnover and other factors specific to the undertaking, from the individual, then the maximum for the individual fine of 1m EUR, and the factors specific to the individual's culpability considered in setting the individual fine, would become meaningless.[144] The Court also rejected indemnification for the expenses for the legal defence, because these had been incurred in order to keep the corporate fine as low as possible, and because the fine itself was not indemnifiable, the benefits of the legal defence accrued to the claimant company, not to the defendant.[145]

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[141] LG Düsseldorf (n 134), para 87; affirmed, OLG Düsseldorf (n 43), para 144.

[142] LG Düsseldorf (n 134), paras 88–91; affirmed, OLG Düsseldorf (n 43), with an extensive discussion in paras 144–188, in particular 178–183, noting that the D&O insurance in the case before the court would otherwise cover amounts up to 10% of the undertaking's turnover.

[143] LG Düsseldorf (n 134), para 90. This is, in itself, not very convincing: depending on the amount of variable compensation, a cartel that operates – as in the case before the LG Düsseldorf – for more than a decade, may well result in private benefits of more than 1m EUR, in particular when combined with promotions and the associated pay raises. In theory, where individual benefits can be shown to have been higher than 1m EUR, the individual fine may be increased under § 17(4) OWiG to disgorge these benefits; but proving that this was the case makes this administratively costly and in most cases impracticable, if not impossible. To the extent there is indemnification for third-party damages claims, this may well be a more significant deterrent, although this depends on D&O insurance not stepping in, and more generally one should not outsource deterrence to private actors. Kersting (n 68) at 1268 argues that individual fines could have no deterrent effect when the European Commission (and not the Bundeskartellamt or other German competition authorities) enforces the law. Introducing criminal sanctions would in my view be a better deterrent (see below). On appeal, the OLG Düsseldorf (n 43), at para 172, acknowledged that the indemnification could, in principle, add to the deterrent effect.

[144] LG Düsseldorf (n 134), paras 93, 94; OLG Düsseldorf (n 43), paras 173–177. I have explained above why I consider this argument in isolation not to be convincing (i.e., independently of the argument that the full effectiveness and dissuasiveness of the fine has to be ensured).

[145] LG Düsseldorf (n 134), para 98; affirmed OLG Düsseldorf (n 43), paras 189–192.

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On 27 July 2023, the Higher Regional Court in Düsseldorf affirmed the Regional Court's judgment in full.[146] The reasoning is largely identical to the Regional Court's.[147] Somewhat surprisingly, the Higher Regional Court perpetuates the Regional Court's error in discussing pass-on issues when it comes to mitigation in the context of the indemnification for third-party damages claims: the Court rejects both a reversal of the burden of proof and of the burden of production based on the reasoning in pass-on cases, and mentions as the only potential benefit for the company the sums the company could have received by passing on the overcharge to customers. This, however, misses the point, which was correctly made by the defendant: that the infringement had already resulted in higher (cartel) profits for the undertaking. In contrast to the pass-on cases, where a corresponding benefit depends on what happens after the loss occurred – namely, whether the loss is subsequently passed on to the next distribution level – in the indemnification cases, the benefits corresponding to the damages (namely the profits resulting from the infringement) have nearly by necessity already been received by the undertaking in practically all cases in which third parties can claim damages – with the exception of those cases where the loss on the part of the victims is substantially higher than the gains by the infringer.[148]

The OLG Düsseldorf allowed the appeal to the highest-instance court in civil matters, the Bundesgerichtshof (BGH). On appeal, the BGH decided on 11 February 2025 (Case KZR 74/23) to make a preliminary reference to the European Court of Justice, seeking clarification whether permitting indemnification for the corporate fine would infringe the principle of effectiveness. It is to be hoped that the European Court of Justice answers this question in the affirmative, and that the German court will extend the impermissibility of indemnification for fines to fines imposed under German law.

4.2.4.4 LG Dortmund: Construction cartel

Such a clarification is highly desirable: two 'indicative orders' of the Regional Court Dortmund, one preceding and one subsequent to the OLG Düsseldorf's decision on 27 July 2023, take the opposing view that indemnification for fines should be possible.[149] The arguments advanced by the LG Dortmund are that the provisions for the company's indemnification by its directors (§ 43(2) GmbHG and § 93(2) AktG) for conduct harming the company require full compensation; that administrative fines and civil liability are separate issues and the fining decision therefore does not predetermine where the burden should eventually fall; that the deterrent effect is overall not impaired because, while the deterrent effect on the undertaking may be reduced, the increased deterrent effect on the individual agent compensates for this loss; and that realistically the undertaking will still have to expect to carry some of the fine because the director, even accounting for D&O insurance, will usually not be able to cover the entirety of the fine. While the Court considers corresponding gains from the infringement received

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[146] OLG Düsseldorf (n 43).

[147] See the parallel pinpoint citations in nn 134–145. There is an additional section on limitation periods (OLG Düsseldorf (n 43), paras 124–134).

[148] Such an exception could apply, for example, where customers of co-cartelists claim the entire loss from the undertaking based on joint and several liability; or in the case of umbrella damages; or where the competition infringement is not one based on a cartel but, e.g., an exclusionary abuse.

[149] LG Dortmund, 8 O 5/22 (Kart), orders of 21 June 2023 and 14 August 2023 (n 81).

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by the undertaking to be, in principle, mitigating factors, in the case before the court no such gains were said to exist. In particular in cases prosecuted by the European Commission, where the individual does not face the prospect of individual fines, indemnification leads, in this Court's view, to a desirable deterrent effect by addressing the principal-agent problem.

4.2.5 Conclusions as to the role of indemnification in deterrence

This section started out by assuming that sanctions on undertakings are optimal and that competition law infringements result purely from a principal-agent problem, where rogue agents act against the principals' interests to further their own goals. More precisely, there are at least two principal-agent relationships one needs to consider: the board of directors acts as an agent for the principal shareholders (first-degree principal-agent relationship); and senior – and, in cases of hierarchical cartel structures, more junior – management acts as an agent to the board (second-degree principal-agent relationship).

The facts underlying the decisions described in this section point in the same direction as the broader research into this question: they do not support the rogue-agent hypothesis, even though these indemnification cases are precisely the cases in which the claim depends on the principal-agent argument, so that one would assume a selection bias towards 'rogue-agent cases'. Competition infringements even in these indemnification cases were either committed by board members, or by senior management, with the board turning a blind eye to the infringement. There is little evidence for the second-degree principal-agent problem. This could still leave the first-degree principal-agent problem to be addressed: possibly, infringements go against the interests of the shareholders, and management goes rogue. However, in the ThyssenKrupp case, where the shareholder was a parent company, the same dynamic played out: even when the parent company's compliance officer was informed, the cartel was allowed to continue. This is at least an indication that from an *ex ante* perspective shareholders may not object to competition infringements, so that there is not necessarily a first-level principal-agent problem either.

The second issue is that even if we do assume that corporate sanctions are optimal *prior* to indemnification, allowing indemnification for fines or third-party damages could turn corporate sanctions into suboptimal ones. This would certainly be the case where indemnification would lead to the recovery of sums that allow the undertaking to retain profits from the infringement. Even those in favour of indemnification for fines recognize this danger and limit indemnification by allowing a mitigation defence, possibly with a presumption that profits from the infringement exceed the fine so that the burden of proof for the assertion that the fine exceeded the profits lies with the company seeking indemnification.

However, this would still not ensure that the full effectiveness of the fine is maintained. The *optimal* fine does not merely skim off the profits of those infringements that are detected because this would allow undertakings *ex ante* to gamble on not being detected. Therefore, to ensure the full effectiveness of the fine, the fine needs to take the imperfect detection of cartels into account (theoretically by multiplying the expected profits by the inverse of the detection probability). The public policy of ensuring the full effectiveness and dissuasiveness of public sanctions, which exists both in European Union law and in national competition laws, therefore requires not merely that indemnification does not interfere with the disgorgement of all profits from the undertaking, but it also requires that the fine that remains with the undertaking is deterrent from an *ex ante* perspective. Only if it could be shown that a fine exceeds this optimal level could indemnification for the fine be permitted. Given the enormous difficulties

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in calculating the optimal fine, this is arguably a *probatio diabolica*, so that the view proposed here leads to a *de facto* prohibition of indemnification for fines.

It is no response to say that 'usually' or 'often' the limited solvency of individuals will prevent indemnification to such a degree that enough of the eventual burden will remain with the undertaking to make infringements undesirable.[150] Not all competition law fines reach hundreds of millions of euros. Some managers may be very rich. Most disturbingly, D&O insurance has been shown to cover very high amounts, and insurance coverage in the case before the OLG Düsseldorf was said to be in the order of magnitude of 10% of the undertaking's turnover, and therefore to cover the entirety of the maximum fine;[151] if indemnification for the fine had been allowed, the undertaking would have been relieved of the fine without *any* deterrent effect on either the undertaking or the individual. Even in the ThyssenKrupp case, where the indemnification settlement covered 'only' some 10% of the fine, the D&O insurance covered the entirety of the settlement, and thereby gave the undertaking (which had demonstrated abysmal compliance) a 10% discount on their fine without *any* additional deterrent on the individual. More generally, if indemnification for fines were allowed, this would create an easy way for the undertaking to circumvent the legal exclusion of direct insurance against corporate fines: the company could insure the directors and officers for a sufficiently high amount, and in case of detection of an infringement choose managers who acted not wilfully but only negligently and recover the fine from them. If the associated moral hazard were not to destroy the D&O insurance market first, it would be an open invitation to infringe competition law with impunity.[152]

The indemnification for third-party damages is, in principle, less problematic than the indemnification for fines. While private damages also serve a deterrent function, so that indemnification for third-party private damages also lightens the undertaking's burden and creates the danger that the overall corporate 'sanction' becomes suboptimal, it is a feature of private actions that private actors decide based on their private interests whether to initiate and when, and on what terms, to end them. The additional deterrent effect of private actions is a welcome side-effect, but the deterrence necessary to uphold the public policy must come from public sanctions without reliance on private damages actions which may or may not follow. Accordingly, by allowing the undertaking's indemnification from individuals for third-party damages claims, the initial welcome side-effect of additional deterrence on the undertaking is removed; but one could not have counted on the third-party damages claim to be brought in the first place, so that nothing is lost.[153]

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[150] Similarly von Schreitter and Lauer (n 83) 2039 (albeit with a focus on disproportionality of the cumulative sanctions borne by the individual).

[151] OLG Düsseldorf (n 43), para 180.

[152] von Schreitter and Lauer (n 83) 2039; Wagner-von Papp, 'Bußgeldregress von Geschäftsleitern vor dem BGH: Kartellverstöße zum Rundum-sorglos-Tarif?' (2025) 75 Wirtschaft und Wettbewerb (WuW) 1-2 (pointing out that insurance companies appear to offer very generous terms to directors in the hope of attracting future business so that the moral hazard may not result in the disappearance of the generous D&O insurance policies).

[153] I wanted to quote Eric Idle here, with the last words of the well-known song lyrics of the final song in The Life of Brian; alas, the publisher considered a quotation consisting of 15 words (three of which were 'nothing') too risky from a copyright perspective. On quoting song lyrics in legal writing in the US, see Alex B Long, '[Insert Song Lyrics Here]: The Uses and Misuses of Popular Music Lyrics in Legal Writing' (2007) 64 Washington & Lee Law Review 531; see also Stephen B

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At the same time, one should not expect the indemnification for third-party damages to contribute much to individual deterrence. Even in those cases where indemnification is sought, any profits from the infringement will need to be deducted to the extent they cannot be shown to have been disgorged in another way, especially by fines. The burden of proof (or, at a minimum, the burden of production and persuasion) for the proposition that the profits from the infringement fall short of the corresponding expenditures, should lie, as in particular Christian Kersting has argued, with the undertaking. Even to the extent the combined fines, third-party damages claims and other expenditures can be shown to exceed the profits from the infringement, D&O liability insurance may prevent the individual from experiencing any meaningful deterrent effect (provided, however, the individual did not act wilfully or intentionally). Further detracting from the deterrent effect is that, precisely because D&O insurance will not cover wilful infringements, it may be more attractive for the undertaking to go after those who negligently failed to uncover an infringement than after those who intentionally infringed competition law.

4.3 Reprise: Direct Private Claims or Indemnification as Substitutes to Public Individual Sanctions?

Overall, then, indemnification actions are not an effective way to counteract any principal-agent problems (even assuming they were to exist in the first place). This is partially due to the 'paradox of compensation', namely that, while compensation may increase the level of precaution taken by the party paying compensation (here: the individual), the recipient of compensation will decrease the level of precaution (here: the undertaking). To a large part, however, the ineffectiveness of indemnification for deterrence is due to the moral hazard created by D&O insurance. While moral hazard can usually be addressed by deductibles and exclusions, a system of deductibles and exclusions that both protects diligent managers who inadvertently trip up in spite of best efforts and at the same time prevents the undertaking from using the insurance to protect itself and possibly its agents from any liability is difficult to conceive. In Germany, D&O insurance policies for executive directors have to include a deductible of at least 10% of the damages, but only up to 150% of the director's annual fixed income.[154] While this (in relation to average competition fines) relatively low deductible could theoretically exert some residual deterrent effect on managers, any such effect is destroyed by the fact that the deductible can, in turn, be insured by the individual (*Eigenversicherung*).[155]

More generally, just as one should not rely on private enforcement to achieve deterrent sanctioning levels *for undertakings*, one should not rely on private actions to achieve deterrence

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Harrison, 'Fair Use and the Quotation of Song Lyrics in Fiction' (2012) 11 Chicago-Kent Journal of Intellectual Property 214 ('quoting with proper citation is standard procedure for academic and legal writing'). On the tragedy of the anticommons, see Michael A Heller, 'The Tragedy of the Anticommons: Property in the Transition from Marx to Markets' (1998) 111 Harvard Law Review 621.

[154] Third sentence of § 93(2) Aktiengesetz.

[155] Gregor Thüsing and Johannes Traut, 'Angemessener Selbstbehalt bei D&O-Versicherungen – Ein Blick auf die Neuerungen nach dem VorstAG' (2010) NZA 140, 142-–43; Hans Grigoleit and Lovro Tomasic, '§ 93 - Sorgfaltspflicht und Verantwortlichkeit der Vorstandsmitglieder', in Hans Grigoleit (ed), *Aktiengesetz – Kommentar* (2nd edn, CH Beck 2020) para 183.

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of individuals, be they private actions directly initiated against the individual by the victims of the infringement or indemnification actions by the undertaking. Similarly, while there are good reasons to support internal sanctions by the undertaking against individuals, such as demotions, clawbacks, and termination – always provided there are appropriate exceptions for leniency cooperation[156] – one should not place too much reliance on these internal measures, either. First, as in the case of private enforcement, their application depends on the decision of private actors. Secondly, they will often come too late anyway, given the average duration of cartels and of the subsequent enforcement actions, especially when combined with the usually older age of those involved in cartels because they often belong to senior management.[157] Internal sanctioning mechanisms are therefore, generally, not effective deterrents for individuals.

Instead, public individual sanctions are required. Pecuniary individual sanctions have the disadvantage of being compensable, which is a particular problem where corporate fines are still suboptimal. Director disqualification orders (DDOs) are more difficult to compensate,[158] but have their own disadvantages: first, where the individuals are at or near retirement age, a DDO is not deterrent. Secondly, even for those who are below retirement age, circumvention of the disqualification order is not particularly difficult where 'consultation services' can be offered.

The most effective individual deterrent for hardcore horizontal cartels is criminal enforcement, although great care has to be taken that the institutional framework allows for effective enforcement. Within the European Union, Article 23 of Directive 2019/1/EU ensures that leniency programmes are not negatively affected by individual sanctions. The compelling case for the introduction of effective criminal competition law enforcement and the institutional preconditions for effective criminal enforcement have been discussed elsewhere in greater detail.[159]

4.4 Forcing the Company to Seek Indemnification? Management's Duty to Enforce and Derivative Shareholder Actions

A follow-up question can only briefly be touched upon here: To the extent one considers indemnification for damages (or perhaps, contrary to the arguments presented here, even for

[156] For the measures taken to ensure cooperation of such individuals in an 'internal amnesty programme', see Dominique S Wagener, 'Internes Amnestie-Programm', in Jörg-Martin Schultze (ed), *Compliance Handbuch Kartellrecht* (2nd edn, R&W 2021) Part C.V.8 (noting, e.g., the core promise not to terminate employment, but also the possibility of a waiver of indemnification claims against the cooperating individual, the indemnification for the individual's legal costs; while it is arguably not possible to promise ex ante that individual fines will be reimbursed, ex post reimbursement is seen to be possible as long as it is in the undertaking's interest).

[157] Haucap and Heldman (n 40) 296 in table 2; see also the references in n 27 above, and Catarina Marvão and Giancarlo Spagnolo, 'CEO Turnover and Shareholder Awareness in Cartel Cases', Chapter 22 in this Handbook, 449.

[158] For a positive assessment of the DDO as a complementary deterrent device, see Peter Whelan, 'The Emerging Contribution of Director Disqualifications in UK Competition Law' in Barry Rodger, Peter Whelan and Angus MacCulloch (eds), *The UK Competition Regime: A Twenty-Year Retrospective* (OUP 2021) 283, 287ff.

[159] See the contributions of others and myself in n 5.

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fines) an available option, one could ask whether there is a duty on management to litigate these indemnification claims, and whether shareholders – or, where existing, the supervisory board – could force management to comply with such a duty, for example, where the executive board is itself involved in the infringement.

In Germany, in the case of Aktiengesellschaften (AG), the two-tier board system generally tasks the supervisory board with the enforcement of claims against the executive board.[160] Not only does it have the power to enforce such claims; under the so-called *ARAG/Garmenbeck* case law the supervisory board may have an *obligation* to enforce such claims. *ARAG/Garmenbeck* requires the supervisory board to assess potential damages claims against the executive board, and, where such claims have merit, to enforce these claims unless important interests of the company outweigh, or at least are comparably as weighty as, the reasons for enforcement.[161] The contours of this exception from the duty to enforce claims against the executive board are still controversial and shrouded in mystery.[162] The Court mentioned that one factor that may be considered in the assessment is the danger of reputational damage to the company. In competition cases, it is difficult to assess how this factor is to be weighted: on the one hand, usually press announcements by competition authorities, and possibly reporting about subsequent damages actions, will already have made public the infringement and the company's involvement. On the other hand, indemnification actions may prolong the bad press and air previously unknown embarrassing details – which may be the case, in particular, because in Germany the Bundeskartellamt's fining decisions are still (and shamefully) not published.[163] It is also unclear how the general duty to enforce claims against management influences the selection of defendants in indemnification actions. Does the duty require actions against the executive board whenever it 'merely' negligently did not introduce an effective compliance scheme, or only where the executive board is actively involved in the infringement? What if the company has already initiated actions against some of those involved – is the marginal benefit of adding another defendant sufficient to trigger the *ARAG/Garmenbec*k

[160] § 112 Aktiengesetz.

[161] BGH, 21 April 1997, II ZR 175/95, BGHZ 135, 244 – ARAG/Garmenbeck, confirmed in various decisions since then, e.g., BGH, 8 July 2014, II ZR 174/13, NZG 2014, 1058, 1059, para 19 (obiter).

[162] See Mathias Habersack, '19 Jahre "ARAG/Garmenbeck" – und viele Fragen offen' (2016) Neue Zeitschrift für Gesellschaftsrecht 321.

[163] This is partially due to a criminal statute (§ 353d StGB) which prohibits publishing (parts of) the indictment before it has been discussed in public proceedings or the proceedings have been closed. It is unclear, however, why this prevents the Bundeskartellamt from publishing the fining decision later, when either the decision was appealed and the fining decision read in open court, or the decision has become final without an appeal. Where the fining decision is appealed, the published court decision will likely contain most of the details; otherwise, only a case summary (Fallbericht) is published. Taking the indemnification decisions discussed above as an example, the inner workings of the cartels become clear in much greater detail from the indemnification decisions than from the associated case summaries. Even where decisions in private damages actions by third parties are published, these will contain much less rich internal details than decisions in indemnification actions.

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duty? These issues may help to explain why, as one commentator put it,[164] 'the law on indemnification in Germany is still hardly developed despite *ARAG/Garmenbeck'*.

Similarly, one may ask whether in companies without a supervisory board, or where a cozy relationship between the executive board and the supervisory board keeps the supervisory board from bringing the suit, shareholders are or should be able to initiate derivative shareholder suits on behalf of the company against management.[165] The question in the latter cases will be under what circumstances and to what extent a minority of shareholders should be allowed to 'circumvent' the usual corporate decision-making process.

In Germany, there is first a distinction depending on the company form. In the case of Aktiengesellschaften, it is, as just described, the supervisory board's task to enforce claims against executive board members (and vice versa). However, there are often close contacts or even a cozy relationship between the executive and supervisory boards – e.g., former executive board members often transfer from the executive to the supervisory board – so that derivative shareholder actions are not entirely irrelevant. § 148 Aktiengesetz codifies the conditions under which a court may admit such a derivative shareholder action. Among other things, there is a requirement that shareholders initiating the action reach a quorum of 1% of the signed capital or 100,000 EUR and have previously tried unsuccessfully to induce management to bring the claim. In addition, the *ARAG/Garmenbeck* case law has left its marks on derivative actions as well: one of the conditions is that the company's best interests do not outweigh the reasons in favour of enforcement; here, as in the case of actions initiated by the supervisory board, a question arises about in what circumstances the best interests of the company prevent the initiation of an action.

In the case of the German limited liability company (GmbH), it is generally for the shareholder meeting to decide, by majority vote, whether to bring compensation actions (§ 46 No. 8 GmbHG). Where the majority of shareholders vote against the initiation of such action, and this constitutes an abuse of the majority's power, the defeated minority shareholders may initiate an action to challenge the shareholder meeting's vote, and so potentially force the company to initiate the action to enforce the compensation claim or to appoint a representative to initiate such an action. The minority shareholders may also bring damages actions against the shareholders who withhold their consent, provided the failure to consent constitutes a breach of the fiduciary duty among shareholders. Where the managers against whom the claim is raised are themselves shareholders, it may also be possible for a shareholder to initiate a derivative claim in the form of a so-called '*actio pro socio*' in certain cases. Where the managers are not themselves shareholders, parts of the literature would also allow such a claim, but the German Federal Court of Justice has recently rejected such a direct claim, arguing that the existing regime just described sufficiently balances the shareholder majority's general right to decide on the management of the company with minority interests.[166]

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[164] Florian Bien, 'Räuberische Aktionärsklagen oder effektive Kartellrechtsdurchsetzung' (2015) 65 Wirtschaft und Wettbewerb 331 (author's translation).

[165] In the US, derivative shareholder suits have met with varying success, both in general and specifically in antitrust cases. For a relatively recent example of a settlement in a derivative shareholder suit, see *Kim Barovic v Steven A Ballmer*, Case No C14-0540 JCC (WD Wash, order preliminarily approving settlement of 24 November 2015; final approval followed on 13 January 2016); the settlement primarily required Microsoft to install and fund an Antitrust Compliance Office.

[166] BGH, 25 January 2022, II ZR 50/20.

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Where the company is not incorporated, the derivative action in the form of an *actio pro socio* is available to a greater extent, provided the withholding of consent by the majority of shareholders constitutes a breach of a fiduciary duty.

In the UK, the question is not (yet?) a live one. As long as *Safeway v Twigger*'s *ex turpi causa* reasoning (and not the 'full effectiveness of the fine' reasoning) prevails, indemnification claims for either fines or third-party damages are not possible in the UK. If this were to change, the question of whether management is not only permitted but under a duty to bring such a claim, and the question of derivate shareholder actions might arise.

Part 11 of the Companies Act 2006 has largely codified the rules on derivative actions in the UK,[167] and derivative indemnification claims in competition cases would, in general, be subject to these rules.

However, there is some residual role left to play for the common law derivative action (which is very restrictive because of the general rule of *Foss v Harbottle*,[168] which requires fraud and control by the wrongdoer). Such a common law derivative action could become relevant for derivative actions in competition cases. The reason for which the common law derivative action may become relevant is that Part 11 of the Companies Act 2006 does not apply to so-called double and multiple derivative actions where shareholders not of the harmed company, but, for example, of its parent company seek redress.[169] This scenario is not unlikely in competition cases, where the concept of undertaking may transcend legal entities.[170] As indemnification claims are, at the moment, hypothetical in the UK, and even if this were to change most derivative actions would fall under Part 11 of the Companies Act 2006, there is no need here to go into the question in what circumstances the restrictive conditions of the exception to the rule in *Foss v Harbottle* could be met.

While these issues raise interesting questions for corporate governance, for the reasons outlined above, there is little public policy value for competition law enforcement in such additional indemnification claims.

5. MANAGEMENT'S DUTY TO INTRODUCE COMPLIANCE MANAGEMENT SYSTEMS?

Where undertakings or their shareholders seek indemnification from managers, a necessary precondition is that the respective managers breached a duty. The active participation in cartel activity is certainly a breach. In the alternative, the failure to introduce (sufficient) compliance

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[167] Arad Reisberg, *Derivative Actions and Corporate Governance* (OUP 2007).

[168] (1843) 2 Hare 461.

[169] *Boston Trust Company Ltd v Szerelmey Ltd (No 2)* [2020] EWHC 1352 (Ch) (appealed on the technical issue whether conditional permissions to continue the claim are possible; the Court of Appeal denied such possibility but substituted an unconditional permission because the condition had been met in the meantime, [2021] EWCA Civ 1176).

[170] Cf the situation in the German Villeroy & Boch case in which the German parent company initiated an action to enforce the Austrian subsidiary's claim against the individual defendant for payment to the subsidiary (cf LG Saarbrücken (n 129), paras 110, 111). A multiple derivative action would have existed if in this case it had not been the parent's management, but shareholders of the parent that initiated the claim.

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management systems is also often alleged as constituting a breach. This section considers the circumstances under which such a failure constitutes a breach of a duty.

Even in the United States, the duty to introduce compliance schemes has not always been uncontroversial. In the 1963 case *Graham v Allis-Chalmers*, shareholders initiated a derivative action against the corporation's directors and four employees for damages suffered following bid-rigging in the electric utility sector.[171] The Delaware Supreme Court denied the directors' duty 'to install and operate a corporate system of espionage to ferret out wrongdoing', unless 'something occurs to put them on suspicion'.[172]

In *re Caremark*,[173] the Delaware Court of Chancery distanced itself from *Graham v Allis-Chalmers* and held that a 'duty to attempt in good faith to assure that a corporate information and reporting system ... exists'[174] but noted that 'only a sustained or systematic failure of the board to exercise oversight – such as an utter failure to attempt to assure a reasonable information and reporting system exists – will establish the lack of good faith that is a necessary condition to liability'.[175] In *Stone v Ritter*, the Delaware Supreme Court approved the *Caremark* standard and held that liability existed only where '(a) the director utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations ...'.[176]

There is also an indication that the *Caremark* standard will be applied more rigorously in the future. In *Marchand v Barnhill*, the Delaware Court of Chancery had considered the plaintiffs' allegations as insufficient, arguing that 'what [the] Plaintiff really attempts to challenge is not the *existence* of monitoring and reporting controls, but the *effectiveness* of monitoring and reporting controls in particular instances.'[177] The Delaware Supreme Court disagreed and reversed.[178] The Delaware Supreme Court conceded that '[a]s with any other disinterested business judgment, directors have great discretion to design context- and industry-specific approaches tailored to their companies' businesses and resources.'[179] Accordingly, where the Board makes a good faith effort, *Caremark* cases will be dismissed 'even when illegal or harmful company activities escaped detection'.[180] The Court will not 'examin[e] the effectiveness of a board-level compliance and reporting system after the fact.'[181] Instead, it asks whether the pleaded facts 'support … a reasonable inference that the board did not undertake good faith efforts to put a board-level system of monitoring and reporting in place.'[182] The defendant-directors argued that the company 'had in place certain manuals for employees regarding safety practices and commissioned audits from time to time', and that the management regularly received reports on the inspection of the production facilities from the govern-

171 *Graham v Allis-Chalmers Manufacturing*, 188 A2d 125 (Del 1963).
172 *Graham v Allis-Chalmers* (n 171) 130.
173 *In re Caremark International Inc, Derivative Litigation*, 698 A2d 959 (Del Ch 1996).
174 *In re Caremark* (n 173) 970.
175 *In re Caremark* (n 173) 971.
176 *Stone v Ritter*, 911 A2d 362, 370 (Del 2006).
177 *Marchand v Barnhill*, No CV 2017-0586-JRS, 2018 WL 4657159 (Del Ch Sept. 27, 2018), at p 18.
178 *Marchand v Barnhill*, 212 A3d 805 (Del 2019).
179 *Marchand v Barnhill* (n 178) 821.
180 *Marchand v Barnhill* (n 178) 821.
181 *Marchand v Barnhill* (n 178) 821.
182 *Marchand v Barnhill* (n 178) 821.

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ment.[183] The Delaware Supreme Court argued, however, that the existence of some measures to comply with the law did not show 'that the *board* implemented a system to monitor food safety *at the board level*'.[184] If it were sufficient to show that the board, from time to time, discussed operational matters, 'then *Caremark* would be a chimera'.[185] It concluded that '[a]lthough *Caremark* may not require as much as some commentators wish, it does require that a board make a good faith effort to put in place a reasonable system of monitoring and reporting about the corporation's central compliance risks.'[186] While *Marchand* did not explicitly change the *Caremark* standard, a shift to stricter application is perceptible.

In German *Aktiengesellschaften*, the executive board's duty of legal compliance follows from §§ 76(1), 93(1) AktG.[187] However, this does not automatically include the duty to introduce a structured compliance management system with a specific set of compliance tools.[188] Nevertheless, where the size, complexity, and risk tendency of the undertaking – especially, but not only where this tendency has already manifested itself in previous infringements – indicate that compliance may be endangered without a structured compliance scheme, the duty of legal compliance may require the introduction of a structured compliance scheme.[189]

§ 91(2) AktG additionally provides that the executive board has a duty to introduce 'appropriate measures, in particular a system of supervision, so that developments endangering the company's continued existence are recognized early'. Again, however, this does not in itself establish a duty to introduce a structured compliance management system; however, as mentioned before, depending on the complexity, volume of business and risk profile of the company, such a duty may result, when combined with the general duty of proper organization under §§ 76(1), 93(1) AktG, even where § 91(3) AktG does not apply.

After the failings of the Wirecard scandal, the German legislator introduced a new provision, § 91(3) AktG, which provides that the executive board of a listed company has the duty to introduce 'an internal control system and risk management system that is appropriate in relation to the company's volume of business and risk profile'. What this means for the duty to introduce compliance management systems is still controversial. The first question is whether the legislator intended to include compliance schemes in the term 'internal control system'. An early draft bill explicitly excluded compliance schemes, arguing that these resulted, depending on the probability of infringements in the specific company, from the general duty of

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183 *Marchand v Barnhill* (n 178) 822–823.

184 *Marchand v Barnhill* (n 178) 823 (emphasis in the original).

185 *Marchand v Barnhill* (n 178) 824.

186 *Marchand v Barnhill* (n 178) 824 (citing, inter alia, John Armour and others, 'Board Compliance' (2020) 104 Minnesota Law Review 1191 as commentators who wish for more).

187 Jens Koch, '§ 76 - Leitung der Aktiengesellschaft', in Jens Koch (ed), *Aktiengesetz – Kommentar* (19th edn, CH Beck 2025) para 19; Christoph Brömmelmeyer, 'Corporate Compliance im Kartellrecht – Besteht Regelungsbedarf?' (2014) Neue Zeitschrift für Kartellrecht (NZKart) 478–479.

188 Koch (n 187) § 76, paras 22-25. Esp in the financial sector, there may be specific requirements for a structured compliance scheme.

189 Cf LG Munich I, 10 December 2013, 5 HK O 1387/10, NZG 2014, 345, 346–347 (in the context of a bribery case of a large undertaking, requiring, inter alia, the designation of personal responsibility for compliance on the level of the executive board, the existence of a compliance scheme, active supervision of the scheme, and the existence of sufficient powers to take appropriate measures where suspicions or infringements are detected); Koch (n 187) § 76, paras 22-25.

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legal compliance; however, the government bill deleted this section.[190] What is more, the government bill considered that 'internal control systems' should also ensure general compliance with legal requirements,[191] and in the financial sector, other provisions explicitly include compliance schemes in the term 'internal control system'.[192]

Nevertheless, it is unclear what, if anything, the introduction of § 91(3) AktG changed when it comes to compliance schemes.[193] Before the legislative change, § 91(2) AktG in combination with the duty of legal conformity under §§ 76(1), 93(1) AktG could already require the introduction of a structured compliance management system, provided the complexity, volume of business and general risk tendency in the company made this the appropriate measure.[194] Under § 91(3) AktG, there is no automatic duty to introduce a specific set of compliance measures either; instead, the specific form the compliance scheme has to take depends again on factors specific to the company in question and its risk tendency. However, it is arguably possible to interpret the legislator's activity as an indication that listed companies have to introduce some form of a structured compliance management system that complies with best practices while taking into account the size, complexity and risk profile of the company in question.[195]

The main issue with an obligation to install specific compliance management systems is that it is difficult to define what an effective compliance scheme looks like; and a structured compliance management system is neither a necessary nor a sufficient condition for achieving actual compliance. It is not a necessary condition: in an undertaking where the company culture is law abiding, open channels exist for reporting problems and there is sufficient knowledge about the content of the law, a shiny compliance programme with a dedicated compliance officer and monthly trainings may be unnecessary and may in a small undertaking be too costly.[196] More importantly, the existence of a structured compliance management system is not a sufficient condition, either; indeed, structured compliance management systems may even have counterproductive effects in certain cases.[197]

For example, in the ThyssenKrupp case described above, there was a compliance management system in place, but even after competition law infringements were reported in the audit, it appears that they were allowed to continue. Compliance schemes that merely detect but do not remedy have two negative effects: first, it may be that the undertaking takes the opportunity to suppress or destroy detected evidence;[198] secondly, that those who report infringements without consequences will draw the conclusion that infringements are unproblematic.[199] Given that the detection of an infringement by a compliance scheme does not in all cases

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[190] Cf. Koch, '§ 91 - Organisation; Buchführung', in Koch (n 187) § 91, para 28.

[191] *Bundestags-Drucksache* 13/9712, 15.

[192] Koch (n 190) § 91, para 28.

[193] Koch (n 190) § 91, paras 29-31.

[194] See n 189 above.

[195] *But see* Koch (n 190) § 91, para 31, who argues for 'generous interpretation' and would only require *some* systematization of compliance measures.

[196] Wils, 'Antitrust Compliance Programmes' (n 11) 63–66.

[197] Wils, 'Antitrust Compliance Programmes' (n 11) 61.

[198] Wils, 'Antitrust Compliance Programmes' (n 11) 61.

[199] As pointed out above, the ArbG Essen (n 88) even took the company's inactivity after the director-defendant had reported suspicions of competition infringements in an audit as a reason to consider that the defendant had sufficiently discharged his duty of supervision (see the judgment

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require that the infringement is reported to the authorities,[200] this may be more than a merely theoretical possibility.

Possibly even more frequent than compliance management systems that detect but do not react are cases where the compliance officer is kept in the dark by those engaging in infringements.[201] Especially in these cases, it is important that the compliance scheme does not work as a 'how-not-to-be-detected' tutorial.[202] An especially bad idea are arguably mock dawn raids.[203]

Nevertheless, in companies of a certain size and complexity, a well-crafted compliance scheme is very likely on balance a benefit from a public interest perspective. Ignorance of competition law is still an important contributor to competition law infringements,[204] and compliance schemes provide a structured framework for educating managers, as well as providing a clear channel for reporting (suspicions of) infringements.[205]

6. MANAGEMENT'S DUTY TO APPLY FOR LENIENCY?

It was mentioned above that it can be corrosive to the corporate culture if suspicions or evidence of infringements are brought to the attention of the compliance officer and no (visible) measures are taken to address the issue.

The problem is that, at least in Germany, there is no general duty for the undertaking or its management to apply for leniency even where competition infringements or the suspicion of infringements are brought to their attention.[206] While the duty of legality requires that the infringement be terminated immediately, and there is a duty of the executive board to inform the supervisory board where there is a sufficiently substantiated suspicion of an infringement,[207] this duty does not in itself require bringing past infringements to the attention of the authorities.[208]

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at paras 101, 108, 110–120, esp 117 in relation to exclusive dealing, and 133, 134, 141 in relation to the price and quota cartel), an interpretation that seems, at a minimum, problematic.

200 See Section 6.

201 Wils, 'Antitrust Compliance Programmes' (n 11) 62–63 with further references in n 35.

202 Wils, 'Antitrust Compliance Programmes' (n 11) 61.

203 Wils, 'Antitrust Compliance Programmes' (n 11) 61.

204 Stephan (n 42) 28, paras 5–9; Combe and Monnier-Schlumberger (n 5) 3 para 10. However, there is arguably a certain mismatch between those companies with a knowledge deficit and those with a compliance scheme: while genuine ignorance of competition rules seems more likely in smaller or medium-sized undertakings (Combe and Monnier-Schlumberger (n 5) 3 para 10), these will often not have the luxury of having a dedicated compliance scheme.

205 Stephan (n 42) 31, para 25.

206 Martin Schockenhoff, 'Geheimhaltung von Compliance-Verstößen' (2015) Neue Zeitschrift für Gesellschaftsrecht (NZG) 409, 410, according to whom the reason for rejecting a general duty to report to authorities is taken to be the principle of *nemo tenetur se ipsum accusare*. It is debatable, however, whether legal persons should be able to rely on *nemo tenetur*, see the German Federal Constitutional Court (BVerfG), 26 February 1997, 1 BvR 2172/96, NJW 1997, 1841.

207 Schockenhoff (n 206) 415–417; Dreher and Burkhart (n 71) 460ff.

208 Dreher and Burkhart (n 71) 463.

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Instead, from a corporate governance perspective, the private corporate interests are usually the yardstick for the decision whether to apply for leniency, unless special rules, in particular financial market regulations, require disclosure. Except for such special rules, it is generally the balancing of private costs and benefits that determines whether there is a duty on management to apply for leniency, and this will, among other things, depend on the probability that the infringement will be detected in the absence of a leniency application by the undertaking in question.[209] Where the probability of such independent detection is sufficiently high, the leniency prize (in the form of immunity for the first-comer or at least a substantial reduction for significant value added) will often make the decision to apply for leniency superior, and management will be duty-bound to apply for leniency. Conversely, where the probability of outside detection approaches zero, it may be privately profitable to sweep the problem under the carpet.[210]

Unfortunately, the decision to apply for leniency is not as clear-cut as the frequent invocation of the 'prisoner's dilemma' suggests.[211] Instead, undertakings need to balance a variety of factors for and against a leniency application.[212] On the one hand, in addition to the leniency prize with regard to fines and possibly avoidance of individual sanctions,[213] a quick and proactive resolution with those harmed by the infringement may get the problem off the table, possibly with limited reputational damage.[214]

If no leniency application is made, and the infringement comes to light later, not only will the leniency prize be forgone, but the reputational damage will likely be higher – especially where the capital market places value on the 'G' of ESG, i.e, governance.

On the other hand, it may be uncertain whether the undertaking would indeed be the first to report the infringement, although the marker system arguably reduces this problem

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[209] Ian S Forrester and Pascal Berghe, 'Leniency: The Poisoned Chalice or the Pot at the End of the Rainbow' in Beaton-Wells and Tran (n 40) 159, 165–171; Stephan and Nikpay (n 40) 139, 152–154; Schockenhoff (n 206) 410, 414–415.

[210] Of course, it would in this case be even more profitable to continue with the infringement; but *this* is not permissible under German law, because the duty of legality does not recognize the balancing of private benefits against the cost of infringement of the law (see n 71 above).

[211] If leniency programmes were (as is often claimed) a prisoner's dilemma, the decision to apply would be the dominant strategy and would be chosen regardless of the other players' actions. For the case that continuation of the infringement is a possibility, Motta and Polo have shown that the game is a stag-hunt game instead, with two equilibria, the risk-dominant and the payoff-dominant equilibrium: Massimo Motta and Michele Polo, 'Leniency Programs and Cartel Prosecution' (2003) 21 International Journal of Industrial Organization 347; see also Massimo Motta, *Competition Policy – Theory and Practice* (Cambridge University Press 2004) 194–202. Under German law, this is not an available option (well, not a legal one) once the undertaking has detected the infringement. However, for the reasons explained in the text following this footnote, applying for leniency may still not be a dominant strategy.

[212] See references in n 209 above.

[213] See Article 23(1), (2) of the ECN+ Directive (Directive 2019/1/EU); in the US, the Antitrust Division Leniency Policy and Procedures provide that in the case Type A Corporate Leniency, current directors, officers and employees are immune from criminal prosecution as long as they cooperate; in the case of Type B Corporate Leniency, non-prosecution protection is discretionary.

[214] See the AirCargo/Lufthansa case study by Howard Bergman and D Daniel Sokol, 'The Air Cargo Cartel: Lessons for Compliance' in Beaton-Wells and Tran (n 40) 301.

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substantially. Nevertheless, even if it can be ascertained that the undertaking would be the first immunity applicant in one jurisdiction, this need not guarantee that the same is true in all other jurisdictions.[215] The continuing cooperation requirements for leniency applicants are onerous, their fulfilment may depend on employees or managers that were intimately involved in the infringement, and failing to comply with the cooperation requirements may make the leniency prize disappear. It is possible that some individuals fear individual sanctions in some of the affected jurisdictions and refuse to cooperate.[216] Moreover, assuming all public sanctions can be avoided, even a successful immunity or leniency application leaves private claims largely unaffected and may make the leniency applicant an attractive target for claimants. Reputational damage may follow the admission of the infringement.

Although there is no general duty to disclose infringements independent of the company's utilitarian interests, such a duty may result in special cases from financial market regulations, in particular capital market rules.[217] The fact that antitrust law was infringed, or that sanctions could be imposed in the future, may need to be disclosed as insider information under Article 17 MAR[218] or as material information in a prospectus when emitting financial instruments on the primary market.[219]

From a public interest perspective, it is of course regrettable that it is largely the private interests of the company that determine whether an internally discovered infringement will be brought to the attention of the competition authority. This merits two observations.

First, the duty of legality requires that any on-going infringement is immediately terminated, and that failure to terminate the infringement is a breach of the executive board member's duty resulting in liability towards the company. This, in turn, also means that where there are first indications of an infringement, the failure to investigate further would also constitute a breach of the duty of legality. While this still does not result in a duty to *disclose* the infringement, the duty to *investigate* credible indications of an infringement is part of the duty of legality and therefore absolute; that is, not subject to a balancing of the company's private interests. This must be the case even where continued investigations significantly increase the

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[215] Cf Case 428/14 *DHL Express (Italy) v AGCM*, EU:C:2016:27. The problem could be attenuated if there were a one-stop shop at least for the filing of marker applications on a global or at least the EU level. See John Taladay, 'Time for a Global "One-Stop Shop" for Leniency Markers' (2012) 27(1) Antitrust 43.

[216] This is not necessarily a problem: whether there is a conflict depends on the legislator's choice how to reconcile individual sanctions and leniency (see n 213). Within the EU, this would not have been a problem at all if the Commission's proposal for the phrasing of Article 23 of the ECN+ Directive (Directive 2019/1/EU) had become the law, which would have provided all-round protection against individual sanctions for cooperating individuals but the Council's intervention (apparently driven by Germany, which seems to relish the conflicts between § 298 StGB and the Bundeskartellamt's leniency programme) resulted in the limitation to the protection in Article 23(3) Directive 2019/1/EU with regard to criminal sanctions.

[217] Schockenhoff (n 206) 411–414.

[218] Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) [2014] OJ L173/1, art 7, 17; Koch (n 187) § 76, para 32; Schockenhoff (n 206) 412–413.

[219] Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market [2017] OJ L168/12, art 6; Schockenhoff (n 206) 413–414.

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risk that the infringement is detected by the public.[220] Also, the potential necessity to publicly distance itself from the infringement in order to terminate participation in the infringement, and the documentation duties which are the precondition for board members later relying on the business judgment rule mean that at least public enforcement through inspections (or, perhaps more theoretically, requests for information) is facilitated.[221] In addition, where the undertaking publicly distances itself from an infringement vis-à-vis its co-infringers, the thus increased probability that one of these co-infringers applies for leniency (because detection has become more likely) is itself a consideration that increases the undertaking's private costs of not applying for leniency. In these cases, it seems unlikely that not applying for leniency is a justifiable course of action for the management.

Secondly, the consequence that a low probability of detection may result in the corporate decision not to apply for leniency (or, indeed, take any action except for the termination of the infringement) once more points to the importance of increasing the probability of detecting cartels in ways that do not rely on leniency programmes. If the probability of detection by outsiders were sufficiently increased, the decision not to apply for leniency would not be a justifiable one. Measures to increase the probability of detection are, for example, the use of market screens,[222] possibly the use of rewards for whistleblowers,[223] and in particular, the use of individual criminal sanctions combined with individual immunity programmes.[224]

7. COMPLIANCE SCHEMES AND ANTITRUST SANCTIONS

It was noted above that compliance management systems are arguably net beneficial to competition law compliance and enforcement, but that there is not always a general duty to introduce compliance management systems.[225] This has led to the frequent call for incentivizing undertakings to introduce compliance schemes, in particular, to grant a rebate for the existence of effective compliance schemes when setting fines. There is no space here to discuss all the arguments exchanged on this topic.[226] The European Commission, in my view rightly,

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[220] But see Schockenhoff (n 206) 411, who considers that the decision whether or not to follow up on indications of a breach is to be decided in the discretion of the executive board, and that the executive board may limit or eschew further investigations if these would significantly increase the risk of detection. This would, however, make a mockery of the duty of legality (see n 71 above).

[221] Dreher and Burkhart (n 71) 464–465.

[222] See, eg, Kai Hüschelrath, 'How are Cartels Detected? The Increasing Use of Proactive Methods to Establish Antitrust Infringements' (2010) 1 Journal of European Competition Law & Practice 522; Rosa Abrantes-Metz, Luke Froeb, John Geweke and Chris Taylor, 'A Variance Screen for Collusion' (2006) 24 International Journal of Industrial Organization 467.

[223] On 6 June 2023, the CMA announced that it would increase the maximum reward for whistleblowers from GBP 100,000 to GBP 250,000.

[224] The main benefit of the individual immunity programme would (as enforcers in the US concede with some regularity) be that the increased number of potential leniency applicants increases the chances of detection so that companies have an incentive to make use of the corporate leniency programme; indeed, if the probability of outside detection is sufficiently high, leniency programmes may be turned into a prisoner's dilemmata after all.

[225] See Section 5.

[226] For references, both pro and contra, see n 11 above.

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rejects such a compliance scheme discount. In contrast, the German Federal Court of Justice decided in 2017 (in the context of tax avoidance) that a compliance management system is to be taken into account as a mitigating factor when setting the fine.[227] The main reason why I consider the discount to be inappropriate is that it is difficult, if not impossible, to distinguish from an outsider's (competition authority's or court's) perspective a compliance scheme that is based on an earnest intention to avoid infringements from a mere façade. Of course, one can attempt to measure the quality of the compliance management system to some extent – how frequent are briefings; is top management involved; are detrimental aspects avoided, etc. However, all these factors, while perhaps distinguishing bad schemes from better schemes, cannot get to the factors that really matter for a law-abiding corporate culture.

To avoid a misunderstanding from the outset: the mere fact that an infringement occurs despite the compliance management system does not necessarily mean that the compliance management system is an ineffective one.[228] Despite the best of intentions and efforts, it is still possible that an infringement occurs.

In law and economics terms, the question really is whether liability for a compliance failure[229] should be strict liability or liability for negligence.[230] A negligence regime is usually preferable where there is the possibility of bilateral precaution, while strict liability may be preferable if only the tortfeasor can influence the level of care. Only the undertaking can influence the quality of the compliance scheme. A negligence regime is sensitive to errors with regard to the required standard of care, while under a strict liability regime, there is no required standard of care; under a strict liability regime, the tortfeasor simply internalizes the entire expected damage, and therefore has an incentive to minimize the expected harm (which equals the expected fine/damages to be paid) by taking optimal precautions. Here, as mentioned above, it is very difficult for outsiders to observe and verify what the appropriate standard of care is (what does a good compliance scheme look like, and what is the corporate culture in the company like) and whether that standard has been met in a specific case. A negligence regime is therefore difficult to establish and to enforce. In contrast, the undertaking is in a better position to assess whether a compliance scheme is a façade or whether the corporate culture truly engenders legal compliance in daily life; the undertaking is in a better position to find the optimal precautions. Strict liability regimes are more sensitive to errors in quantum of damages: if the quantum is set too high, in a strict liability regime too high a level of precaution will be chosen, and if the quantum is set too low, there will be correspondingly more infringements. In contrast, negligence regimes tend to be more robust vis-à-vis errors

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[227] BGH, 9 May 2017, 1 StR 265/16, (2017) 67 Wirtschaft und Wettbewerb 456, 457, para 118.

[228] This is how Competition Commissioner Almunia's statement on this question ('to those who ask us to lower our fines where companies have a compliance programme, I say this: if we are discussing a fine, then you have been involved in a cartel; why should I reward a compliance programme that has failed', Speech of 25 October 2010) is frequently interpreted, esp by proponents of a discount.

[229] Note that the question is only whether *liability for the compliance failure* should be strict liability; of course, *the infringement* has to have been committed negligently or intentionally to attract a fine under Article 23 of Regulation (EC) 1/2003.

[230] Interestingly, Riley and Sokol (n 11) 40 correctly point out that the European Commission's approach is 'a strict liability legal theory', but do not then discuss the usual factors that determine whether negligence or strict liability is the better approach.

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of quantum. However, quantum errors are arguably not the most pressing issue here. A strict liability regime will not only lead to the optimal level of precaution, but also to the optimal activity level; whereas under a negligence regime, once the required standard of care is met, activity levels will be too high. In our context, this last argument is attenuated because the question is not (as is usually the case in negligence liability) whether liability is zero where the requisite standard of care is met, but only whether there will be a discount from the fine. In other words, even under a negligence regime the undertaking would arguably not be tempted too much to engage in more risky activity just because they have a 'state-of-the-art' compliance scheme, as they would still have to pay, e.g., 90% of the fine once an infringement occurs and is detected. Furthermore, a negligence regime will produce administrative costs to determine whether the legal standard of care was met; the competition authority would have to expend resources into determining the quality of the compliance scheme, and where the undertaking challenges the authority's assessment, courts would have to assess this as well. These costs do not exist under a strict liability regime. While strict liability regimes are often said to produce higher administrative costs because they entail a higher number of cases, this does not apply here, because all the cases in question here are enforcement cases anyway. Lastly, a negligence regime sets a fixed standard of care, and this is set in stone, unless the standard of care is revised; once the undertaking has reached this standard of care (and therefore, under the negligence regime, the compliance scheme discount), there is no incentive to improve on the level of precaution by innovation. Under a strict liability regime, however, undertakings retain an incentive to improve on their compliance scheme by innovation.

All this is a lengthy way to say that strict liability automatically rewards good schemes, and only good schemes: the expected fine is reduced due to the lower probability of an infringement. This endogenous level of reward depending on the quality of the scheme has the advantage that it is not dependent on the assessment by any outsider.

It has been argued that it is easier to persuade management of the necessity to introduce a compliance management system if a compliance scheme discount can be dangled as a carrot in front of management.[231] However, a manager who does not understand that the expected damages (through fines and third-party damages) will be reduced by reducing the probability of an infringement, but instead wants to see a discount on a fine once it has been imposed, does not really belong in management.

Another suggestion is to allow a discount to the fine where the undertaking promises to introduce an effective compliance management system in the future. This approach has been taken in France and Germany. However, at least theoretically, this could result in the perverse incentive not to introduce a compliance management system before the first infringement is detected, unless there is already an inherent incentive for the undertaking to introduce such a system;[232] and if there is an inherent incentive, there is no need to reduce the fine in the first place. Finally, one could consider an *increase* of the fine for the *absence* of a compliance scheme as a solution.[233] If the fine against the undertaking were at exactly the optimal level or higher, this would indeed be a less problematic option. However, if we are in world where – as I consider more likely – corporate fines are still suboptimal, there is no difference between

[231] Geradin (n 11) 338.

[232] Wils, 'Antitrust Compliance Programmes' (n 11) 79.

[233] Cf Wils, 'Antitrust Compliance Programmes' (n 11) 77–78 (making a proviso against the lowering of the baseline level of the fine, and skeptical of the solution for further reasons).

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giving a bonus for having a compliance management system in place or attaching a malus for not having such a system in place. Accordingly, the same arguments that make the bonus system unattractive also counsel against introducing a malus system.

8. THE CONCEPT OF UNDERTAKING AND PIERCING THE VEIL

A question that logically precedes the shifting of the burden to managers or other individuals is the question, on whom the sanctions (fines or damages) are to be imposed in the first place, especially because the amount of the sanctions may heavily depend on this question. Competition infringements are committed by 'the undertaking', and this concept transcends the notion of the legal entity and may encompass several legal entities into a 'single economic unit' (or 'single economic entity'). Accordingly, conduct from one legal entity may be imputed to another legal entity within the same single economic unit, and fining decisions may be issued against all legal entities within a single economic unit. From the perspective of company lawyers, this is anathema.

It would go too far here to develop the entire concept of undertaking in the European Union.[234] It has been around for some 50 years,[235] and many issues are well rehearsed. It is a functional concept, and it serves many different functions. Unsurprisingly, then, it has many different facets. Its usual definition – any 'entity engaged in an economic activity, regardless of the legal status of the entity and the way in which it is financed',[236] with the addition that economic activity is 'activity consisting in offering goods or services on a given market'[237] – is only helpful when it comes to some functions, such as excluding private consumption or genuine state activity from the purview of competition law.

The function of the undertaking in our context is a different one, and one where the aforementioned definition does not help. The question here is what the boundaries of the undertaking are in terms of sanctions (in the broader sense, that is, including private enforcement[238]).

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[234] For more detail on the concept of undertaking in the context of the interaction between competition law and corporate law see Thépot (n 2) 33–129; C Urraca Caviedes, 'Concept of Undertaking and Allocation of Liability for Antitrust Fines' in Kris Dekeyser, Céline Gauer, Johannes Laitenberger, Nils Wahl, Wouter Wils and Luca Prete (eds), *Regulation 1/2003 and EU Antitrust Enforcement – A Systematic Guide* (Wolters Kluwer 2023) 539–546 (with further references at 545–546); for a thorough economic analysis see Koenig (n 15). See also Stephen Daly and Alison Jones, 'The Undertaking and Single Entity Doctrine in EU and UK Competition Law: Proposals for a Refined Approach', Chapter 7 in this Handbook, 128; Thomas K. Cheng, 'The Single Economic Entity Doctrine', Chapter 8 in this Handbook, 152; Marcos Araujo Boyd, 'Undertakings and Legal Entities as Addressees of Articles 101 and 102 TFEU', Chapter 9 in this Handbook, 170; Carsten Koenig, 'Enforcement of EU Competition Law Against Groups of Companies: The Calculation of Fines', Chapter 10 in this Handbook, 193.

[235] Case 48/69 *Imperial Chemical Industries v Commission* EU:C:1972:70, [1972] ECR 619, paras 132–141; Case 52/69 *JR Geigy v Commission* EU:C:1972:73, [1972] ECR 787, paras 44, 45.

[236] E.g., Case C-41/90 *Höfner and Elser v Macrotron* EU:C:1991:161, [1991] ECR I-1979, para 21; Case C-205/03 *FENIN* EU:C:2006:453, [2006] ECR I-6295, para 25.

[237] E.g., *FENIN* (n 236) para 25.

[238] For the equivalent treatment of the concept of undertaking in fining and damages cases see *Skanska* (n 13); *Sumal* (n 4) para 38.

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In that context, the Court has stated that 'the concept of an undertaking … must be understood as designating an economic unit even if in law that economic unit consists of several persons, natural or legal'.[239] It is that economic unit that has to answer for an infringement under the principle of personal responsibility,[240] although the decisions have to be addressed to individual legal (or natural[241]) persons. While the *infringement decision* is thus addressed to one or more legal persons within the single economic unit, the *conduct* of legal or natural persons is imputed to the undertaking under certain conditions. The typical case is that a subsidiary's conduct is imputed to the parent: '[T]he conduct of a subsidiary may be imputed to the parent company in particular where, although having a separate legal personality, that 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, organisational and legal links between those two legal entities …'.[242] Where the parent holds 100%, or nearly 100%,[243] of the capital, or all the voting rights,[244] the parent can exercise decisive influence over the subsidiary's commercial policy, and there is a rebuttable presumption that the parent did exercise decisive influence.[245]

Even after 50 years of discussing the concept of undertaking, new facets continue to be developed. In *Skanska*, the Court held that the concept of the single economic unit determines the entity liable not only for fines but also for compensation, because EU law determines that it is the undertaking that infringes competition law and that it is the infringer that is liable for compensation.[246] In *Sumal*, the Court decided that it was also possible that the subsidiary is liable where the parent infringed competition law: it is, after all, the single economic unit constituting the undertaking that is liable.[247] However, in this scenario, it becomes particularly

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[239] Case C-97/08 P *AKZO Nobel v Commission* EU:C:2009:536 [2009] ECR I-8237, para 55 and the case law cited; also cf *Sumal* (n 4) paras 39, 41.

[240] *AKZO Nobel* v *Commission* (n 239) para 56 and the case law cited.

[241] This was considered in the pre-insulated pipes case, but natural persons so far have not been considered undertakings by the EU institutions. See Wils, 'EU Antitrust Fines and Managerial Liability' (n 42) 585 in n 12; for the 'sequel' of the individual who had been spared being classified as an undertaking see n 38.

[242] Joined Cases C-628/10 P and C-14/11 P *Alliance One and Standard Commercial Tobacco v Commission* EU:C:2012:479, para 43; see also Case C-179/12 P *Dow Chemical v Commission* EU:C:2013:605, para 52; *AKZO Nobel* v *Commission* (n 239) para 58; this goes back to the earliest cases on the economic unit, namely *ICI* (n 235) paras 133, 134; *Geigy* (n 235) para 44.

[243] Case C-521/09 P *Elf Aquitaine v Commission* EU:C:2011:620, [2011] ECR I-8947, paras 63, 95 (where Elf Aquitaine held 98% of the shares; it did not, on appeal, challenge in principle that the presumption applied at this level of ownership). In Case C-595/18 P *The Goldman Sachs Group v Commission* EU:C:2021:73, para 34, the Court reports that it was common ground that 91% and later 84% of the capital was not, in itself, sufficient to trigger the presumption.

[244] *The Goldman Sachs Group* (n 243) para 35.

[245] *Alliance One and Standard Commercial Tobacco v Commission* (n 242) paras 46–48; *AKZO Nobel* v *Commission* (n 239) paras 60, 61; Case C-393/23 *Athenian Brewery and Heineken v Macedonian Thrace Brewery* ECLI:EU:C:2025:85, para 37.

[246] *Skanska* (n 13) para 28ff; *Sumal* (n 4) paras 34, 38; *Athenian Brewery* (n 245) paras 28, 29.

[247] *Sumal* (n 4) paras 39–52. See previously already Case T-677/14 *Biogaran v Commission* EU:T:2018:910, paras 206–234, esp 213–220 (and, for the proposition that the subsidiary need not have knowledge of the parent's infringing conduct, paras 221–234); however, in *Biogaran*, there was complementary conduct of the parent and the subsidiary that constituted the infringement,

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relevant that the boundaries of the single economic unit are not structurally fixed: the single economic unit constituting the undertaking cannot be determined by ticking off boxes in the way it can be done under Article 5(4) of the EC Merger Regulation[248] to determine the persons whose turnover is relevant in the context of concentrations. Instead, given that the concept of undertaking is a functional one, the boundaries of the single economic unit need to be determined in the relevant context, and the constitution of the single economic unit may differ from infringement to infringement.[249] In order to determine whether a subsidiary is liable for fines or damages for an infringement, the question is whether the parent's conduct can be imputed to the subsidiary, and this is the case where, first, the general 'economic, organisational and legal links' that are always necessary to show the economic unit are present, and, second, a 'specific link between the economic activity of that subsidiary and the subject matter of the infringement' exists.[250] The Court's approach is close to the approach British courts had chosen early on: the relevance of the undertaking as a single economic unit but with what is known as an exception for the so-called 'shoe-polish subsidiary', that is, a subsidiary active in a completely different relevant market.[251]

This case law raises quite a number of questions for the competition-corporate governance intersection. First, there is the question what 'economic, organisational and legal links' are sufficient to result in a single economic entity. Outside the rebuttable presumption where the parent holds all or virtually all of the subsidiary's capital or voting rights,[252] actual exercise of decisive influence needs to be shown.[253] There is not, however, a closed catalogue of links that can establish such decisive influence – they 'may vary from case to case and cannot therefore be set out in an exhaustive list'.[254] For the discussion of compliance management systems covering corporate groups, it may be relevant that one of the factors contributing to the conclusion that *Schindler* actually exercised decisive influence over its (joint-venture) subsidiary was that the parent audited the subsidiary's compliance with the code of conduct,[255] and in

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and there was also (disputed) evidence that the subsidiary was aware of the parent's exclusionary conduct.

[248] Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation) [2004] OJ L24/1.

[249] *Sumal* (n 4) paras 45, 47.

[250] *Sumal* (n 4) paras 46–52.

[251] For an overview of the English case law see Florian Wagner-von Papp, 'Private Enforcement in the United Kingdom' in Ferdinand Wollenschläger, Wolfgang Wurmnest and Thomas MJ Möllers (eds), *Private Enforcement of European Competition and State Aid Law* (Wolters Kluwer 2020) 161, 176–179. The main principles had already been developed in *Roche v Provimi* [2003] EWHC 961 (Comm). English courts for a long time required 'knowing implementation' of the infringement. However, the requirement that the implementation must have been 'knowing' had already been questioned before *Sumal*: *Media-Saturn Holding v Toshiba* [2019] EWHC 1095 (Ch), [146]–[157] (discussing *Biogaran* (n 247)). The path chosen by the Court in *Sumal* appears equivalent to the standard for 'implementation' chosen at the strikeout stage in *Provimi*, namely that it was sufficient that the defendant trades in products affected by the infringement.

[252] See text at nn 243, 244 and 245 above.

[253] *Dow Chemical* (n 242) paras 55, 56.

[254] *Alliance One* (n 245) paras 45; *Dow Chemical* (n 242) para 54.

[255] Case T-138/07 *Schindler Holding and others v Commission* ECLI:EU:T:2011:362, para 88: '[T]he implementation within the subsidiaries of Schindler Holding of that code of conduct rather

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Dow Chemical the instruction to the subsidiary to open an internal investigation was likewise interpreted as one of the factors indicating actual exercise of decisive influence.[256]

Secondly, there is no denying that most corporate lawyers (and some competition lawyers) perceive this case law with distaste or at least great suspicion.[257] The principle of limited liability is, after all, seen as a fundamental concept in corporate law – and what good are the intricate and only highly exceptionally applied doctrines for piercing the corporate veil if the European institutions ride roughshod over boundaries between separate legal entities?

When contrasting the doctrine of the single economic unit in competition law with the company law doctrine of separate legal entities and their limited liability, it has to be recalled that the Court of Justice could not invoke 'EU company law principles' or any particular company law: there were and are many different national company laws in the EEC, EC, and EU. This was precisely the reason why the autonomous concept of the 'undertaking' was used in the ECSC, EEC, and later the EC and now FEU Treaties. The autonomy of the concept is most obvious in the English language, where, when translating the terms '*Unternehmen*'/'*entrepri ses*', the artificial term 'undertaking' was chosen as a deliberately awkward term to alert the reader not to confuse the European concept with any of the manifold concepts from the various national company laws. Accepting national company law definitions of the boundaries of legal entities would have subjected European law to the whim of national laws and this would have clashed with the principle of the primacy of EU law.[258] Similarly, there is not – and there certainly was not at the time – any 'EU law doctrine of piercing the corporate veil'.

Of course, this does not mean that the Court of Justice was or is unaware of the concept of legally separate entities or the exceptional circumstances under which the legal separation may be overcome in company law. Limited liability allows investment without the fear of losing more than one's investment, so that capital can be collected for large ventures in the form of small contributions from a multitude of persons who cannot sufficiently monitor and control the venture. Limited liability is required for the diversification of shareholder portfolios

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suggests that the parent company did in fact supervise the commercial policy of its subsidiaries, particularly since the applicants themselves have confirmed that compliance with the code of conduct was checked by means of regular audits and other measures taken by an employee of Schindler Holding responsible for compliance (a compliance officer).'

[256] See Case T-77/08 *Dow Chemical v Commission* ECLI:EU:T:2012:47, para 88: '[T]hat investigation was ordered by the parent companies in order to examine whether the joint venture might have participated in the cartel. The fact that the parent companies were engaged in the implementation of that investigation confirms that they believed that they had the means of requiring their joint venture to conduct itself in accordance with the competition rules' (affirmed in *Dow Chemical* (n 242) para 70).

[257] Leddy (n 15); Koch, '§ 1 - Wesen der Aktiengesellschaft' in Koch (n 187) para 21 (with further references); see also the references in Koenig (n 15) 286 in n 18 (Koenig himself considers the single economic entity doctrine to be economically justified), and in Thomas Ackermann, 'Das Unternehmen als wirtschaftliche Einheit: Zur Expansion eines unionskartellrechtlichen Konzepts' (2023) Zeitschrift für Europäisches Privatrecht 529, 531 in n 7, 8 (Ackermann takes a moderate critical stance: while agreeing with the traditional case law and Koenig's arguments for making the parent liable for the subsidiary's actions as putting substance over form [at 538–544], he criticizes the extension to the subsidiary's liability – or laterally between subsidiaries – as itself a formalistic approach to the concept of the single economic unit [at 544–551, 564–565]).

[258] Ackermann (n 257) 534–535.

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and the liquidity in the market for shares. However, limited liability has its drawbacks as well. Any limitation of liability externalizes part of the harm of potentially harmful conduct (at least where involuntary creditors are concerned[259]), so that there will be – as in any case of negative externalities – more risky activity than socially desirable because the social costs of the activity exceed the private costs, and the decision-makers only consider their private costs. This tendency towards excess risky activity, which is inevitable in a system of limited liability, is exacerbated by opportunistic behaviour due to moral hazard.[260]

The widespread use of limited liability stems from the 19th century's necessity to collect large sums of funds for big capital expenditures in railways and the industrial revolution, where individual investors would not otherwise have invested – in a system of unlimited liability, small investments might have had enormous downside risks, and the separation of ownership and control, as well as large information asymmetries, add principal-agent problems; efficient diversification of shareholder portfolios would be prevented. In this context, it is understandable that removing the benefits of limited liability must be a very rare exception. The conditions for such rare exceptions, of course, depend on the applicable company law, but abstracting from details they include, for example, cases in which the limited liability company is used as a principal's 'mere instrumentality' or 'alter ego', where the shareholder abuses the corporate form by intermingling assets, or cases of extreme under-capitalization. In addition to the doctrine of piercing the corporate veil, German corporate law also provides for a system of payments within corporate groups, which is, however, dependent on whether or not parent and subsidiary have entered into a 'control agreement' or a 'profit and loss absorption agreement'.[261]

It has been pointed out long ago that the reasons for limited liability are less pressing, and perhaps less persuasive, where involuntary creditors are concerned and the target of the piercing is not an individual as a shareholder but another company that itself has limited liability. The persuasiveness of the reasons for limited liability is further reduced where the principal-agent problem is attenuated or eliminated because the target-shareholder controls the subsidiary.[262] One of the fathers of ordoliberalism, Walter Eucken, was radically against limited liability, based on the core principle of responsibility: 'he who has the benefit must also bear the costs'.[263] According to Eucken, limited liability was 'acceptable only where a capital source is not, or only to a limited extent, responsible for the management of the company, for example, the dispersed shareholder or the limited partner in a limited partnership. If, however, in a group of companies it is the legal person of the dependent subsidiary that is

[259] Where voluntary – in particular contractual – creditors are concerned, Coasean bargaining generally internalizes these seeming externalities (they have a choice of contracting out of limited liability). Cf Ronald Coase, 'The Problem of Social Cost' (1960) 3 Journal of Law and Economics 1.

[260] Koenig (n 15) 312–316.

[261] §§ 302, 291 Aktiengesetz.

[262] Koenig (n 15) 302.

[263] Walter Eucken, *Grundsätze der Wirtschaftspolitik* (6th edn, JCB Mohr, 1952/1990, edited by Edith Eucken and K Paul Hensel) 279 (author's translation). For similar scepticism of joint stock companies see Adam Smith, *An Inquiry into the Nature and Causes of The Wealth of Nations* (The University of Chicago Press, 1776/1976, edited by Edwin Cannan, with a new preface by George J. Stigler) Vol Two, Bk V, Ch 1, Pt III, Art 1, 277-282.

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exclusively liable, while the controlling shareholder takes the relevant decisions, this limitation of liability is incompatible with a competitive order.'[264] He concluded that it was 'necessary that shareholders holding a larger share of a corporation are liable for the liabilities of the corporation'.[265] Even more radical is, of course, Hansmann and Kraakman's approach, which abolishes limited liability in favour of unlimited pro-rata liability for corporate torts.[266]

Corporate law and economics literature has also recognized that 'enterprise liability' – a concept that is not identical, but close to the single economic unit concept – poses different questions from piercing the veil through to individual shareholders. Nevertheless, this literature predominantly rejects enterprise liability.[267] The main reason for this rejection is that the 'Theory of the Firm' by Ronald Coase[268] and the resulting field of new institutional economics identified a choice (and continuum) between contract and vertical integration based on the respective costs of the respective institution (market or hierarchy), so that enterprise liability would result in higher relative costs of vertical integration and accordingly vertical disintegration and outsourcing to independent firms. Again, however, the preconditions for this incentive in the antitrust context are unlikely to be strong. First, as Koenig has pointed out, the activities relevant in antitrust cases are generally too close to the core business function to be outsourced.[269] Secondly, where the group does not outsource to an independent entity, but only restructures to a horizontal relationship of the former 'parent' and 'subsidiary',[270] there are only two options: one possibility is that there are shareholders who control both these companies, in which case, they may still form a single economic unit with both these companies.[271] Alternatively, there could be no controlling shareholders, in which case there is no

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[264] Eucken (n 263) 281 (author's translation).

[265] Eucken (n 263) 282–283 (author's translation), noting that this could also be extended to cases where the controlling entity was a natural person or partnership. His proposal was to change the German law on Aktiengesellschaften to make the controlling shareholder under § 15(2) AktG liable for the controlled entity's liabilities. Eucken considered the then-current use of limited liability within groups of companies (which, in the past 70 years has increased rather than decreased) to be one of the reasons for the 'anonymous power' and the 'depersonalization' of the economy (at 281 and 285). See also Lynn Stout, 'The Economic Nature of the Corporation', in Francesco Parisi (ed), The Oxford Handbook of Law & Economics (Vol. 2, OUP, 2017) 337, 340-341 (sceptical as to the inevitability of limited liability for the rise of public corporations, and in particular where controlling shareholders are concerned).

[266] Henry Hansmann and Reinier Kraakman, 'Towards Unlimited Shareholder Liability for Corporate Torts' (1991) 100 Yale Law Journal 1879.

[267] See, e.g., Richard Posner, *Economic Analysis of Law* (9th edn, Wolters Kluwer 2014) § 15.7, 560–561.

[268] Ronald Coase, 'Theory of the Firm'(1937) 4 Economica 386.

[269] Koenig (n 15) 318–319.

[270] See Figure 1 in Koenig (n 15) 317.

[271] However, the Court of Justice stated 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 with the result that, under Community competition law, the actions of one company can be attributed to the other and that one can be held liable to pay a fine for the other.' See Case C-196/99 P *Aristrain v Commission* ECLI:EU:C:2003:529, para 99. One could see this differently: cf in German law § 36(3) GWB. In any case, the statement of *Aristrain* only mentioned the 'simple fact … in itself', so that the exercise of decisive influence and the 'specific link' required by *Sumal* may change the assessment.

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interest in holding both these companies to account, and the same is true where true outsourcing through contract takes place. Where the company outsources activity to an independent entity, and this entity infringes competition law, both the benefits and the liability lie with the independent entity; there is no reason why the infringing independent entity would pass on the benefits of the infringement to the company.[272] Accordingly, the company would not have any incentive to facilitate infringements by the independent contractor, and there would be no reason to hold the company liable for the independent entity's conduct.

German corporate legal academics in particular object to the single economic unit liability concept that the parent does not have the legal power to control the subsidiary's individual decision-making absent a control agreement (and, conversely, where such a control agreement exists, the controlling shareholder is already under an obligation to cover the subsidiary's losses). This, however, underplays the de facto dynamics within corporate groups, even where there are no de iure control agreements. Koenig has rightly pointed out that '[t]he managers of the subsidiary can be expected to know who is deciding their fate. If not, the parent company may look out for a different management',[273] and also that there are often dual appointments between parents and subsidiaries.[274] Parent companies are well placed to scrutinize the conduct of their subsidiaries, in particular through group-wide compliance schemes and audits, influence the subsidiary's choices via performance expectations, and benefit from their subsidiary's infringements.[275]

In the context of parental liability for antitrust infringements, it is therefore unsurprising that the Court of Justice fashioned a construct, the single economic unit, whose internal divisions into separate legal entities under national company laws were of less relevance than is the case in any national company law. As described above, the Court requires that the parent controls the subsidiary by exercising decisive influence (rebuttably presumed to exist where the subsidiary is wholly owned or virtually wholly owned or controlled via voting rights[276]). In contrast, the justifications for limited liability in national company laws consider as their starting point minority or even dispersed shareholders and presuppose difficulties in monitoring management and other shareholders. Where parent companies with controlling stakes are concerned, the persuasive power of the arguments in favour of limited liability is limited from the start, and the balance between the benefits of limited liability and its dangers in externalizing costs and of opportunistic conduct shifts therefore in the direction of unlimited liability within the economic unit.[277]

Accordingly, the single economic entity liability of the parent for the subsidiary's infringements is justified in principle.[278]

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[272] In contrast, Koenig (n 15) writes, at 318, that 'the benefits could be passed on to the "customer"'. However, in the absence of the infringing entity being controlled, I can see no reason why the independent entity would want to pass on the benefits.

[273] Koenig (n 15) 301.

[274] Koenig (n 15) 302–303.

[275] Wils, 'Antitrust Compliance Programmes' (n 11) 59–60; Wils, 'EU Antitrust Fines and Managerial Liability' (n 42) 588; Koenig (n 15) 301–304, 308, 310.

[276] See text at nn 243, 244, 245.

[277] Koenig (n 15) 314–316; see also, more generally, Eucken (n 263) 281–285.

[278] The same conclusion is reached, e.g., by Koenig (n 15); Wils, 'Antitrust Compliance Programmes' (n 11) 59–60; Wils; 'EU Antitrust Fines and Managerial Liability (n 42) 588; and,

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Even accepting the parent's liability, however, a number of additional issues can be raised.

Thépot is not alone in suggesting that the parent's liability should not be strict but negligence-based: where the parent can show that 'adequate internal measures' in the form of an effective compliance management scheme were taken, parental liability should be averted.[279] The reasons why I do not share this particular view of hers are the ones that I have outlined above in the context of fine reductions for the existence of compliance schemes. Being able to avert parental liability where an effective compliance scheme is present would indeed result in an incentive to introduce some form of compliance scheme; but the effectiveness of the compliance scheme in the overall incentive structure and corporate culture would necessarily remain questionable: there simply is no good way to distinguish a mere box-ticking exercise from a genuine commitment to a compliant culture. It should be noted that Thépot would, presumably for these reasons, place the burden of proof for the assertion that the internal measures were 'adequate' on the parent company.[280] My point is mostly that this is a *probatio diabolica* – there is no way to prove the adequacy, and in any event the administrative costs – namely a protracted argument about the quality of the compliance scheme in every case – would outweigh the benefits. For the reasons discussed above,[281] strict liability is preferable: it sets an endogenous incentive for the parent to install a truly effective compliance scheme.

Another point for discussion is whether the reasoning above justifies not only the parent's liability for its subsidiary's transgressions, but also the subsidiary's liability for its parent's (or sibling's) infringements. If one is willing to take the concept of the undertaking as single economic unit seriously, or if one is simply averse to limited liability within an enterprise in general, the answer is relatively simple, and is to be answered in the way the Court of Justice did in *Sumal* (and the General Court in *Biogaran*).[282] This reasoning has been criticized as formalistic.[283] Not all of the reasons that justify the parent's liability for the subsidiary's actions also justify the reverse scenario. The subsidiary does not control the parent and has no power to supervise it or to introduce compliance schemes in the parent company;[284] the subsidiary will not *generally* derive profits from the parent's competition law infringements. In the 'regular' case of parental liability for the subsidiary's actions, any minority shareholders of the parent at least stood to profit from the infringement and have minority rights (in extremis: to exit) to induce the controlling shareholder to ensure the subsidiary's compliance. In contrast, where the parent's conduct is imputed to the subsidiary, any minority shareholders in the subsidiary had no such opportunity (except to exit).[285]

The Court of Justice's apparent acceptance of the 'shoe-polish exception' by requiring – in addition to the decisive influence of the parent on the subsidiary – a 'special link between the subsidiary's economic activity and the subject matter of the infringement' is an acknowledgement of sorts that the mere invocation of the concept of the single economic unit may not be

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to this extent, Ackermann (n 257). Contra, e.g., Leddy (n 257), Koch (n 257), and the literature referenced in the sources mentioned in n 257.

279 Thépot (n 2) 48–65.

280 Thépot (n 2) 65.

281 See Section 7.

282 See n 247 above.

283 Ackermann (n 257).

284 Ackermann (n 257) 547.

285 Cf Ackermann (n 257) 548–549.

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sufficient. Unless one wants to leave it at the formal 'single economic unit' argument, one could ask whether there should be further requirements, such as the necessity of the subsidiary's 'implementation' or even 'knowing implementation' of the parent's infringement before the parent's conduct is imputed to the subsidiary. The same question can, a fortiori, be asked where sibling companies within a group of companies are concerned. However, even though the substantive arguments for imputing the parent's conduct to the subsidiary are weaker than in the reverse case, holding the subsidiary liable under the Court's additional requirement of a 'special link' appears justified.

The 'special link' the Court of Justice required in *Sumal* is arguably a specific emanation of the requirement mentioned in the General Court's decision in *Biogaran* that imputation of conduct requires that 'each part of [the] undertaking must have contributed to its implementation, even in a subsidiary, accessory or passive role'.[286]

Requiring additionally a 'knowing' implementation by the subsidiary would create loopholes, given that the parent has decisive influence over the subsidiary. The substantive reason for which the joint and several liability of the subsidiary for the parent's infringing conduct is desirable is that the parent may implement an infringement by using the subsidiary as an unwitting (or at least not provably witting) tool for implementation, in particular by channelling sales and profits to the subsidiary.[287] If the subsidiary were not included in the single economic unit in these circumstances, the relevant sales would not be included in the fines calculation. The justification for burdening minority shareholders in the subsidiary is not fault-based – they cannot realistically force the parent to comply – but based on potential gains. Such a shifting of gains is more likely where the subsidiary is wholly owned or substantially wholly owned by the parent. In contrast, the participation of minority shareholders reduces the likelihood of the controlling parent shifting profits to the subsidiary; the greater the share of the minority shareholders, the more of the profits would be externalized to the minority shareholders, and the less likely this is to happen. It is to be hoped, therefore, that the Court will take seriously the 'special link' criterion, and pay special attention to it where minority shareholders are involved in the subsidiary.

The ease with which corporate groups appear to deal with de facto enterprise liability when it comes to European antitrust fines, despite their magnitude, raises the much more general question whether the trade-off between the advantages and disadvantages of limited liability within the enterprise is worth a second look; but this is not the place.

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[286] *Biogaran* (n 247) para 225, although the cases referenced there do not really support the proposition, given that they referred to attribution in the context of the single and continuous infringement and facilitators.

[287] The General Court pointed out in *Biogaran* (n 247) para 226: 'It would be sufficient for a parent company to apportion the unlawful conduct between itself and its subsidiary and to argue that the subsidiary was unaware of the parent company's conduct in order for the part of the infringement resulting from the subsidiary's direct participation in the infringement to be imputed only to the subsidiary.' This, however, is not the problematic direction: the subsidiary's conduct can be imputed to the parent under the general principles. The problematic case is the reverse one: the parent would have to apportion the conduct such that the subsidiary implements the parent's infringing conduct unknowingly but nevertheless profits from the infringement; in that case, the danger would be that the subsidiary's sales could not be included if a 'knowing' implementation were necessary.

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9. CONCLUSIONS AND OUTLOOK

This chapter has primarily looked at three of the intersections between competition and corporate law from the perspective of optimal, or at least moderately effective, sanctions that deal with the allocation, and possible reallocation, of duties and responsibility within the undertaking: indemnification actions, legal compliance schemes, and the boundaries of the undertaking.

Indemnification actions against directors, officers and employees force the direct conflict between the company law concept that these persons should generally be liable for damages inflicted on the company, on the one hand, and the competition law concept that the full effectiveness of corporate sanctions needs to be ensured so that the company is incentivized to take all proper steps to avoid antitrust infringements.[288] The discussion showed that allowing indemnification for fines would create the incentive for the company to seek indemnification from merely negligent individuals so as to recover the fines ultimately from D&O insurance. Far from creating, as proponents of indemnification actions claim, efficient incentives for individuals, this shifting of the corporate fine to D&O liability insurance destroys efficient incentives for both the undertaking and the individuals. It would be a recipe for positively *encouraging* competition law infringements, at least until D&O insurers limit their coverage or the moral hazard destroys the D&O insurance market. An alternative would be to prohibit the insurance against antitrust fines by law. In that case, indemnification actions would at least deter the individual. However, it would still mean that, where the individual has sufficient funds to indemnify the undertaking for more than a negligible proportion of the fine, the full effectiveness of the corporate sanction would no longer be ensured (also, potentially ruinous liability even for negligently overlooking that others infringed antitrust laws would make it exceedingly difficult to find anyone willing to act on a corporate board). The preferable view is therefore that the company's indemnification by directors, officers or employees should not be allowed for reasons of public policy. Similar arguments could be made regarding the indemnification for third-party *damages claims* to the extent such claims add to deterrence. However, here the arguments are weaker: as private parties are not under a public duty to bring such claims or see them through, the shifting of funds can arguably not be prevented for public policy reasons.

Regarding optimal sanctions, the chapter has shown repeatedly that private claims may serve a subsidiary role in deterring infringements, but that they are inherently unreliable. Whether, to what extent, and against whom they are enforced depends on the private interests and fancies of potential or actual claimants. This is a commonplace when it comes to corporate sanctions: hardly anyone in Europe argues that public fines could be dispensed with because of the possibility of private enforcement (although there are some who propose considering damages paid by the undertaking to third parties to be a mitigating factor when setting the fine,[289] which would, problematically, de facto result in a partial transformation of fines into damages). It is also true, however, when it comes to the deterrence of individuals. Such deterrence of individuals would be of prime importance if corporate sanctions were already optimal, that is, if the undertaking had *ex ante* no incentive to infringe competition law, and

[288] Section 4.
[289] E.g., Makatsch (n 37) 642.

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infringements were owed to 'rogue agents'; in that case, the principal-agent problem would necessarily have to rely on individual deterrence. Even in the more likely case that corporate sanctions are still suboptimal, however, individual deterrence is important to incentivize individuals to resist the undertaking's explicit or, more often, implicit attempts to induce these individuals to engage in infringing conduct. Therefore, deterrence of individuals is necessary both when corporate fines are optimal and when they are suboptimal.[290] Some have argued that the individual's liability towards cartel victims or towards the company (in indemnification actions) could be the way to deter individuals. For the reasons outlined above,[291] this is not an option. Instead, just as a corporation's private antitrust liability is not a substitute to corporate fines when it comes to protecting competition in the public interest, the individual's private liability towards cartel victims or towards the infringing company is not a substitute to public law sanctions against the individual: if it were, whether individual deterrence is actually achieved would be subject to the discretion of a potential claimant. Accordingly, there is a strong case for public law sanctions, and – because administrative fines can be compensated and DDOs have little practical effect – in particular criminal sanctions against individuals.[292]

Any liability of individuals is subject to a breach of their duties, and the interplay of competition law and corporate governance is to be considered when it comes to the assessment whether duties have been breached. The law is reasonably clear that the individual must act lawfully, so that individuals may be liable where they infringe competition law by their own actions. Less clear is the scope of duties when it comes to the monitoring of others and the introduction of compliance schemes. Good compliance schemes, coupled with a genuine corporate culture of law abidance, are undoubtedly an excellent thing to have. From a company law perspective, the introduction of a structured compliance management system is not always mandatory, but with increasing size and complexity of the company a duty to introduce such a system may arise.[293] While there is a duty to *investigate* infringements to comply with the duty of legality, there is, under general company law, not necessarily a duty to *report* detected infringements. However, such a duty to report may arise under financial market rules, such as Article 17 MAR. Apart from such exceptions, the decision whether or not to apply for leniency, after a compliance scheme has uncovered an infringement, is predicated on a balancing of the private interests of the company.[294] This already shows that compliance schemes primarily serve the private interests of companies, not the public interest. Accordingly, there is no reason to publicly subsidize compliance schemes.[295] The often demanded and in some jurisdictions available bonus for the existence of compliance management systems in the setting of fines procedure would only create an incentive to install a form of compliance management system that just reaches the threshold to secure the bonus. As the quality of the compliance scheme and culture depends, for the greatest part, on factors not verifiable from the outside, a bonus would only create the incentive to introduce 'box-ticking' compliance schemes. Nor is such a bonus necessary to create an incentive: a good compliance scheme (whether formalized or not) will pay for itself by reducing the probability of an infringement and increasing the

290 Sections 2 and 4.
291 Sections 3 and 4.3.
292 See the references in n 5.
293 Section 5.
294 Section 6.
295 See Section 7.

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probability that if there is an infringement, it is reported sufficiently quickly to benefit from leniency immunity or reduction of the fine. This endogenous reduction in the *expected value* of the fine is the reward for effective compliance efforts and will be proportionately greater the better the compliance efforts are (whether observable from the outside or not). If management does not recognize these endogenous benefits of a good compliance scheme, it may be time for a change of management.

Frictions between (national) company law and competition law are created by the fact that it is the 'undertaking' that infringes competition law and fines are imposed on legal entities within the undertaking as a single economic unit. Company lawyers consider this to be anathema absent the conditions for piercing the corporate veil. While the effect of the single economic entity indeed resembles the 'enterprise liability' (piercing) doctrine, the specific conditions under which EU competition law is confronted with the problem justifies the less stringent conditions of parental liability in competition law when compared to the restrictive conditions established by piercing-the-corporate-veil doctrines in national company laws. The reasons for the recently established liability of subsidiaries for their parent's conduct (or possibly even for liability between sibling companies) are weaker than for the 'traditional' parental liability. Nevertheless, the special-link requirement established in *Sumal* for this scenario, combined with the possibility that the subsidiary benefited from the parent's infringing conduct, justifies the Court's approach in this new scenario.

This chapter has looked at the interplay of corporate governance and competition law sanctions. In the future, corporate governance consequences of competition enforcement will become more common, in particular where theories of harm are involved that have an inherent connection to corporate governance such as minority shareholdings in competitors, common ownership, or hybrid platforms. Terminating an infringement in these cases automatically forces competition authorities to find remedies that will have, possibly intrusive, corporate governance implications.

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24. Management Liability for Companies' Antitrust Fines

Jens-Uwe Franck and Till Seyer

1. INTRODUCTION[1]

Where a company is fined for antitrust infringements, the question that arises is whether it can recover the fine or at least some of it from its directors and officers. These managers may be held responsible for infringing compliance duties, either by committing an antitrust infringement through their own dealings or by failing to take sufficient precautions to prevent infringements by other employees.

Courts in the UK and Germany have found that the success of such recourse actions[2] could be contrary to the policy of antitrust fining. The fine, so it has been argued, must ultimately burden shareholders. If they could pass the fine on to their managers, this would undermine the intended deterrent effect. The company would no longer have sufficient incentive to ensure the effective prevention of antitrust infringements.

Although courts have relied on various doctrinal considerations rooted in national law to reject claims for recourse against (former[3]) managers, the main instrumental argument that has been invoked is the effect of managerial liability on the deterrent objective of antitrust fines. This argument may be particularly relevant in the context of EU antitrust infringements: given the obligation of sincere cooperation, Member State law must not undermine the effective sanctioning of EU antitrust law violations – whether fines are imposed by the Commission or by national antitrust authorities. The effectiveness requirements of EU law may therefore be crucial when considering managerial liability under national law.

Against this background, this contribution focuses on whether the deterrent effect contemplated by antitrust fines indeed requires a ban or a limitation of managerial liability. It

[1] For valuable comments and suggestions, we are grateful to the editors, the participants of a workshop in Mannheim on 27–28 March 2023, in particular Marcos Araujo Boyd and Florian Wagner-von Papp, as well as the participants of the 18th ASCOLA Annual Conference in Athens on 29 June–1 July 2023, in particular Paul Nihoul and Aurelien Portuese. For helpful insights into Dutch law and jurisprudence, we are indebted to David R van Wamel, Tim van Dijken, and Stephan Balthasar. Throughout this text, if not otherwise indicated, translations are by the authors. Jens-Uwe Franck gratefully acknowledges support from the Deutsche Forschungsgemeinschaft (CRC TR 224, project B05).

[2] We use the term 'recourse action' to denote any lawsuit filed against (former) directors and officers aimed at compensating the company for an antitrust fine payment, regardless of whether the lawsuit is brought by way of a shareholder derivative suit, filed by the (new) board of directors or by any other entity authorized to act on behalf of the company.

[3] In practice, liability actions are often brought after a change of management (as it can go hand in hand with a change of control, for example) or by a liquidator after the company has gone bankrupt.

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will be argued that neither is the case. While the availability of recourse claims against the management may weaken the deterrent effect of the fine on the company and its shareholders, a prohibition on recourse claims – as well as the prohibition on other internal sanctions or salary cuts that result in a flow of money from the managers to the company triggered by the fined antitrust infringement – would deprive the company of an essential tool for controlling the behaviour of its managers.

This also holds true if the availability of D&O insurance is included in the analysis. It is true that the deterrent effect of cartel fines may not work perfectly as a result of deficiencies in the design of D&O insurance and its regulatory framework. However, we do not find that these deficiencies are of such magnitude as to render the deterrent effect of management liability for antitrust fines impossible or to undermine it on a broad scale. Should this prove to be wrong, this should be a reason to regulate D&O insurance but not to call into question managers' recourse liability.

Finally, although unlimited recourse liability may entail a risk of over-deterrence with respect to managers, these risks are not considered to be so significant as to make a limitation indispensable to the policy of antitrust fines.

We will present our findings in six steps. First, we highlight five cases in which management liability for antitrust fines has been litigated. While, in one Dutch case, a former director was held liable, the judgments in the UK and Germany provide us with a good illustration of how courts have justified the denial of recourse liability against directors and officers and how they have framed their arguments (section 2). Next, we will show that the main purpose of antitrust fines is to prevent infringements and that the intended deterrent effect is based on the threat of a cash outflow from the company in the event of an infringement. Consequently, when defining the scope of management liability for antitrust fines, company law must in principle take into account the deterrence rationale of such fines. In the case of an infringement of EU antitrust law, this may result in the EU law principles having a regulatory impact on national company law (section 3). In the main sections of this contribution, which consider management liability as an instrument of corporate law and governance, we examine whether, in order to ensure adequate deterrence as envisaged by the law on antitrust fines, management's liability should be barred or limited to prevent under-deterrence of the company. We will advocate that this is not the case (section 4) even if D&O insurance and its regulatory shortcomings are taken into account (section 5). At the same time, from the point of view of the adequate deterrent effect of antitrust fines, there is no need to limit managerial liability in order to avoid over-deterrence of the management. From a company law perspective, however, a restriction may seem reasonable (section 6). We then briefly consider the parallel issue of managerial liability for antitrust damages owed by the company to cartel victims (section 7). Section 8 concludes.

2. RECOURSE ACTIONS BEFORE NATIONAL COURTS: THE NETHERLANDS VS THE UK AND GERMANY

Managerial liability cases are typically negotiated out of the public eye. For different reasons, the parties involved – the companies and their (former) managers, as well as the insurers – have an interest in reaching a discreet settlement. This is all the more true when it comes to recourse liability for antitrust fines. But the fact that these disputes are usually resolved

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through out-of-court settlements or arbitration proceedings does not mean that the legal framework is irrelevant. After all, the parties negotiate in the shadow of the law.

Below we present five cases[4] that came to light when they were litigated in court. While the court in the *Heiploeg* case found in favour of the plaintiffs, the recourse claims in the four other cases were dismissed. These latter judgments are particularly instructive for us because they contain considerations as to why managerial liability may be considered problematic in cases of antitrust fines.[5]

2.1 The Heiploeg Case

In the Heiploeg case, the District Court of Noord-Nederland assumed the liability of a former company director for an antitrust fine.[6] The verdict was confirmed by the Court of Appeal of Arnhem-Leeurwarden.[7] The director lodged an appeal with the Hoge Raad against this decision, but the case was settled a short time later.[8]

The litigation followed a fining decision by the European Commission. In 2013, the latter had fined four companies for their participation in the North Sea shrimps cartel.[9] The fine imposed on Heiploeg was the highest, amounting to approximately EUR 27 million. When the company went bankrupt in 2014, Heiploeg's trustees in bankruptcy claimed damages from various former managing and supervisory directors. While most of the directors settled with

[4] It should also be noted that there are ongoing proceedings before the Regional Court of Dortmund, Germany, which also relate to the recourse liability arising from the imposition of antitrust fines. The court has made public two indicative orders ('*Hinweisbeschlüsse*') in which it explains why, in contrast to the decisions of the three German courts analysed below, it is of the opinion that the recourse liability of managers cannot be excluded. The court intends to stay the proceedings with regard to the recourse liability for the antitrust fines as it expects the Federal Court of Justice (Bundesgerichtshof) to clarify the legal situation in the course of an appeal against the judgment of the Düsseldorf Higher Regional Court in the *Stainless Steel Companies* case presented below in section 2.5. See LG Dortmund 8 O 5/22 (Kart), order of 21.6.2023 and order of 14.8.2023, Juris ('Construction Cartel').

[5] Obviously, we cannot claim to have a complete overview of the relevant case law in Europe. In any case, recourse liability is widely discussed in the legal literature. The debate in Austria, for example, has been remarkable. Under section 11 of the Austrian Act on Corporate Criminal Liability (Verbandsverantwortlichkeitsgesetz), managerial liability for corporate fines is excluded. Although this provision is not (directly) applicable to fines imposed under EU or Austrian antitrust law, some authors argue for its application by analogy. See Daniel Madari, 'Die Regressfähigkeit von Kartellgeldbußen' (2021) 50 Der Gesellschafter 14, 19–20. However, there are voices in the literature to the contrary. See Manuel Steiner, 'Der Kartellbußgeldregress' (2023) 22 Zeitschrift für Gesellschaftsrecht und angrenzendes Steuerrecht 21, 25–29.

[6] Rechtbank Noord-Nederland 23.9.2020, *Gerald Willem Breuker*, ECLI:NL:RBNNE:2020:3292. See Tialda Beetstra and Mariska Van De Sanden, 'The Dutch District Court of Noord-Nederland Holds a Former Director Personally Liable for the North Sea Shrimps Cartel *(Gerard Willem Breuker)*' (September 2020) Concurrences N°97360.

[7] Gerechtshof Arnhem-Leeuwarden 6.12.2022, ECLI:NL:GHARL:2022:10497.

[8] Information provided by Mr Tim van Dijken, Dorhout Advocaten, on 22 March 2024.

[9] Case AT.39633 *Shrimps* [2014] OJ C453/16.

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the trustees (apparently in consultation with their D&O insurers[10]), one did not and was subsequently sued in court.

It was found that the defendant director had been directly involved in the administration of the (fined) price fixing arrangements and had thus breached his managerial duties towards the company. As a result, the claim based on directors' liability under Article 2:9 of the Dutch Civil Code succeeded, and the former director was held personally liable for damages of about EUR 13 million.

Before the Court of Appeal, the former company director argued that liability would undermine the intended effect of the fine.[11] He relied on the decision of the Landgericht Saarbrücken in the *Villeroy and Boch* case, which will be referred to below.[12] The court rejected the argument. On the one hand, it distinguished the case at hand because, given that the company was bankrupt, only its creditors, and not the company, would benefit from a recourse payment by its former managers.[13] On the other hand, the court also stated that the managers' liability does not relieve the company of its obligation to pay the fine.[14] The former argument is somewhat surprising from a doctrinal point of view: should it really mean that liability arises only with the bankruptcy of the company? Besides, the company's creditors can benefit from the liability regardless of the company's bankruptcy.[15]

Moreover, the court stressed that manager liability is in line with the objective of EU competition law, which is to allow anyone to claim compensation for the harm caused by a cartel.[16] At this point, the court referred to the ECJ's finding in *Courage* that the 'practical effect' of Article 101(1) TFEU 'would be put at risk if it were not open to any individual to claim damages for loss caused to him by a contract or by conduct liable to restrict or distort competition'.[17]

In *Courage*, as is well known, the ECJ had clarified that an innkeeper's right to claim antitrust damages from a brewery must not be a priori denied on the grounds that he himself was a party to the supply contract in violation of Article 101 TFEU. The ECJ had thus forced a change in English law, from which the Court of Appeal of England and Wales had meant to derive an exclusion of the damages claim based on the 'unclean hands' defence and the presumption that Article 101 TFEU was not intended to protect parties to an agreement in violation of antitrust law.[18]

By referring to the *Courage* doctrine, the Dutch court maintains that recourse claims by the fined company against its (former) director must not be excluded from the outset on the grounds that the company was itself responsible for the antitrust infringement (in that the conduct of its director establishes the company's fault). This would represent a remarkable extension of the ECJ's statement in *Courage* into the realm of managerial liability and, indeed,

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10 Rechtbank Noord-Nederland (n 6) para 2.34.

11 Gerechtshof Arnhem-Leeuwarden (n 7) para 6.4.

12 See section 2.3.

13 Gerechtshof Arnhem-Leeuwarden (n 7) para 6.5. See also Beetstra and Van De Sanden (n 6) 5, and A Karapetian, 'Noot' (2023) 147 Jurisprudentie Onderneming & Recht 1913, 1914, point 5.

14 Ibid.

15 A Karapetian (n 13) 1914, point 5.

16 Gerechtshof Arnhem-Leeuwarden (n 7) para 6.5.

17 Case C-453/99 *Courage v Crehan* ECLI:EU:C:2001:465, para 26.

18 Ibid paras 11–12.

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would address concerns that led the Court of Appeal of England and Wales (which, of course, is no longer bound by ECJ case law) to deny managerial liability in the *Safeway Stores* case analysed below. The reference to the *Courage* case law suggests that the Court of Appeal may have found a case of managerial liability even in the absence of the insolvency of the company.[19]

Finally, it is worth noting that the director's liability insurance company apparently stated that there was no cover because the claim had been filed late.[20] In addition, the insurance company reserved the right to refuse payment because the insurance policy excluded deliberate intent.[21]

2.2 The Safeway Stores Case

Under English law, the judgment in *Safeway Stores v Twigger* set a precedent for the denial of recourse liability for an antitrust penalty. In 2005, the UK's then antitrust authority, the Office of Fair Trading ('OFT'), launched an antitrust investigation against Safeway because of its participation in the 'dairy retail price initiatives'. In its decision, the authority imposed a penalty of GBP 5,691,553 on the firm for illegal coordination pursuant to section 2(1) in Chapter I of the Competition Act 1998.[22]

Even before the penalty decision was adopted, Safeway had brought a civil liability action against 11 former employees, including directors. While the High Court did not strike out the action,[23] the Court of Appeal held that, even if the defendants had been responsible for the illegal activities, the shareholders were not entitled to recover the penalty. The court argued that the cartel fine was grounded in personal responsibility on the part of the company; it was not regarded as a case of vicarious liability. Directors and employees could not be held liable for breaches of the Competition Act 1998. Therefore, under the principle of *ex turpi causa non oritur actio*, Safeway was barred from bringing recourse claims based on breach of contract and/or fiduciary duties and/or negligence. The rationale of the principle, pursuant to which no compensation could be sought for damage resulting from one's own criminal act, was described as ensuring consistency between the criminal and the civil justice systems:

> It would be inconsistent for a claimant to be criminally and personally liable (or liable to pay penalties to a regulator such as the OFT) but for the same claimant to say to a civil court that he is not personally answerable for that conduct.[24]

In the principal judgment, delivered by Longmore LJ, the significance of this consideration is essentially explained by how competition law conceptualizes the 'undertaking' as the addressee of the antitrust laws and the ensuing liability of the company for the antitrust infringement, reaching the conclusion that '[t]he liability is a "personal" one and that is enough

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[19] See A M Helstone, 'Noot' (2023) 52 Jurisprudentie Arbeidsrecht 479, 480.

[20] See Rechtbank Noord-Nederland (n 6) para 4.2; see also Gerechtshof Arnhem-Leeuwarden (n 7) para 6.8.

[21] Beetstra and Van De Sanden (n 6) 5.

[22] Office of Fair Trading, 26 July 2011, CA98/03/2011, Case CE/3094/03, *Dairy retail price initiatives*, 373.

[23] *Safeway Stores Ltd v Twigger* [2010] EWHC 11 (Comm), [2010] 3 All ER 577 (Flaux J).

[24] *Safeway Stores Ltd v Twigger* [2010] EWCA Civ 1472 [16] (Longmore LJ).

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to make the acts of the company "personal" for the purpose of the application of the maxim [*ex turpi causa non oritur actio*]'.[25]

The concurring judgments given by Lloyd and Pill LJJ reinforced that the antitrust fine relates to the company's own, 'personal' responsibility, which was seen as being reflected in the fact that only the company could appeal against the imposition of the fine.[26] Remarkably for present purposes, Pill LJ added a consideration to indicate the functional logic behind the rhetoric of 'consistency' between criminal (or quasi-criminal) liability and civil liability:[27]

> The policy of the 1998 Act is to protect the public and to do so by imposing obligations on the undertaking specifically. The policy of the statute would be undermined if undertakings were able to pass on the liability to their employees, or the employees' D & O insurers. Only if the undertaking itself bears the responsibilities, and meets the consequences of their nonobservance, are the public protected. A deterrent effect is contemplated and the obligation to provide effective preventative measures is upon the undertaking itself … In the present case, the policy of the Act attributes liability to the undertaking and it is for the undertaking to organise its affairs in such a way as can prevent infringements.[28]

In other words, Pill LJ argued that the deterrence effect as intended by the antitrust fine would be undermined if the shareholders did not have to shoulder the burden of the fine but could shift it to the directors and other employees, and ultimately possibly further to the D&O insurers. The reference to D&O insurance indicates that the court assumed that, if managerial liability were affirmed, it would be covered by the defendant's D&O insurance policies.[29]

Although the Supreme Court did not allow an appeal,[30] some observations in its subsequent judgment in *Jetivia v Bilta*[31] have raised expectations that the court might consider overruling *Safeway* if it were to rule on the matter in the future.[32] The case did not involve antitrust infringements but a carousel fraud that raised questions regarding the attribution of knowledge and state of mind of directors to the company and when this would bar action of the company against directors for breach of fiduciary duty. In their judgment, Lord Toulson and Lord Hodge disagreed with the principal reasoning in *Safeway Stores*. Pointing to criticism in the academic literature,[33] they argued that the company's personal responsibility for the antitrust infringement and its ensuing personal liability for the penalty could not in itself explain why the company should be barred from having recourse for the antitrust penalty against its

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[25] Ibid [27] (Longmore LJ).

[26] Ibid [36] (Lloyd LJ), [43] (Pill LJ).

[27] Ibid [29] (Longmore LJ).

[28] Ibid [44], [46] (Pill LJ).

[29] Anna Morfey and Conall Patton, '*Safeway Stores Ltd v Twigger*: The Buck Stops Here' [2011] Competition Law 57, 63.

[30] Order dated 4 April 2011.

[31] *Jetivia v Bilta Ltd (in Liquidation)* [2015] UKSC 23.

[32] Aidan Robertson, 'Pulling the Twigger: Directors and Employees Back in the Firing Line for Damages after Jetivia in the Supreme Court?' (2015) 36 ECLR 325, 326.

[33] Peter Watts, 'Illegality and Agency Law: Authorising Illegal Action' (2011) Journal of Business Law 213, 220.

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directors. Such a limitation of recourse would instead require countervailing policy reasons.[34] Lord Toulson and Lord Hodge accepted that:

> there may be circumstances where the nature of a statutory code, and the need to ensure its effectiveness, may provide a policy reason for not permitting a company to pursue a claim of the kind brought in Safeway [,]

but left undecided whether they found Pill LJ's reasoning convincing.[35] The five other Supreme Court justices in *Jetivia* were less outspoken with regard to *Safeway Stores*. Lord Mance expressed his sympathy with the position taken by Lords Toulson and Hodge, but declined to engage in any further discussion;[36] Lord Sumption, without further ado, treated *Safeway* as good law;[37] Lord Neuberger, with whom Lords Clarke and Carnwath agreed, saw no need to discuss the case, but stated that he 'would take a great deal of persuading that the Court of Appeal did not arrive at the correct conclusion in that case'.[38]

2.3 The Villeroy & Boch Case

In 2010, the European Commission fined Villeroy & Boch AG, the parent company of the Villeroy & Boch group, around EUR 70 million for price fixing; various subsidiaries were jointly and severally liable with the parent company for partial amounts of the fine.[39] Appeals brought against the decision were essentially unsuccessful.[40] Subsequently, the company took legal action against its former CEO before the Regional Court of Saarbrücken.[41] During his term of office, he was alleged to have violated preventive and supervisory duties. In particular, with regard to the Austrian subsidiary of the plaintiff, the defendant CEO was said not to have raised awareness of antitrust risks and not to have considered introducing compliance training.

For stock corporations under German law – such as the plaintiff in the *Villeroy & Boch* case – section 93(2) of the Stock Corporation Act[42] codifies directors' liability for breaches of duties owed to the company. Based thereon, the plaintiff claimed that the former CEO was liable for damages of approximately EUR 2.3 million resulting from the fine imposed by the Commission and approximately EUR 143,000 from legal advice in the course of the antitrust proceedings. This relatively small proportion – in relation to the total fine and the total legal

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[34] *Jetivia v Bilta Ltd (in Liquidation)* [2015] UKSC 23 [159]–[161] (Lord Toulson and Lord Hodge).

[35] Ibid [162].

[36] Ibid [52] (Lord Mance).

[37] Ibid [83] (Lord Sumption).

[38] Ibid [31] (Lord Neuberger).

[39] Case COMP/39092 *Bathroom Fittings and Fixtures* [2010] OJ C348/12.

[40] See Case C–656/13 P *Villeroy & Boch Austria GmbH v Commission* ECLI:EU:C:2017:54.

[41] LG Saarbrücken 15.9.2020, 7 HK O 6/16 *Vorstandsregress* Juris.

[42] Section 93(2), 1st sentence of the German Stock Corporation Act reads: 'Members of the management board acting in dereliction of their duties are liable as joint and several debtors to compensate the company for any damage resulting from their actions.' (Translation taken from https://www.gesetze-im-internet.de/englisch_aktg/index.html accessed 13 April 2025.)

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fees[43] – resulted from the fact that the action only concerned the cartel violations committed by the Austrian subsidiary during the defendant's term of office.[44]

The Regional Court dismissed the case as it considered the recourse claim time-barred. By way of obiter dictum, the court nonetheless gave its opinion on whether, as a matter of principle, such a claim could be brought:

> The Commission is … committed to a policy of public enforcement of cartels. Fines imposed by it must have a sufficient deterrent effect. Within this framework, cartel fines constitute the essential element of the deterrent effect against undertakings.
>
> The possibility of recourse of cartel fines would mitigate this effect and thus affect the core of public cartel enforcement by the Commission and, thus, of Articles 101 and 105 TFEU. Even if company law that governs the liability of directors is national law, it must not contradict the so-called general principles of EU law; these are [the principles of] non-discrimination and the protection of effet utile … However, the effet utile in relation to Articles 101 and 105 TFEU would be violated by the possibility of recourse [actions] for fines, because the company fined under EU [antitrust] law could pass on part of the fine to board members … In addition, there would also be the risk of further passing on to D&O insurers.[45]

Thus, the court clearly indicated that it was prepared to consider the passing on of an antitrust fine by way of recourse actions to directors and, ultimately, to D&O insurers, as unacceptable and, indeed, in the case of breach of EU competition law, as a violation of the principle of effectiveness. On appeal, the Saarland Higher Regional Court upheld the dismissal of the action on the grounds of limitation. With regard to the possibility of recourse as such, the court stopped short of describing the Regional Court's considerations as 'respectable' ('*beachtlich*').[46]

As reported in the media, the legal representatives of the D&O insurers followed the proceedings closely.[47] Indeed, an insurer to whom a third-party notice had been addressed by a defendant director, and who could then intervene in the litigation, would be bound by the court's findings (in particular as to a breach of duty by the director and any resulting loss) in any subsequent litigation. Whether and to what extent the insurers would have had to cover the directors' liability in this case is, however, idle speculation. After all, the above reference shows that the court saw the possibility that insurance cover would step in for the defendant's benefit and was therefore inclined to reject liability from the outset.

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[43] In total, the lawyers' fees amounted to around EUR 3.2 million, LG Saarbrücken 15.9.2020, 7 HK O 6/16 *Vorstandsregress,* Juris, para 32.

[44] See OLG Saarland 16.2.2022, 1 U 114/20, p. 9 (on file with the authors; not yet published in a database).

[45] LG Saarbrücken 15.9.2020, 7 HK O 6/16 *Vorstandsregress,* Juris, paras 150–51.

[46] OLG Saarland 16.2.2022, 1 U 114/20, p. 28 (on file with the authors; not yet published in a database).

[47] Sonja Behrens, 'Gleiss-Mandantin Villeroy & Boch bleibt auf Kartellstrafen sitzen' (Juve, 20 November 2020) https://www.juve.de/verfahren/ex-vorstand-haftet-nicht-gleiss-mandantin-villeroy-boch-bleibt-auf-kartellstrafen-sitzen/ accessed 13 April 2025.

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2.4 The Thyssenkrupp Case

The recourse actions in the *Thyssenkrupp* case attracted a lot of public attention. After the Bundeskartellamt had imposed two fines totalling EUR 191 million[48] on ThyssenKrupp GfT Gleistechnik GmbH owing to its participation in the rail cartel,[49] the company sued its former managing director in the labour courts for payment of damages in the same amount under section 43(2) of the German Limited Liability Companies Act (GmbHG).[50]

The Düsseldorf Regional Labour Court dismissed the action at second instance, rejecting the possibility of recourse liability in general. The court based its decision on a number of considerations, the main one being the sanctioning effect of the antitrust fines. It was emphasized that any fine imposed on a company was based on an implicit finding that the company had not sufficiently monitored its managers. The purpose of the fine, according to the court, is to encourage the company to exercise adequate control.[51] The court then went on to say that precisely this kind of sanctioning effect is intended by antitrust fines – whether under EU or German law – and concluded:

> This sanctioning effect can only materialize if the company is prevented from passing on the fine … to the persons acting on its behalf …. Only if the company has ultimately to carry the burden of the fine the objective of antitrust fining laws … will be met.[52]

The court seems to have considered this point so important that it repeated it later in different language:

> The fine must stay with the company and affect the owners of the company to have an impact on their future behaviour. The company owners select, hire, and appoint the directors and officers so that they also have to bear the financial responsibility for all consequences of their actions … The preventive effect on the company would disappear if the actual addressee of the rule [scil. the company] could exonerate itself easily at the expense of its directors and officers.[53]

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[48] See the Bundeskartellamt's press reports of 5 July 2012 (EUR 103 million fine imposed on ThyssenKrupp) https://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2012/05_07_2012_Schienenkartell.html?nn=3591568 and of 23 July 2013 (EUR 88 million fine imposed on ThyssenKrupp) https://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2013/23_07_2013_Schienen.html?nn=3591568 accessed 13 April 2025.

[49] The Bundeskartellamt does not publish fining decisions but only press releases as cited above (n 48), from which, however, it is not clear whether the authority also found a violation of EU antitrust law (Article 101 TFEU). This is apparent, however, from judgments on follow-on damages actions. See BGH 13.4.2021, KZR 96/18, Juris, para 10.

[50] Section 43(1) and (2) of the German Limited Liability Companies Act reads: '(1) The directors are required to conduct the company's affairs with the due care of a prudent businessperson. (2) Directors who breach the duties incumbent upon them are jointly and severally liable to the company for any damage arising.' (Translation taken from https://www.gesetze-im-internet.de/englisch_gmbhg/englisch_gmbhg.html#p0234 accessed 13 April 2025.)

[51] LAG Düsseldorf 20.1.2015, 16 Sa 459/14, Juris, para 165.

[52] Ibid para 166.

[53] Ibid para 167.

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We can also identify a consideration similar to the 'consistency' rationale put forward by the Court of Appeal in *Safeway*.[54] The Düsseldorf court maintained that, if the directors' liability under company law prevented the company and its owners from being held accountable, the civil justice system would effectively be 'correcting' a decision of the law of (antitrust) fines. However, this would mean that 'the legal system contradicts itself'.[55]

On appeal, the Federal Labour Court overturned the judgment on formal grounds, holding that the ordinary civil courts, not the labour courts, had jurisdiction to hear cases involving recourse claims for compensation for antitrust fines.[56] As a result, the case was referred to the competent regional court, which ultimately did not have to rule on the case as the parties reached an out-of-court settlement. According to media reports, the D&O insurer ultimately paid less than 10 per cent of the damages claimed by ThyssenKrupp.[57]

Even though the judgment of the Regional Labour Court did not stand, since it was overturned only on formal grounds, and given the depth of the court's reasoning, it is not surprising that it remained an important point of reference in the debate on recourse actions for antitrust fines.

2.5 The Stainless Steel Companies Case

The Düsseldorf Higher Regional Court rejected recourse liability in a case involving steel producers. An appeal to the German Federal Court of Justice (Bundesgerichtshof) is pending.[58] In a decision of 11 February 2025, the reasoning of which was not yet available at the time of writing, the Bundesgerichtshof referred to the ECJ for a preliminary ruling the question whether EU law precludes the liability of a managing director for cartel fines.

The case arose out of a fine imposed by the Bundeskartellamt on a company belonging to a group of companies (referred to in the judgment as the 'X-group') that specialized in the cold forming of stainless steel and other materials into profiles, strips, and other semi-finished products.[59] The competition authority had found that the former managing director of the company had contributed to the maintenance of a price cartel between steel producers. Although the company did not benefit from this cartel in the upstream market, the manager had apparently felt compelled to do so in order to secure supply.[60] The authority found a violation of Article 101 TFEU and section 1 of the German Competition Act, and imposed a fine on

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[54] See above n 24 and accompanying text.

[55] LAG Düsseldorf 20.1.2015, 16 Sa 459/14 Juris, para 161.

[56] BAG 29.6.2017, 8 AZR 189/15 Juris.

[57] Christine Albert, 'D&O-Versicherer zahlen für Verstöße bei Thyssenkrupp – ein bisschen' (Juve, 14 February2022) https://www.juve.de/verfahren/do-versicherer-zahlen-fuer-verstoesse-bei-thyssenkrupp-ein-bisschen/ accessed 13 April 2025.

[58] The case number of the appeal at the Bundesgerichtshof is KZR 74/23.

[59] OLG Düsseldorf 27.7.2023, 6 U 1/22 (Kart), Juris, para 2. The decision by the Bundeskartellamt was part of a series of decisions between 2018 and 2021 in which the authority imposed fines totalling around EUR 355 million on 10 special steel producers, two trade associations and 17 individuals responsible for coordinating price components and exchanging competitively sensitive information. See Bundeskartellamt, Case summary of 28.9.2021, B12-22/15 and B12-21/17.

[60] Ibid paras 8 and 103.

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the managing director and on the company. The latter then sought recourse against its (former) managing director for the amount of the antitrust fine that it had paid.[61]

The D&O insurer intervened on the side of the defendant manager. The insurer had initially refused to cover the claim on the grounds that recourse to fines for intentional, knowing antitrust infringements ('*wissentliche Pflichtverletzung*') was not insured. However, the Frankfurt Regional Court ordered the insurer to provide cover because it considered that the defendant had not acted knowingly within the meaning of the insurance terms and conditions. In this respect, the Frankfurt court had emphasized the complexity of the applicable antitrust law and had assumed that the manager had made a legal error and was entitled to assume that his actions were lawful.[62]

In essence, the Düsseldorf court agreed with the view expressed in the two German judgments analysed above that a company cannot demand reimbursement of an antitrust fine from its management, as this would undermine the sanctioning purpose of the fine. Therefore, the liability of the directors to the company should not be applicable in this scenario.[63]

The court argued that antitrust fines against the company were designed to reduce its assets. The aim was to deprive companies of the unlawfully obtained benefits resulting from the directors' breach of the law. This is one crucial element in the prevention of antitrust violations. If the company could pass the fine on to its managers, this mechanism would be undermined.[64] In fact, the sanctioning effect of the fine on the company would be completely nullified if the D&O insurer were ultimately to bear the damage to the company (and thus the fine).[65] Managers, on the other hand, would be sanctioned through other mechanisms, such as individual fines.[66]

It can be assumed that the court's reasoning was influenced by the specific circumstances of the case: the defendant manager had been fined EUR 126,000 by the Bundeskartellamt. The recourse action against him was for damages suffered by the company as a result of the antitrust fine proceedings, namely a fine of EUR 4.1 million imposed on the company and lawyers' fees of approximately EUR 1.04 million. The claims were of a painful magnitude, but one that a defendant who had worked as a business manager for many years could reasonably expect to be able to satisfy. In addition, the court had to assume that the D&O insurer would ultimately have to pay for these damages (probably in full[67]) on the basis of the previous judgment of the Frankfurt District Court. These case-specific aspects, particularly the fact that most probably the final bearer of the fine would be the D&O insurer, may have played a role in the court's reasoning.

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[61] In addition, a second company, which was also part of the 'X-group' and for which the defendant had worked as a member of the board of directors and later as its chairman, joined the proceedings as a plaintiff and claimed compensation for further costs incurred in connection with the cartel infringement. Ibid paras 2 and 35.

[62] LG Frankfurt 20.1.2023, 2-08 O 313/20 (on file with the authors; not published in a database).

[63] OLG Düsseldorf (n 59) paras 159 and 185. Note that the court did not reject the managing director's liability for damages suffered by the company due to cartel damage claims by third parties. OLG Düsseldorf (n 59) paras 1, 44, 56–57, 73–156.

[64] Ibid para 202.

[65] Ibid para 204.

[66] Ibid para 203.

[67] The insurance policy contained a limit of liability that was, however, not specified in the judgment.

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Finally, the court relied on a special characteristic of German law on antitrust fines.[68] The imposition of a fine on a company necessarily presupposes that an individual person who acted on behalf of the company can be identified as responsible for the antitrust violation. Thus, the court argued that if, according to the law on antitrust fines, a responsible natural person, typically a manager, can always be fined in parallel to the company, it would seem inconsistent to allow the fine imposed on the company to be redirected to the manager by way of recourse liability.[69]

2.6 Conclusion

While there is one case in the Netherlands in which a (former) director was held liable for an antitrust fine (*Heiploeg*), the courts in both the UK and Germany have so far rejected the availability of such recourse claims. However, in neither jurisdiction has the issue been settled by supreme court precedent. In the UK, the judgment in *Safeway* provides for a binding authority at the Court of Appeal level, but, following *Jetivia*, an overruling by the Supreme Court seems conceivable. In Germany, we find statements in lower court judgments, which were either rendered as mere obiter dictum (*Villeroy & Boch*) or overturned, albeit on formal grounds (*Thyssenkrupp*) or against which an appeal is pending (*Stainless Steel Companies*).

In analysing these latter judgments, we can identify three considerations that are particularly noteworthy for present purposes.

First, the civil justice system must not decide on managerial liability in isolation from antitrust (fining) law. Managerial liability may have to be excluded; otherwise, the rationality of the fine would be undermined.

Second, when the effectiveness of fines for breach of EU antitrust law is at issue, this is not only a question of consistency of values within the national legal system but may also become a question of EU law.

Third, the most crucial consideration underlying the denial of recourse claims is the assumption that allowing the company to pass on the antitrust fine to its directors and officers (and possibly further to the D&O insurers) would undermine the deterrent effect intended by the fine. Thus, the argument goes, the company would no longer have sufficient incentive to ensure that antitrust infringements are avoided through the selection and monitoring of directors and officers.

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[68] The significance of this consideration is therefore doubtful because, from the point of view of a company and a director or officer, it is ultimately a matter of chance whether, for example, an infringement of Article 101 TFEU will be fined by the European Commission or by the German competition authority. That this should actually be relevant to the question of whether or not there is a right of recourse does not seem very convincing. See LG Dortmund 8 O 5/22 (Kart) ('Construction Cartel'), order of 14.8.2023, sub 3, juris.

[69] OLG Düsseldorf (n 59) paras 195–200.

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3. THE DETERRENT EFFECT INTENDED BY ANTITRUST FINES AND THE PRINCIPLE OF EFFECTIVENESS

In this section, we will show that three premises of the courts seeking to deny actions for recourse are valid. First, deterring antitrust infringements is the principal objective of antitrust fines. Second, the fines are meant to have a preventive effect by affecting the shareholders of the company that is held responsible for an infringement. Therefore, in deciding whether or not a company may take recourse against its (former) directors or officers (thus effectively relieving the shareholders), company law must also have regard to the deterrence rationale of antitrust fines. Third, where a fine is imposed by the Commission, or by a Member State competition authority or court for infringing Articles 101 or 102 TFEU, the adequate consideration of the latter is not a matter of national (company) law alone but, through the principle of effectiveness, governed by EU law.

3.1 Deterrence as the Guiding Objective of Antitrust Fines

It is the guiding objective of antitrust fining to deter infringements. Even in its early case law, the ECJ clarified that it is the object of the fines provided for in Article 15 of Regulation No 17 (First Regulation implementing (then) Articles 85 and 86 of the Treaty) to 'suppress illegal activities and to prevent any reference'.[70] This has been reaffirmed and specified in later jurisprudence, the court stipulating that:

> It is settled case-law … that the fines imposed for infringements of [now] Article [101 TFEU] … are designed to punish the unlawful acts of the undertakings concerned and to deter both the undertakings in question and other operators from infringing the rules of Community competition law in future.[71]

Here, as in other judgments,[72] the ECJ has made it explicit that the purpose of the fine must be both to specifically deter the addressed undertakings from further infringements and to have a general preventive effect, encouraging other market participants to be law-abiding. The design of the fines under Article 23 of Regulation 1/2003[73] as an instrument for ensuring antitrust compliance is laid down in the underlying legislative competence pursuant to Article 103(2)(a)

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[70] Case C-41/69 *Chemiefarma v Commission* ECLI:EU:C:1970:71, para 173.

[71] Case C-289/04 P *Showa Denko KK v Commission* ECLI:EU:C:2006:431, para 16. See also Case C-100 to 103/80 *Musique Diffusion Francaise v Commission* ECLI:EU:C:1983:158, paras 105–06. Prevention of antitrust infringements has been identified in the literature as the primary goal of fines under EU law. See Ralf Sauer and Manuel Kellerbauer, 'Infringement Decisions and Penalties' in Luis Ortiz Blanco (ed), *EC Competition Procedure* (4th edn, OUP 2021) para 11.31 ('the essential purpose of penalties is to deter and persuade') and Jörg Biermann, 'Unionsrechtliche Geldbußen und Zwangsgelder' in Torsten Körber, Heike Schweitzer, and Daniel Zimmer (eds), *Immenga/Mestmäcker, Wettbewerbsrecht Band 1 EU* (6th edn, C.H. Beck 2019) Vor Art. 23 VO 1/2003 para 25 ('In the center of the Commission's and the ECJ's practice of imposing fines is negative general prevention').

[72] Case C-447/1 *Caffaro* ECLI:EU:C:2013:797, paras 36–37.

[73] Council Regulation (EC) 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.

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TFEU. The Commission mirrors these requirements in its guidelines on fines, taking it upon itself to 'ensure … the necessary deterrent effect'.[74]

The disgorgement of gains improperly made from an antitrust infringement is not to be considered an objective of antitrust fines in its own right, understood in the sense of a pursuit of corrective justice.[75] This is illustrated by the Commission's fining guidelines, which provide for the option 'to increase the fine in order to exceed the amount of gains' attributable to the infringement[76] – yet do so under the heading 'specific increase for deterrence' and, thus, only as a means to ensuring the fines' deterrent purpose.[77] In any case, fining could at most be viewed as a very imperfect mechanism for rectifying the injustice inflicted by antitrust violations because the fines collected do not reach the parties aggrieved by antitrust violations. The conferring of claims for antitrust damages constitutes a more suitable instrument for the pursuit of corrective justice.[78]

Therefore, the disgorgement of gains attributable to the infringement must, as such, not be regarded as a guiding principle for antitrust fining. It is thus not a viable normative basis for drawing implications for actions for recourse, and for evaluating and possibly justifying the courts' reluctance to pass on (in part) antitrust fines to managers responsible for an infringement.[79] This insight does not preclude limiting managerial liability for antitrust fines on grounds of distributional justice, or simply 'fairness', which might be inherent to company law – as long as it does not undermine the deterrence rationale of fines.[80]

Via the ECN+ Directive, the EU legislature has laid down requirements regarding the preventive function of fines imposed under national law for violations of Articles 101 and 102 TFEU. National competition authorities must have the power to impose 'effective, proportionate, and dissuasive fines',[81] either directly in administrative proceedings or by applying for

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[74] Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003 [2006] OJ C 210/2, para 4. See also recital 29 to Regulation No 1/2003 (n 73).

[75] See Miguel de la Mano, Renato Nazzini and Hans Zenger in Jonathan Faull and Ali Nikpay (eds), *Faull & Nikpay, The EU Law of Competition* (3rd edn, OUP 2014) para 4.36.

[76] Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003 [2006] OJ C210/2, para 31.

[77] See Antoine Colombani, Jindrich Kloub and Ewoud Sakkers in Jonathan Faull and Ali Nikpay (eds), *Faull & Nikpay, The EU Law of Competition* (3rd edn, OUP 2014) para 8.673.

[78] See below n 230 and accompanying text.

[79] If one were to see this differently, one would have to consider that typically a portion of the cartel-related profits will have been passed on to the employees of the fined company. This is obvious in the case of profit-based compensation (which is especially common among managers). Furthermore, studies suggest that – depending on the bargaining position of employees and the power of trade unions – parts of monopoly returns benefit employees through higher wages. See W Kip Viscusi, John M Vernon and Joseph E Harrington, *Economics of Regulation and Antitrust* (5th edn, MIT Press 2018) 80. Therefore, recognizing the disgorgement of cartel-induced profits from shareholders as an independent objective of antitrust fines would not justify an outright ban on recourse actions, but might even support their availability. A consistent implementation of this goal would indeed require a complex analysis of antitrust effects.

[80] See also below n 216 and accompanying text.

[81] This requirement is based on a line of jurisprudence that goes back to the ECJ's *Greek Maize* judgment; see below n 104 and accompanying text.

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the imposition of such fines in judicial proceedings.[82] The requirement pursuant to which sanctions must be 'dissuasive' points directly to an intended preventive effect: 'A penalty is dissuasive where it prevents an individual from infringing the objectives pursued and rules laid down by Community law.'[83] More specifically, to ensure a sufficient 'deterrent effect of fines'[84] and, thus, 'dissuasiveness' in the aforementioned sense, the ECN+ Directive prescribes that Member States must set the possible maximum amount of the fine at a level 'not less than 10% of the total worldwide turnover of the undertaking … in the business year preceding the decision'.[85]

As far as UK law is concerned, it suffices to refer to Section 36(7A)(b) of the Competition Act 1998, which provides that the Competition and Markets Authority (CMA) 'in fixing a penalty … must have regard to … the desirability of deterring both the undertaking on whom the penalty is imposed and others from' infringements. Thus, the UK legislature has recognized specific and general deterrence as central objectives of the imposition of fines, as has the case law of the ECJ.

3.2 Intended Deterrence Mechanism: Burden Shareholders, Incentivizing Them to Abstain from and to Prevent Antitrust Infringements

While the deterrent effect of antitrust fines has been repeatedly and unequivocally confirmed by legislatures and courts, there is little clear guidance in the case law as to how the intended deterrent effect should unfold in the case of a fined company. As far as we can see, for example, the ECJ has never explicitly stated that it is the shareholders of a company at whom the effect of an antitrust fine is directed. Since it is the 'undertaking' within the meaning of Articles 101 and 102 TFEU that infringes EU antitrust law, the court has held that, in general, 'personal liability for an infringement and the principle that the penalty must be specific to the offender and the offence' relates only to the 'undertaking per se'.[86]

Nevertheless, some more specific conclusions can be drawn from the ECJ's jurisprudence on the application of the fine rules in the event of changes in the control structure. While it is beyond the scope of this chapter to lay out in detail how the deterrence rationale unfolds in the ECJ's doctrine of 'economic continuity',[87] a reference to one basic rule will suffice for our purposes: those who controlled a company (natural or legal person) at the time of the infringement are liable for the infringement, regardless of whether the company was sold

[82] Article 13 and recital 40 of Directive (EU) 2019/1 of the European Parliament and of the Council to empower the competition authorities of the Member States to be more effective enforcers and to ensure the proper functioning of the internal market [2019] OJ L11/3 ('ECN+ Directive').

[83] AG Kokott, Case C-387/02 *Berlusconi and Others* ECLI:EU:C:2004:624, para 89.

[84] Recital 49 to the ECN+ Directive (n 82).

[85] Article 14 of the ECN+ Directive (n 82).

[86] Case C-231/11 P *Commission v Siemens Österreich and Others et Siemens Transmission & Distribution and Others / Commission* ECLI:EU:C:2014:256, para 56. See also Case T-77/08 *Dow Chemical v Commission* ECLI:EU:T:2012:47, para 74 ('Where such an economic entity infringes the rules of competition, it falls to that entity, in accordance with the principle of personal responsibility, to answer for that infringement. However, the infringement of European Union competition law must be imputed unequivocally to a legal person on whom fines may be imposed').

[87] An overview is provided in Ioannis Lianos, Valentine Korah and Paolo Siciliani, *Competition Law* (OUP 2019) 357–64.

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before the adoption of the decision imposing the fine.[88] Thus, for example, in the case of a wholly owned subsidiary that ceased its illegal activities before being sold, only the subsidiary and the original parent company will be held jointly liable, not the succeeding parent company.[89] Moreover, if the subsidiary that committed the infringement was transferred during the course of the infringement, the successive parent companies will be jointly and severally liable with the subsidiary. However, each parent company will be jointly and severally liable for only a part of the antitrust fine, which will be determined according to the gravity and the duration of the infringement for which it is individually responsible.[90]

In Germany, it was the introduction of section 81(3a) to (3e) of the Competition Act, i.e. provisions essentially equivalent to the ECJ's single entity doctrine in the case of a group of companies and the doctrine of economic continuity, that gave the legislature reason to take a stand on the preventive effect of antitrust fines:

> Antitrust fines are intended to … ensure that the fine affects the assets used for specific economic purposes of the economic operators who benefit from the offense, so that antitrust [infringements] are ultimately not profitable and the undertakings are induced to comply [with antitrust laws].[91]

Thus, regardless of the corporate structure underlying the undertaking that has committed the antitrust infringement, the desired deterrent effect should be achieved by causing the fine to deprive those assets of the financial benefit derived from the infringement.

All of this leads to the conclusion that the antitrust fines are indeed intended to have a deterrent effect by making the shareholders of the company responsible for an infringement bear the fine. Of course, this only begs the question: how is this supposed to prevent antitrust violations? The answer is twofold: shareholders should have no incentive to encourage (possibly) profitable breaches of antitrust law and they should also use their influence to prevent infringements by those acting on behalf of the company, in particular by exercising due care in the selection of their directors and officers.[92] Given the second dimension of the intended deterrence mechanisms, the finding that shareholders should bear the antitrust fines should only be a starting point for an analysis of whether the deterrence objective actually requires the exclusion or limitation of recourse actions against directors and officers: a question that we will address below.[93]

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[88] Case C-279/98 P *Cascades v Commission* ECLI:EU:C:2000:626, para 78 ('It falls, in principle, to the legal or natural person managing the undertaking in question when the infringement was committed to answer for that infringement, even if, when the Decision finding the infringement was adopted, another person had assumed responsibility for operating the undertaking').

[89] The liability, however, may pass to the acquirer if it absorbs the subsidiary which hence ceases to exist. Joined cases T-259–264 and 271/02 *Raiffeisen Zentralbank Österreich AG and Others v Commission* ECLI:EU:T:2006:396, para 326.

[90] Case C-247/11 P *Areva and Others v Commission* ECLI:EU:C:2014:257, paras 133, 139.

[91] Deutscher Bundestag, Drucksache 18/10207, 7 November 2016, Gesetzentwurf der Bundesregierung, Entwurf eines Neunten Gesetzes zur Änderung des Gesetzes gegen Wettbewerbsbeschränkungen, 88.

[92] See below section 4.3.

[93] See below sections 4 and 5.

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3.3 The Principle of Effectiveness and the Potential Leverage of EU Antitrust Law over Company Law

It is clear from the foregoing that company law must not determine autonomously – i.e., without regard to the deterrent rationale of antitrust fines – who ultimately has to shoulder the burden of the fines. In particular, if antitrust fines are imposed for a violation of EU antitrust law, it is also a matter of EU law to ensure that the intended deterrence mechanism is not undermined by an imprudent application of established doctrines of (national) company law.

Pursuant to the principle of sincere cooperation embodied in Article 4(3) TEU, the Member States must assist the Union 'in carrying out tasks that flow from the Treaties'. Member States must therefore refrain from any conduct that could undermine the effectiveness of measures taken by the EU institutions. The ECJ has elaborated and developed this general principle in various settings. For example, national time limits for bringing actions must not limit the effects of a judgment of the EU courts.[94] Member States must also refrain from entering into international treaties that could limit the scope and effectiveness of EU law.[95] Where EU law provides for individual rights, the ECJ has specified Member States' loyalty obligations through the doctrine of *Rewe* effectiveness,[96] which requires that applicable national rules must not be 'framed in such a way as to make it in practice impossible or excessively difficult to exercise the rights conferred by EU law (principle of effectiveness)'.[97] In addition, the national courts' obligation to ensure that adequate effect is given to EU law may even require the creation of new remedies, the most prominent example being the liability of Member States under *Francovich*.[98]

Against this background, it is clear that if the opportunity for a company to recover (parts of) an antitrust fine imposed by the Commission from its (former) managers does indeed jeopardize the deterrent effect of the fine, the principle of loyal cooperation would oblige the Member States to intervene and, if necessary, to adapt established doctrines of national company law. Otherwise, the Commission would not be able to fulfil its task of ensuring compliance with the antitrust rules. In line with this, the ECJ found that the effectiveness of an antitrust fining decision is significantly reduced if the company can deduct the fine from its taxable profits.[99] The Commission, acting as amicus curiae before the Belgian Constitutional Court, argued that national measures allowing tax deductibility of fines would undermine the

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[94] Case C-62/00 *Marks & Spencer plc v Commissioners of Customs & Excise* ECLI:EU:C:2002:435, para 36.

[95] Case C-469/98 *Commission v Finland (Open Skies)* ECLI:EU:C:2002:627, para 112.

[96] This case law was first laid down in Case C-33/76 *Rewe v Landwirtschaftskammer für das Saarland* ECLI:EU:C:1976:188, para 5, and Case C-199/82 *Amministrazione delle finanze dello Stato v San Giorgio* ECLI:EU:C:1983:318, para 14.

[97] Case C-505/14 *Klausner Holz Niedersachsen* ECLI:EU:C:2015:742, para 40.

[98] Joined cases C-6/90 and C-9/90 *Andrea Francovich and Danila Bonifaci and others v Italian Republic* ECLI:EU:C:1991:428, para 36.

[99] Case C-429/07 *Inspecteur van de Belastingdienst v X BV* ECLI:EU:C:2009:359, para 39. The ECJ had to rule only on the legality of the amicus curiae submission, not on the substantive issue as such.

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punitive and deterrent purpose of the fine and, thus, would go against the principle of sincere cooperation enshrined in Article 4(3) TEU.[100]

The duty of sincere cooperation under Article 4(3) TEU applies to all institutions of the Member State, including the courts. Indeed, as the ECJ has emphasized, 'it is for the national courts to interpret, as far as it is possible, the provisions of national law in such a way that they can be applied in a manner which contributes to the implementation of EU law'.[101] This obligation has its limits in general principles of law. The EU principle of effectiveness does not require courts to rule *contra legem*.[102]

Where the Member States enforce Articles 101 and 102 TFEU by imposing fines under national law,[103] they are likewise bound by the principle of sincere cooperation pursuant to Article 4(3) TEU. It should be noted that, starting with the *Greek Maize* case, the ECJ has given concrete expression to the principle as it applies to the enforcement of EU law by Member States through a specific strand of case law. Accordingly, Member States 'must ensure … that infringements of Community law are penalized under conditions, both procedural and substantive … which, in any event, make the penalty effective, proportionate and dissuasive'.[104] This latter triad of attributes has been taken up by the EU legislature and included in various measures of secondary law including, as mentioned above, in Article 13 and recital 40 of the ECN+ Directive.[105] It seems natural to merge the case law on 'effective, proportionate and dissuasive' sanctioning with other rules derived from the general requirement of sincere cooperation, thus creating a single standard under Article 4(3) TEU to ensure effective sanctioning of EU law.[106] This is in line with the fact that, in scenarios that do not concern the effectiveness of a sanction imposed by a national authority as such but rather procedural aspects of the

[100] Commission, Amicus Curiae Observations to the Constitutional Court (Belgium), *Tessenderlo Chemie v Belgische Staat*, sj.e(2012)227414, 8 March 2012, paras 25 and 29, available at https://competition-policy.ec.europa.eu/system/files/2021-02/amicus_curiae_2012_tessenderlo_en.pdf accessed 13 April 2025. Accordingly, management liability for antitrust fines must also be measured against the principle of effectiveness. It should be noted, however, that the availability of management liability is an indispensable governance tool to ensure the effectiveness of antitrust fines. See below section 4.3. This is a crucial difference from the assessment of the tax deductibility of fines. See Christian Kersting and Manuel May, 'Managerial Liability for Fines–Company Law and Principle of Effectiveness' (2024) European Competition Law Review 528, 540–541.

[101] Case C-505/14 *Klausner Holz Niedersachsen* ECLI:EU:C:2015:742, para 31.

[102] Ibid para 32.

[103] See Article 5 of Regulation 1/2003 (n 73).

[104] Case C-68/88 *Commission v Greece (Greek Maize)* ECLI:EU:C:1989:339, para 24.

[105] See above section 3.1.

[106] Thus, Advocate General Kokott referred to the yardstick of *Rewe* effectiveness to specify the effectiveness requirement under the *Greek Maize* test. AG Kokott, Case C-387/02 *Berlusconi and Others* ECLI:EU:C:2004:624, para 88. See on the interrelation between *Rewe* effectiveness and the *Greek Maize* test Michael Dougan, 'Who Exactly Benefits from the Treaties? The Murky Interaction between Union and National Competence over the Capacity to Enforce EU Law' (2010) 12 Cambridge Yearbook of European Legal Studies 73, 106–07; Folkert Wilman, *Private Enforcement of EU Law before National Courts – The EU Legislative Framework* (Edward Elgar 2015) 2.19; Christian Heinze, *Schadensersatz im Unionsprivatrecht* (Mohr Siebeck 2017) 42–44.

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enforcement of EU antitrust law by national authorities, the ECJ does not refer to the *Greek Maize* test but rather to the general case law on Article 4(3) mentioned above.[107]

In sum, we may conclude that, in cases of infringements of Articles 101 and 102 TFEU, it is (also) a matter of Union law, namely of effectiveness requirements based on Article 4(3) TEU. This is true regardless of whether these fines were imposed by the Commission, a national competition authority, or court. For the application of this standard, reference can be made to the general sanction-related case law on Article 4(3) TEU, but also in particular to the case law on the so-called *Greek Maize* test.

4. AVOIDING UNDER-DETERRENCE OF THE COMPANY'S SHAREHOLDERS (1): SHOULD MANAGERIAL LIABILITY FOR ANTITRUST FINES BE BARRED?

Company law cannot turn a blind eye to the impact that managerial liability may have on the deterrent effect of antitrust fines. In particular, when a fine is imposed for a breach of EU antitrust law, it follows from principles of EU law that possible repercussions must be analysed and taken into account. In this section, we will argue that, while these assumptions have been correctly made – for example, by the German courts as presented above – the conclusion drawn is not convincing: for the effectiveness of antitrust fines as a deterrent instrument, the availability of recourse actions is the preferred second-best solution. It is true that the prospect of being able to shift part of a potential antitrust fine onto management may weaken the optimal sanctioning effect on shareholders. However, as we will explain below, this seems to be outweighed by the fact that it leaves them with a crucial tool to address conflicts of interest in relation to their management.

4.1 Deterring Individuals vs Deterring Companies

Contemplating whether managerial liability must be precluded to preserve the effectiveness of antitrust fines, one must first appreciate that companies respond differently to financial sanctions than individuals do. If an individual is punished with a fine for an infringement of the law or is to be deterred from an infringement by the threat of a fine, the underlying preventive mechanism is straightforward. The (potential) infringer should include the possibility of a fine in their calculation of whether it is worthwhile breaking the law or not. If the amount of the fine is set correctly, considering potential profits from the infringement and the probability of detection[108]

[107] Case C-439/08 *VEBIC* ECLI:EU:C:2010:739, para 57.

[108] Anything said regarding this is inherently speculative. For Spain, for example, the probability of detection of cartels was estimated at 11.5 per cent. Javier García-Verdugo, Carlos Merino Toncoso and Ane M Martin, 'Probability of Cartel Detection in Spain: An Assessment' (2020) 11 Journal of European Competition Law & Practice 188. For the US, according to a survey of studies and opinions, the detection rate of cartels is predominantly estimated to be in the 10 to 25 per cent range. See John M Connor and Robert H Lande, 'Cartels as Rational Business Strategy: Crime Pays' (2012) 34 Cardozo Law Review 427, 462–465, 486–490, tbl. 3. See also Peter L Ormosi, 'A Tip of the Iceberg? The Probability of Catching Cartels' (2013) 29 Journal of Applied Econometrics 549, according to which less than 20 per cent of all cartels are detected.

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and punishment, it will deter deliberate breaches of the law.[109] Things are more difficult when – unlike in the case of hardcore cartels, for example – individuals cannot readily anticipate the dividing line between legal and illegal conduct. The conditions[110] and the amount of the fine may then be used to control what effort the individual will make in order to identify this line as accurately as possible (through obtaining legal advice, etc.), and how they will behave in the event of remaining legal uncertainty. The aim is that individuals are not deterred from activities that are, in fact, perfectly legal and socially desirable just because they are unclear about the legality of those activities.[111]

Where a fine, however, does not address an individual but a company, and if ownership and management do not coincide in one (or more) person(s), this mechanism is complicated by the fact that the interests of the company's owners are not aligned with those of its managers who make decisions on their behalf, a situation that is commonly referred to as an 'agency problem'. If, as assumed above, in this scenario the fines are conceptually designed to address the company's shareholders, then the point is not only that shareholders themselves should be deterred from committing or encouraging antitrust infringements but that they should be incentivized to ensure that those who run the company's business do not commit and initiate antitrust violations[112] and, moreover, actively prevent infringements by (other) employees.

See also Florian Wagner-von Papp, 'Managerial Liability, Managerial Duties, and Liability Within Corporate Groups: Optimal Competition Law Sanctions by Rearranging the Deckchairs Within the Undertaking?', Chapter 23 in this Handbook, 485–486, notes 47–52 and accompanying text.

[109] Note the dispute as to whether an optimal sanction should be calculated on the basis of the damage caused (net harm-based) or the profit made by the cartel (gain-based). Ultimately, this only concerns the question of whether efficiency gains that might occur – e.g., due to savings in production costs – should also be disgorged from the infringer or whether incentives for an 'efficient breach' should be left. For the former position, see Wouter PJ Wils, 'Optimal Antitrust Fines: Theory and Practice' (2006) 29 World Competition 183, 191–93 and, for the latter position, William M Landes, 'Optimal Sanctions for Antitrust Violations' (1983) 50 University of Chicago Law Review 652, 656, and Richard A Posner, *Economic Analysis of Law* (9th edn, Wolters Kluwer 2014) 394. It is submitted that the former position is indeed to be preferred because, by setting the antitrust laws, a line is drawn between business practices that are socially desirable and those which are not. For making this choice, legislatures are democratically legitimized and can be held accountable. Sanctions should therefore be aimed at respecting this boundary line, not deliberately leaving open the door for an 'efficient breach'.

[110] The requirement of fault may be used by authorities and courts to avoid or cushion risks of over-deterrence. See, in the context of antitrust damages liability, Jens-Uwe Franck, 'Umbrella Pricing and Cartel Damages under EU Competition Law' (2015) 11 European Competition Journal 135, 144–45.

[111] See Connor and Lande (n 108) 431 n 16.

[112] Indeed, in various studies, the point was made that senior management was directly involved in a significant proportion of detected infringements. See, e.g., Michelle Berzins and Francesco Sofo, 'The Inability of Compliance Strategies to Prevent Collusive Conduct' (2008) 8 Corporate Governance 669, 675; Andreas Stephen, 'Hear No Evil, See No Evil: Why Antitrust Compliance Programmes May Be Ineffective at Preventing Cartels' (2010) 31 The Company Lawyer 231, 235–37; Joseph C Gallo, Kenneth Dau-Schmidt, Joseph L Craycraft and Charles J Parker, 'Department of Justice Antitrust Enforcement, 1955–1997: An Empirical Study' (2000) 17 Review of Industrial Organization 75, 104–07.

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The relevance of this agency problem in the relationship between shareholders and (senior) managers is not called into question by the finding that managers involved in antitrust violations typically assume that they are indeed acting in the economic interest of their company and, consequently, of the shareholders.[113] This should come as no surprise, given that the probability of detection in hardcore cartels, for example, is speculative but certainly well below 100 per cent,[114] and the extent of the damage to the company – both short term and long term[115] – in the event of detection is difficult to predict. Therefore, regardless of whether or not management receives a signal from shareholders that (profitable) antitrust violations are acceptable, it stands to reason that management that initiates or tolerates antitrust violations will typically do so on the assumption of a positive expected value for the company – a profit from which it will also benefit itself. This assumption may be the result of a miscalculation based on an overly optimistic estimate of the (individual) risk of detection and/or the amount of potential damage to the company if detected. However, the assumption may also be flawed simply because, contrary to management's assumption, shareholders may not appreciate antitrust violations, even if they appear to be profitable ex ante: shareholders may have an intrinsic preference for compliance with the law. These two scenarios illustrate that agency problems can be real and serious even though, in the case of a profitable antitrust violation, shareholders and management alike benefit economically.

Furthermore, against the background of these two scenarios – the risks of miscalculation and the intrinsic preference for legality – the law should provide shareholders with the means to send a clear and strong signal to management that antitrust violations are unacceptable, even if they appear ex ante to be actions with a positive expected value. As we will explain in more detail below, this necessarily includes the availability of internal financial sanctions – including the option to recover antitrust fines.

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[113] This is the result of several studies on managers' motives in antitrust violations. See, e.g., Jeffrey Sonnenfeld, 'Executive Apologies for Price Fixing: Role Biased Perception of Causality' (1981) 24 Academy of Management Journal 192; Wayne E Baker and Robert R Faulkner, 'The Social Organization of Conspiracy: Illegal Networks in the Heavy Electrical Equipment Industry' (1993) 58 American Sociological Review 837; John M Conley and William O'Barr, 'Crime and Custom in Corporate Society: A Cultural Perspective on Corporate Misconduct' (1997) 60 Law and Contemporary Problems 5; see also Maurice Stucke, 'Am I a Price Fixer? A Behavioural Economics Analysis of Cartels' in Caron Beaton-Wells and Ariel Ezrachi, *Criminalising Cartels: Critical Studies of an International Regulatory Movement* (Hart 2011), 263, 267 and 275; Wouter PJ Wils, 'EU Antitrust Fines and Managerial Liability – A Legal and Economic Analysis' (2023) Wirtschaft und Wettbewerb 583, 587.

[114] See above n 108.

[115] For example, a prolonged decline in share value due to investor distrust or being excluded from public procurement needs to be considered; see Luca Aguzzoni, Gregor Langus and Massimo Motta, 'The Effect of EU Antitrust Investigations and Fines on a Firm's Valuation' (2013) 61 Journal of Industrial Economics 290; OECD, 'Director Disqualification and Bidder Exclusion in Competition Enforcement' (2022) OECD Competition Policy Roundtable Background Note 28–37 https://web-archive.oecd.org/2022-12-23/645446-director-disqualification-and-bidder-exclusion-in-competition-enforcement-2022.pdf accessed 13 April 2025.

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4.2 Ensuring Managers' Antitrust Compliance: Selection, Remuneration, Monitoring, and Sanctioning

To ensure that managers comply with their duty to ensure that the company acts in accordance with the law,[116] the shareholders – or, depending on the organizational form of the company, a body elected by them, such as a supervisory board[117] – need to overcome the said agency problem: ensuring that the managers respond to the shareholders' interest in preventing antitrust violations rather than initiating or tolerating such infringements – even if such illegal activities ex ante appear (correctly or not) to be profitable for the company and, consequently, also for the managers. Various mechanisms are available to achieve this.[118]

First, the criteria for selecting managers certainly play a role. Company law provides certain general (statutory) requirements for taking a position as a director or comparable managerial positions.[119] Beyond this, however, there will typically be broad discretion in the selection process, in the exercise of which an attempt can be made to find criteria that vouch for compliance with the law. For instance, it has been suggested that increased female representation in management positions can have the benefit of making compliance with competition law more likely.[120] In addition, it is conceivable that antitrust compliance attitudes and skills may

[116] The existence of such a legal obligation will usually be obvious and well understood. On German company law, see BGH 10.7.2012, VI ZR 341/10 Juris, para 23, and more specifically regarding compliance with antitrust law, see LAG Düsseldorf 20.1.2015, 16 Sa 459/14 Juris, para 149. See, relating to UK company law, Paul Davies, Sarah Worthington and Christopher Hare, 'Director's Duties' in *Gower: Principles of Modern Company Law* (11th edn, Sweet & Maxwell 2021) para 10-024.

[117] See, for examples of jurisdictions that provide for two-tier board structures, John Armour, Luca Enriques, Henry Hansmann and Reinier Kraakman, 'The Basic Governance Structure: The Interests of Shareholders as a Class' in Reinier Kraakman et al (eds), *The Anatomy of Corporate Law* (3rd edn, OUP 2017) 50–51. For a comparative overview of various jurisdictions in the EU, see Carsten Gerner-Beuerle, Philipp Paech and Edmund Philipp Schuster, 'Study on Directors' Duties and Liability' (LSE Enterprise, April 2013) 3–12 https://eprints.lse.ac.uk/50438/1/__Libfile_repository_Content_Gerner-Beuerle,%20C_Study%20on%20directors%E2%80%99%20duties%20and%20liability(lsero).pdf accessed 13 April 2025.

[118] As lucidly summarized by Stephen Calkins in 'Corporate Compliance and the Antitrust Agencies' Bi-Modal Penalties' 60 (1997) Law and Contemporary Problems 127, 147 ('[A company] can emphasise the quality of its people, by hiring honest employees, encouraging them to live healthy lives, and taking care of them in time of need. It can create good incentives, by tying compensation to long-term results, by refraining from exerting undue pressure, and by paying supra-competitive wages employees will not want to risk losing. It can teach and remind. It can monitor and audit. And it can threaten with whatever draconian consequences are in its power').

[119] Under German law, such statutory requirements are given pursuant to section 6(2) of the Act on Limited Liability Companies and section 76(3) of the Stock Corporation Act. See Gerhard Wagner and Fabian Klein, 'Directors' and Officers' Liability in Germany' in Simon Deakin, Helmut Koziol and Olaf Riss (eds), *Directors & Officers (D&O) Liability* (De Gruyter 2018) 162–63.

[120] Justus Haucap, Christina Heldman and Holger Rau, 'Gender and Collusion' (2021), OECD Gender Inclusive Competition Policy Project #5, 15 https://www.oecd-ilibrary.org/content/dam/oecd/en/topics/policy-sub-issues/gender-inclusive-competition-policy/gender-inclusive-competition-proj-5-gender-and-collusion.pdf accessed 13 April 2025. Gender may play a role in cartel

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be tested as part of the process of vetting management candidates. In general, for a company genuinely interested in avoiding antitrust violations (and not just in not getting caught), the trick is to select managers who are intrinsically motivated to ensure antitrust compliance and not to act opportunistically.[121] It may also be prudent to dismiss an executive if involvement (or at least a strong suspicion) in an antitrust infringement from a previous employment comes to light after he or she has been hired.[122]

Second, the terms and conditions of employment may affect managers' incentives to abstain from and prevent antitrust infringements. Incentive-based remuneration should not lead to undue pressure. In any case, there is a risk that it could weaken the intrinsic motivation for (antitrust) compliance.[123] Moreover, it is well understood that certain compensation schemes and performance benchmarks may promote a willingness to engage in collusive behaviour (although not necessarily through illegal coordination).[124] Abandoning these schemes and avoiding overly ambitious profit targets reduces the likelihood of management initiating or tolerating antitrust infringements.

Third, managerial activities can be monitored. The more intensive this monitoring is, the lower the risk of managerial misconduct.[125] To effectively deter breaches of managerial obligations, any indications of misconduct should be followed up.[126]

Fourth and finally, it is essential that managers face dissuasive sanctions for breaching their antitrust compliance obligations. This is the focus of the following section.

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stabilization. As was reported in the media, the people who organized the rail cartel (which ultimately led to the *Thyssenkrupp* case presented above in section 2.4) regularly combined their meetings with visits to brothels. See Martin Murphy 'Die Rotlicht-Freunde' *Handelsblatt* (11 September 2012) 18. Regarding the importance of avoiding gender imbalance, see Carolina Abate and Alexis Brunelle, 'Cartel Behaviour and Boys' Club Dynamics: French Cartel Practice Through a Gender Lens' (2022) 13 Journal of European Competition Law & Practice 473. See also Amber Sheepers, 'The Effect of Corporate Board Gender Diversity on Compliance with EU Competition Law', Chapter 21 in this Handbook.

[121] 'Intrinsic' motivations based on moral norms and ethical beliefs are part of what is known in the economics literature as 'low-powered' incentives – as opposed to so-called 'high-powered' (i.e. monetary) incentives. See John Armour, Henry Hansmann and Reinier Kraakman, 'Agency Problems and Legal Strategies' in Reinier Kraakman et al (eds), *The Anatomy of Corporate Law* (3rd edn, OUP 2017) 35.

[122] A notable example is the Belgian Post Group (BPost). Recently, the company dismissed two CEOs in a row on suspicion of being involved in antitrust violations. See Jean-François Noulet, L Van de Berg and M. Gassée, 'Bpost a perdu son patron, l'autorité de la concurrence enquête à propos de la distribution des journaux: que se passe-t-il?' (*RTBF*, 12 December 2022) https://www.rtbf.be/article/bpost-a-perdu-son-patron-lautorite-de-la-concurrence-enquete-a-propos-de-la-distribution-des-journaux-que-se-passe-t-il-11121769 accessed 13 April 2025.

[123] Armour, Hansmann and Kraakman (n 121) 36.

[124] For an overview of the economic literature, see Florence Thépot, *The Interaction between Competition Law and Corporate Governance* (CUP 2018) 150–52.

[125] Note that, for example, under the German Act on Limited Liability Companies, shareholders have no general duty to monitor the managing director. See Karsten Schmidt, in Scholz, *GmbHG* (12th edn, Dr. Otto Schmidt 2021), § 46 para 112.

[126] In the case of German stock corporations, for example, this obligation arises from section 111(1) of the German Stock Corporation Act.

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4.3 Recourse Actions (and Other Internal Monetary Sanctions) as a Critical Mechanism to Ensure Management's Antitrust Compliance

The selection of managers, their terms of employment and remuneration, and their supervision are important mechanisms for ensuring management's compliance with antitrust law. However, without the availability of internal sanctions, including the threat of recourse actions, an essential mechanism is missing to translate the incentives through antitrust fines against the company into appropriate corporate governance. If the courts take the tool of recourse actions out of the hands of companies, a crucial building block in the menu for ensuring management compliance will be missing.[127]

Depending on the legal framework, managers may face a variety of sanctions from public enforcement and from third parties ('external sanctioning'[128]). National antitrust authorities may impose fines on individuals.[129] In some jurisdictions, managers may face criminal prosecution.[130] Moreover, antitrust infringements may result in disqualification proceedings for directors. In the UK, this sanctioning tool is legally endorsed and generally applicable.[131] In most jurisdictions, however, it is only rudimentary.[132] Furthermore, third parties aggrieved by

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[127] See Kersting and May (n 100) 537 and 538, who follow our argument at this point.

[128] We use the term 'external' sanction to characterize any sanctioning mechanism that is *not* initiated by the company's shareholders or an entity acting on behalf of the company, such as a supervisory board or its (new) directors.

[129] In Germany, a fine can be imposed for a single-handed violation of cartel law pursuant to section 81 of the German Competition Act in conjunction with section 9 of the German Act on Regulatory Offences. The same applies to violations of supervisory duties pursuant to section 130 of the Act on Regulatory Offences.

[130] See sections 188–90A of the (UK) Enterprise Act 2002, as amended by the Enterprise and Regulatory Reform Act 2013. The usefulness and necessity of criminal sanctions for EU antitrust law were also discussed. See, e.g., Wouter PJ Wils, 'Is Criminalization of EU Competition Law the Answer?' (2005) 28 World Competition 117. In Germany, bid-rigging is a criminal offence under section 298 of the Criminal Code and may in part also be prosecuted as fraud under section 263 of the Criminal Code. For other cartel law violations, parts of the literature consider criminal liability for fraud under section 263 of the Criminal Code to be possible. See Thomas Lampert and Susanne Götting, 'Startschuss für eine Kriminalisierung des Kartellrechts?' (2002) Wirtschaft und Wettbewerb 1069. However, this latter issue has not been addressed in case law. See Florian Wagner-von Papp, 'What If All Bid Riggers Went to Prison and Nobody Noticed? Criminal Antitrust Law Enforcement in Germany' in Caron Beaton-Wells and Ariel Ezrachi (eds), *Criminalising Cartels: Critical Studies of an International Regulatory Movement* (Hart Publishing 2011) 157, 165.

[131] See sections 9A–9E of the Company Director Disqualification Act 1986, added by the Enterprise Act 2002 to deal specifically with disqualification as a consequence of breach of competition law. See the CMA's first application for a competition disqualification order, which reached the courts in *CMA v Michael Martin* [2020] EWHC 3318 (Ch). Instead of filing an application with the court, the CMA may also accept a disqualification commitment from the person, which occurs more often in practice. See Peter Whelan, 'The Emerging Contribution of Director Disqualification in UK Competition Law' in Barry Rodger, Peter Whelan and Barry MacCulloch (eds), *The UK Competition Regime: A Twenty-Year Perspective* (OUP 2021) 283, 290–300.

[132] See OECD, 'Director Disqualification and Bidder Exclusion in Competition Enforcement' (2022) *OECD Competition Policy Roundtable Background Note* 45–50 https://web-archive.oecd

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an antitrust infringement may bring damages actions against directors and officers.[133] Finally, the discovery of antitrust violations alone might lead to a loss of a manager's reputation, resulting in a loss of future income.[134]

Against this background, a system of antitrust deterrence based on a 'division of labour' concept is conceivable: the antitrust fine against the company ensures that a violation of antitrust law is not worthwhile for the shareholders. External individual sanctions ensure that the management does not act against the interests of the shareholders.

However, given that there is no solid basis for a deterrent effect of private third-party actions, and that the finding of a negative reputational effect on managers caught as antitrust infringers also seems unclear, the best hope seems to lie in public individual sanctions. In particular, the Düsseldorf Higher Regional Court based its rejection of the right of recourse on the fact that, under German law, the imposition of a fine on a company requires that a natural person be identified as responsible for the antitrust infringement and can therefore (potentially) be fined.[135]

Yet, when looking at the realities of public individual sanctions, this does not appear to be a safe bet either. It is striking that the EU Commission is prevented from imposing fines on individual managers who are responsible for a company's antitrust infringement.[136] Moreover, even in those Member States where fines (or even criminal sanctions) can be imposed on individual managers, there seems to be a reluctance to use these instruments, which is probably related to the typically high standards of proof, among other things. It can be observed that at most a few individuals have been sanctioned.

To illustrate this, for example, in Germany, we looked at a sample of the last 30 fining decisions by the Bundeskartellamt. We used the case reports published on the Bundeskartellamt's

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.org/2022-12-23/645446-director-disqualification-and-bidder-exclusion-in-competition-enforcement-2022.pdf accessed 13 April 2025.

[133] In Germany, the availability and scope of such (direct) claims for damages against directors and officers have not yet been definitively settled by case law. The Düsseldorf Higher Regional Court found that a managing director of a GmbH (limited liability company) was liable for antitrust damages as he had induced other employees of the company to engage in conduct in violation of antitrust law. See OLG Düsseldorf 13.11.2013, VI-U (Kart) 11/13 *Badarmaturen* Juris paras 115–17. An appeal was not allowed by the OLG Düsseldorf. The Bundesgerichtshof rejected an appeal against this decision. See BGH 23.9.2014, KZR 88/13, not published.

[134] While this is partly assumed in the academic literature – see, e.g., Richard Posner, *Antitrust Law* (2nd edn, University of Chicago Press 2001) 271 – there seems to be no clear empirical evidence for this. Based on their empirical work, Catarina Marvão and Giancarlo Spagnolo, 'CEO Turnover and Shareholder Awareness in Cartel Cases', Chapter 22 in this Handbook, 452, conclude that 'the evidence we present here points to a very limited effect of convictions on the CEO's career path and more generally on corporate governance, for example, in terms of CEO removal and managerial contracts including provisions discouraging collusion'. See also Andreas Stephan, 'Cartels' in Ioannis Lianos and Damien Geradin (eds), *Handbook on European Competition Law* (Edward Elgar 2013) 217, 237 (pointing to anecdotal evidence that managers have been promoted even though they have been involved in activities that are illegal under antitrust law).

[135] See above n 69 and accompanying text.

[136] For an elaboration of the historical roots of this regulatory decision, Walter Mölls, 'Why Does Regulation (EC) No 1/2003 Provide for the Imposition of Penalties Only on Undertakings?: A Historical Perspective' (2022) 45 World Competition 195.

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website, which usually, but not always, give the number of companies fined as well as the number of fined individuals. In seven decisions, the Bundeskartellamt announced that fines had been imposed on the companies and responsible individuals, but did not publish the precise number of fines imposed on individuals.[137] In the 23 remaining decisions, a total of 127 companies and 76 responsible persons were fined.[138] This corresponds to an average of 0.6 fined individuals per fined company. However, in a typical case, more than one and possibly several people in the company can be considered at least negligently responsible for the infringement. Even if one takes into account that in three of these cases[139] the Bundeskartellamt referred the proceedings to the respective public prosecutor's offices on suspicion of submission fraud, and that it is therefore possible that the individuals responsible were nevertheless punished,[140] it appears that – contrary to the assumption of the Düsseldorf Higher Regional Court – there is on average quite limited threat of a fine against those individually responsible for an antitrust infringement.[141]

Therefore, relying solely on external sanctions to deter managers would, as far as we can tell, be an abandonment of society and shareholders. Consequently, the availability of recourse actions against managers (or holding them financially liable in some other way) is an essential, and indeed indispensable, governance tool. Several further observations are significant in this context.

Firstly, it could be argued that, if directors' liability for fines is prohibited, this internal prevention gap could be filled by directors' liability for third-party damages claims against the company. In fact, the Düsseldorf Higher Regional Court, for example, rejected management liability for fines but affirmed it for third-party damages claims.[142] Whether this case law will prevail (in Germany and beyond) and have a real deterrent effect on management is, of course, still uncertain. Crucially, however, the effectiveness of this mechanism depends on effective third-party damages claims against the company. However, with a view to the practice of competition damages actions in the EU Member States, this can at most be assumed in the case of cartelization to the detriment of purchasers, and only if they have not suffered

[137] Bundeskartellamt, case report of 14.1.2021, B11-8/18; 5.8.2021, B11-31/19; B11-33/19; 21.10.2020, B10-22/15; 17.5.2019, B11-28/16; 26.2.2018, B9-44/14; 18.8.2017, B12-16/13; 15.4.2019, B11-13/13.

[138] Bundeskartellamt, case report of 15.2.2023, B10-28/18 (number of fined companies: 4/number of fined individuals: 0); 25.5.2022, B10-21/17 (2/0); 10.2.2022, B11-22/17 (2/0); 17.12.2021, B10-23/20 (1/0); 28.9.2021, B12-22/15 and B12-21/17 (10/17); 16.7.2021, B10-26/20 (1/0); 10.2.2021, B12-22/17 (3/2); 3.2.2021, B12-24/17 (5/10); 27.3.2020, B11-21/14 (11/0); 29.5.2020, B10-22/17 (5/5); 3.8.2020, B12-25/16 (3/3); 9.1.2020, B12-23/16 (3/0); 10.4.2019, B1-189/18, B1-11/15 (1/0); 20.9.2018, B7-185/17 (1/1) (in addition, a fine was imposed on the company's lawyer); 16.3.2018, B5-139/12 (10/1); 8.8.2017, B2-62/16 (2/0); 1.9.2017, B12-13/09 (22/33); 11.1.2017, B1-164/13, B1-167/13, B1-87/14, B1-47/15 (5/4); 14.12.2016, B10-20/15 (11/0); 12.9.2016, B12-23/16 (3/0); 14.12.2016, B10-40/14 (7/0); 18.1.2016, B10-50/14 (5/0); 6.7.2015, B12-15/12 (10/0).

[139] Bundeskartellamt, case report of 25.5.2022, B10-21/17; 10.2.2022, B11-22/17; 27.3.2020, B11-21/14.

[140] In a fourth case, there have already been reports of the discontinuation of proceedings by the competent public prosecutor's office on the grounds of discretion. Bundeskartellamt, case report of 15.2.2023, B10-28/18.

[141] See also Kersting and May (n 100) 539–540.

[142] See above n 63.

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dispersed and relatively small damages. In the case of other antitrust violations, in particular in cases involving foreclosure of competitors, whether through anti-competitive horizontal or vertical coordination or through abuses of a dominant position, damages actions generally appear not to be effective. This is because the antitrust damage then essentially consists of lost profits. Calculating these usually requires the determination of volume effects, which in practice poses considerable problems of proof for the plaintiff.

Secondly, one might ask: if fined shareholders were barred from recourse actions, then surely they could threaten directors and officers with financial sanctions of some other kind, such as by way of contractual penalties, a clawback of bonuses or other kinds of variable compensation,[143] or a reduction in future salary. However, taking the perspective of those who see managerial liability as unduly weakening the effectiveness of fines against the company, it is hard to see why those financial sanctions should be treated differently; after all, a contractual penalty, a clawback of past incentive-based compensation, or a reduction in future salary as a result of an antitrust fine have the equivalent effect of a recourse action, since the financial burden of the fine imposed is ultimately not (fully) borne by the shareholders but is (partially) passed on to the directors and officers. In addition, it should be noted that the above contractual mechanisms certainly have the potential to pass on not just a small but a significant part of a fine to the managers. Moreover, it is difficult to see why it should make a difference at this point whether the pass-on effect is based on managers' liability inherent in company law (which, depending on the jurisdiction and the type of company that is concerned, may be a mere default rule[144]) or on a contractual liability (contractual penalty, clawback clause, etc.) agreed between the company and the manager. Functionally, the resulting claims of the company are each aimed at preventing the management from breaching their duties towards

[143] Most listed corporations in Germany use clawback clauses related to compliance rules. See for an overview of the current clawback prevalence in the US and in Europe Johanna Stark, 'Clawback Provisions in Executive Compensation Contracts' (2021) European Company and Financial Law Review 669, 676–81, and regarding shortcomings of clawback design, 687–95. Under US securities law, companies may be required to adopt a 'clawback' policy, which might also apply if earning figures disclosed were inflated by anticompetitive conduct. James S Venit and Andrew S Foster, 'Competition Compliance: Fines and Complementary Incentives' in Philip Lowe and Mel Marquis (eds), *Integrating Public and Private Enforcement of Competition Law – Implications for Courts and Agencies* (Hart 2014) 63, 75.

[144] If and insofar as managerial liability is conceived as a mere default rule, it seems even harder to see why, in our context, it should be understood as legally distinct from contractual liability as set out in the manager's contract with the company. For a comparative overview of the leeway left by various company laws to modify the scope and standard of care, to exclude or limit liability, and to waive claims arising from managerial liability, see Simon Deakin and Olaf Riss, 'Directors' and Officers' Liability: Comparative Report' in Simon Deakin, Helmut Koziol and Olaf Riss (eds), *Directors & Officers (D&O) Liability* (De Gruyter 2018) 910–15. It should be noted that, under German law, the liability of the members of the management board of a stock corporation ('*Aktiengesellschaft*') is mandatory, whereas the liability of the managing director ('*Geschäftsführer*') of a private limited company ('*Gesellschaft mit beschränkter Haftung*' or 'GmbH') is widely considered to be only a default rule. However, the parties' scope for limiting liability has not yet been defined and confirmed by case law. See Holger Fleischer, 'Haftung der Geschäftsführer' in Holger Fleischer and Wulf Goette (eds), *Münchener Kommentar zum GmbHG* (4th edn, C.H. Beck 2023) § 43 GmbHG paras 368–86.

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the company. Therefore, we do not see any relevant economic or legal difference here.[145] Those who believe that recourse actions should generally be prevented in order to ensure the effectiveness of antitrust fines should, to implement this idea consistently, also insist on banning any other form of monetary sanction that involves a flow of money from the company's management to its shareholders triggered by the imposition of an antitrust fine.

Following this line of reasoning, the question arises: what sanctioning tools would be left to a company that was not allowed to threaten its management with financial sanctions? It seems to us that if the employment has not already ended, the company's options are basically limited to terminating the manager's contract for misconduct and removing her from her post. Further, the company could look at damaging the person's reputation, for example, by issuing a bad employment reference or otherwise signalling the person's failure to the market.

Given that, first, the exclusion of recourse actions in the case of antitrust fines imposed on the company would consequently also have to entail the exclusion of other monetary sanctions against the management and, second, that the remaining (non-monetary) sanctions have little or no deterrent potential, it should be clear that the prohibition of recourse actions is not appropriate for a good deterrent effect of antitrust fines against the company. Shareholders would be deprived of an essential and possibly their most effective (internal) governance instrument for responding adequately to the risk of an antitrust fine. All in all, therefore, a ban on management liability for antitrust fines would be counterproductive for the effective prevention of antitrust infringements.

Our analysis appears to coincide with the judgment in *Jetivia* of Lord Toulson and Lord Hodge, who disagreed with the Court of Appeal's reasoning in *Safeway*:

> Safeway's direct liability … under the Competition Act arose through the acts of its directors and employees as its agents, but should the company therefore be denied the right to hold its errant directors and employees to account? … Unless there are special circumstances, the innocent shareholders should not be made to suffer twice. The reasoning in Safeway, if taken to its logical conclusion, would also mean that the company could not lawfully dismiss the errant employees or directors; for to rely on their misconduct would be to rely on its own misconduct …[146]

While this statement is framed as a criticism of the scope of the principle of *ex turpi causa non oritur actio* as assumed by the Court of Appeal in *Safeway*, it is essentially based on the same reasoning that we have developed above: an innocent shareholder would 'be made to suffer twice' if, on the one hand, it had to bear the fine imposed on the company and, on the other hand, the denial of any recourse action deprived it of the most effective governance tool for deterring antitrust violations by directors and officers in the first place.

4.4 Is the Weakening of Shareholder Deterrence the Predominant Effect?

If shareholders can expect that, in the event of a fine for an antitrust infringement, part of the fine will be passed on to management, the deterrent effect on shareholders will be reduced. Assuming that the fine just reaches the level for an optimal sanction, the availability of

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[145] Contra Wils (n 113) 589. See also Kersting and May (n 100) 537.

[146] *Jetivia v Bilta Ltd (in Liquidation)* [2015] UKSC 23 [160]–[161] (Lord Toulson and Lord Hodge).

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recourse claims may therefore lead to a suboptimal deterrent effect on shareholders. It is then not entirely certain that antitrust violations will no longer be profitable for them.

4.4.1 Three effects of managerial recourse liability on the overall deterrence

The overall effect of the availability of managerial recourse liability on the prevention of antitrust infringements, therefore, requires the netting out of three distinct effects: first, the prospect of an effective solution to the agency problem between shareholders and management (i.e., the actual function of managerial liability); second, a weakening of shareholder deterrence; and, third, the creation of an additional deterrence mechanism (distinct from the solution to the agency problem). Whether the availability of recourse actions is preferable to effectively deter antitrust infringements or, on the opposite, whether it is contrary to the principle of effective deterrence, depends on how these three mechanisms are assessed and measured.

4.4.1.1 First effect: addressing the agency problem between shareholders and management

First, it is the conclusion of the above sections that the availability of recourse liability is indeed an essential prerequisite for addressing the agency problem. The recourse liability of management for the damage caused to a company by antitrust infringements is the strongest and most visible signal that antitrust infringements are not wanted and will not be tolerated, even if, from the management's point of view, they should have a positive expected value for the company's value.

The effectiveness of this mechanism therefore depends on whether the threat of recourse liability from the perspective of managers is not just 'cheap talk': that managers have a serious expectation that the company will ultimately enforce liability against them. It seems plausible to us that, although there is no certainty in this regard, there is a high probability that a company will assert claims against (former) managers arising from an antitrust violation. This is partly due to the attention and public pressure from stakeholders but also from shareholders, in particular as the issue has also come under the scrutiny of activist shareholders.[147] Ultimately, this also depends on the company law framework, such as the availability and effectiveness of shareholder derivative actions and mechanisms to ensure that supervisory boards, where they exist, enforce the sanctioning of (former) management in the event of misconduct.[148]

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[147] See, e.g., Reuters, 'Carl Icahn Sues Illumina Board for Violating "Fiduciary Duties"' https://www.reuters.com/business/healthcare-pharmaceuticals/activist-icahn-sues-illumina-board-over-grail-acquisition-ft-2023-10-17/ accessed 13 April 2025. Activist investor Carl Icahn had reportedly sued Illumina's board of directors after Illumina had proceeded with the acquisition of Grail in violation of a European Commission's 'standstill' order, for which the Commission fined the company EUR 432 million (Case M.10483 *Illumina / Grail* [12.7.2023]). The Commission prohibited the takeover (Case M.10188 *Illumina / Grail* [6.9.2022]) and ordered Illumina to unwind the acquisition (Case M.10939 *Illumina / Grail* [12.10.2023]). However, these decisions have been overturned by the ECJ on the grounds that referrals under Article 22 of the EU Merger Regulation are only admissible if an acquisition is subject to merger control under national law. Case C-611/22 P *Illumina v Commission* ECLI:EU:C:2024:677.

[148] For a more detailed account, see Florian Wagner-von Papp, 'Managerial Liability, Managerial Duties, and Liability Within Corporate Groups: Optimal Competition Law Sanctions

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4.4.1.2 Second effect: reducing the deterrent effect on shareholders

Second, one has to ask: how significant is the weakening of the deterrent effect on the shareholders by the availability of managerial liability for antitrust fines? The availability of D&O insurance is discussed separately below.[149]

To assess this, it is necessary to take the perspective of the shareholders at the time they make decisions relevant to the likelihood of antitrust violations in the company: selection of managers and terms of remuneration, setting performance targets, sending signals that antitrust violations will be tolerated, etc. When shareholders weigh the opportunities and risks of a potential antitrust violation at this stage, given the risk of antitrust fines against the company, how much do they see this risk as mitigated by the prospect of management liability?

Of course, it is not the right of full recourse as such that is decisive but the realistic prospect of being able to hold one or more directors or other employees liable. First of all, it should be noted that the fact that a company is fined does not necessarily mean that it will be able to demonstrate and prove in a subsequent trial that the underlying cartel infringement was due to a breach of duty by one of its managers. Depending on the jurisdiction and the remedy underlying the recourse in the individual case, it must also be proven that the manager acted at least negligently.[150]

Moreover, since fines imposed on a company are based on the turnover of the company (or even of the group to which it belongs), shareholders are often only able to recover a small fraction of the antitrust fine.[151]

The Düsseldorf Higher Regional Court refused to accept this latter consideration, arguing that the actual enforceability of the liability depends on the contingencies of the individual circumstances, in particular on 'the respective financial situation of the manager and the amount of the corporate fine'.[152] However, it is in fact no coincidence that the amount of the fines typically far exceeds the assets of a managing director, in particular due to the above-mentioned method of assessing the fines (especially in hardcore cartel cases, which are most at stake). Moreover, it is true that, in individual cases, the fines can be in a range so that they do not exceed a manager's assets. The task facing the courts here, however, is to establish an ex ante rule according to which managerial liability is (or is not) excluded because it significantly weakens (or does not weaken) the deterrent effect of the fine. Of course, although there may be outliers in individual cases, the court must look at the typical scenarios to assess this.

Therefore, to assess – particularly in the light of the effectiveness requirement under EU law – the extent to which the availability of legal remedies reduces the deterrent effect of a fine on the company, it is not the legally conceivable but the actual expected effects that must be taken into account. If courts argue otherwise 'to be on the safe side', they run the risk of unnecessarily restricting the availability of recourse claims as a tool to address agency problems in the fight against antitrust violations.

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by Rearranging the Deckchairs Within the Undertaking?', Chapter 23 in this Handbook, section 4.4, 510–513.

[149] See below section 5.

[150] Christian Kersting, 'Organhaftung für Kartellbußgelder' (2016) Zeitschrift für Wirtschaftsrecht (ZIP) 1266, 1268.

[151] LG Dortmund 8 O 5/22 (Kart), order of 21.6.2023, Juris, para 7 ('Construction Cartel').

[152] OLG Düsseldorf 27.7.2023, 6 U 1/22 (Kart), Juris, para 204.

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In sum, the availability of managerial recourse liability weakens the deterrent effect on shareholders. However, if we take into account the substantial uncertainties and limitations of potential managerial liability for antitrust fines, the overall reduction in the deterrent effect is likely to be non-negligible but severely limited.

4.4.1.3 Third effect: managerial liability as supporting deterrence mechanism in its own right

The availability of managerial recourse liability may weaken the deterrent effect on shareholders, but at the same time, it creates a further deterrence mechanism that may compensate for the former effect: if managers face the prospect of having to pay for the damage caused to the company by antitrust violations, including fines, they will be reluctant to take these risks – even if shareholders do not clearly signal that profit maximization through antitrust violations is per se unacceptable or, as in some cases, even encourage or blatantly turn a blind eye to such violations.[153] Thus, beyond addressing agency problems between shareholders and management, managerial liability can play a useful complementary enforcement role by preventing the deterrent effect from fizzling out as the shareholders merely price the fine in as a cost factor.

4.4.2 Conclusion

The overall effect of the availability of managerial recourse liability for antitrust fines on the deterrence of antitrust infringements is the sum of three effects, the magnitude of which depends on various parameters that are difficult to determine: on the one hand, a weakening of the deterrent effect on shareholders, and on the other hand, a significant contribution to solving the agency problem of shareholders vis-à-vis management and the establishment of an independent deterrence mechanism against directors and officers.

In our view, however, there are good reasons to believe that the latter effects outweigh the former, so that the availability of managerial recourse liability for antitrust fines is a superior 'second best'. There are two key considerations here. First, if one accepts that the availability of managerial (recourse) liability is crucial for the company (i.e., the shareholders) to address its agency problems and, thus, to actually translate the deterrence directed at them into the prevention of antitrust violations, then it should be clear that, without the availability of recourse liability, the deterrent effect on shareholders may be stronger but ultimately (significantly) less effective in terms of the overall effect of preventing antitrust infringements by senior management or by other employees of the company (supervised by senior management). Second, directors' and officers' liability for antitrust fines provides an independent deterrence mechanism that can at least partially compensate for the fact that the deterrent effect on shareholders may fall to a suboptimal level. On balance, we see no reason to believe that the availability of directors' and officers' recourse liability for antitrust fines would undermine the effectiveness of antitrust fines against the company as a tool to deter antitrust violations. However, if it should turn out that our assumptions above are wrong and that the weakening of shareholder deterrence is indeed, owing to the availability of unlimited recourse liability, the dominant effect, then this should not justify excluding this liability altogether. Such a step would unnecessarily deprive the company (i.e., shareholders) of an essential tool for solving the agency

[153] See Catarina Marvão and Giancarlo Spagnolo, 'CEO Turnover and Shareholder Awareness in Cartel Cases', Chapter 22 in this Handbook, sections 6.2 and 6.3.

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problem. Rather, the possibility of recourse liability in such circumstances should be limited, by judicial intervention according to the principle of effectiveness of EU law or, if necessary, by legislative intervention. As explained below in the context of the discussion on the possible over-deterrence of managers, the amount of profit-related remuneration paid during the period of the infringement can be a useful benchmark to determine the lower bound of an adequate deterrence mechanism against managers.[154]

4.5 Waiver of Recourse Liability in Connection with Leniency Applications

In the course of the preparation of leniency applications, it appears to be not uncommon for agreements to be reached between a company and its managers in which the company waives recourse claims, including those relating to antitrust fines that may be imposed on the company at a later stage.[155] In this situation, the company's overriding interest may be to ensure full cooperation with the competition authorities as quickly as possible. If the threat of (recourse) liability and/or individual sanctions discourages suspected managers from assisting the investigation, the prospect of indemnification against liability and other sanctions may serve as an incentive to cooperate.

The prospect of the company's waiver of (recourse) liability in this situation may actually have the effect of diminishing its (ex ante) governance effect vis-à-vis management. But this effect should not be overestimated. First, leniency applications are only possible in cartel cases.[156] Yet, in the case of illegal vertical coordination, in abuse cases, or even in the case of 'gun-jumping' in merger control,[157] the company could also face high fines, for which it could seek recourse against the management.[158] Second, it is difficult for an individual manager to foresee ex ante whether the scenario of a leniency application will even arise and whether the company will necessarily depend on his full cooperation in that situation.

In addition, it should be noted that the waiver of recourse liability in the scenario outlined enhances the effectiveness of the leniency programme and thus serves the purpose of detecting and punishing cartels. In any event, the existence of a certain trade-off between recourse liability as a governance tool and the effectiveness of the leniency policy is not an argument for forgoing the availability of recourse liability. After all, the company could not incentivize

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[154] See section 6.5.

[155] The legality of these waivers and indemnities may be questionable depending on the applicable corporate law. See, e.g., Franz Jürgen Säcker, 'Gesellschafts- und dienstvertragsrechtliche Fragen bei Inanspruchnahme der Kronzeugenregelung' (2009) Wirtschaft und Wettbewerb 362, 372.

[156] See Article 4a of Commission Regulation (EC) No 773/2004 of 7 April 2004 relating to the conduct of proceedings by the Commission pursuant to Articles 81 and 82 of the EC Treaty (as amended).

[157] See, e.g., European Commission 12.7.2023, M.10483 (Art. 14 procedure), *Illumina/GRAIL*: The European Commission imposed a fine of EUR 432 million on Illumina for the implementation of an acquisition without prior clearance. However, the ECJ annulled the fine. Case C-611/22 P *Illumina v Commission* ECLI:EU:C:2024:677.

[158] It should be noted, however, that even in these cases, antitrust fines against the company can be significantly reduced if the company cooperates (fully) with the authorities, so there may also be an incentive for the company to secure the cooperation of one of its managers by waiving recourse liability.

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managers to cooperate by waiving fines if there were no liability for antitrust fines in the first place.

4.6 Conclusion

Contrary to what some courts have argued, ensuring effective deterrence through fines imposed on companies does not require the exclusion of managerial liability for antitrust fines. The availability of recourse actions against directors and officers (or the ability to hold them financially liable in some other way) is an essential and indeed indispensable governance mechanism. If it were denied to shareholders, they would be unable to respond adequately to the threat of antitrust fines. The intended deterrent effect would thus be undermined by a prohibition of management's recourse liability.

It is true that the deterrent effect on shareholders is (possibly) reduced below the optimal level by passing on (part of) the fine to management. However, there is good reason to believe that this effect is outweighed by the positive impact that the availability of managerial recourse liability has on the deterrence of antitrust infringements. First, it allows the agency problems within the company to be addressed more effectively, so that the reduced deterrence to shareholders may ultimately be more valuable in terms of preventing antitrust violations. Second, in addition to its use as a tool to overcome a company's agency problems, managerial liability can be conceived as one element of sanctioning those who are individually responsible for a company's antitrust infringement, thus effectively complementing sanctions directed at the company and compensating for the weakening of shareholder deterrence that may occur as a result of the availability of management liability in the first place. In any case, the weakening of shareholder deterrence should only lead to a limitation, not to a complete exclusion of management liability.

5. AVOIDING UNDER-DETERRENCE OF THE COMPANY'S SHAREHOLDERS (2): SHOULD D&O INSURANCE BE RESTRICTED?

Managers' liability risks for their misconduct are nowadays widely hedged by D&O insurance taken out by the company. Although D&O insurance is formally structured as third-party insurance, in practice it may be equivalent to first-party insurance: the company pays the premiums to cover the damage (such as an antitrust fine) it suffers from the misconduct of its directors and officers.[159] This raises the question of whether managerial liability for antitrust infringements in combination with D&O insurance borne by the company has the effect of unacceptably weakening the deterrent effect intended by the antitrust fines. Indeed, it was not least the prospect that the antitrust fine might ultimately be borne by the managers' D&O insurance that led the Court of Appeal in *Safeway Stores*,[160] the Landgericht Saarbrücken in

[159] Gerhard Wagner, 'Organhaftung im Interesse der Verhaltenssteuerung – Skizze eines Haftungsregimes' (2014) 178 Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht 227, 278–79.

[160] See *Safeway Stores* (n 23).

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Villeroy & Boch,[161] and the Oberlandesgericht Düsseldorf in the *Stainless Steel Companies* case[162] to conclude that managerial liability for antitrust fines should be excluded.

5.1 Mechanisms to Cope with Moral Hazard and Apparent Deficiencies in D&O Insurance

Insurance protection has to cope with moral hazard: those who know that they might be liable for faults but do not have to bear the damages may have too little incentive to invest in avoiding liability and in keeping potential damages to a minimum. Therefore, to succeed economically, insurers must find and use mechanisms to incentivize the insured to invest in damage prevention: adjustment of insurance premiums according to the individual damage risks as revealed, for instance, in the event of a claim and the stipulation of deductibles and caps, as well as other limitations on insurance coverage.[163] Thus, as a matter of principle, the availability of insurance does not eliminate the deterrent effect of liability but rather cushions and channels it. In this sense, Graystone concluded an empirical study on deterrence and motor liability insurance by stating:

> The major conclusions of this work provide strong support for the hypothesis: Liability insurance does not remove the deterrence to accident-causing behavior provided for by the fault determinations of the tort system.[164]

However, with regard to managerial liability in Germany, for example, it has been critically observed that it appears to be common practice for companies to take out group D&O policies for all members of the managing board and the supervisory board. These policies, it is said, are not based on an individual risk assessment of the executives whose behaviour is insured. It would appear, therefore, that standard D&O insurance operates without the sophisticated risk assessment mechanisms known, for example, from motor vehicle liability insurance.[165] It is understood that the stipulation of a mandatory deductible under German stock corporation law is a regulatory response to that insufficient preservation of incentives to avoid harm. Section 93(2), 3rd sentence of the German Stock Corporation Act provides that:

> [w]here the company has taken out insurance to protect a member of the management board against risks arising from their professional activities for the company, the insurance policy is to provide for a deductible of at least 10 per cent of the damage, up to a minimum of 150 per cent of the annual fixed remuneration of the member of the management board.[166]

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[161] See *Villeroy and Boch* (n 40).

[162] See *Stainless Steel Companies* (n 59).

[163] Gerhard Wagner, 'Tort Law and Liability Insurance' in Michael Faure (ed), *Tort Law and Economics* (Edward Elgar 2009) 377, 389–92.

[164] Richard W Graystone, 'Deterrence in Automobile Liability Insurance – The Empirical Evidence' (1973) 40 Insurance Counsel Journal 117, 126.

[165] Wagner (n 159) 246–47, 272.

[166] Section 93(2) 3rd sentence of the German Stock Corporation Act. Translation taken from https://www.gesetze-im-internet.de/englisch_aktg/index.html accessed 13 April 2025.

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Yet, this provision does not preclude managers from taking out (additional) personal insurance at their own expense, thereby effectively covering *any* liability risk. This appears to be common practice. While the company must not bear the premiums for such additional personal insurance, in practice, it often does so indirectly through a supplement to the managers' regular remuneration.[167]

It is conceivable that mechanisms such as risk-adjusted premiums and deductibles could be used in this personal insurance to promote preventive incentives. However, experts doubt that the volume of this type of insurance would be large enough to make individual risk classification profitable for the insurer, or that deductibles would be high enough to encourage managers to take adequate preventive action. Therefore, in order to ensure a sufficient level of prevention through liability, it has been proposed to prohibit the use of personal insurance to cover the mandatory deductible for D&O insurance.[168]

5.2 Do Deficiencies in D&O Insurance Lead to a Failure of Antitrust Fines' Deterrent Effect?

In the light of the criticisms of the design of D&O insurance policies that may be raised in this or a similar form in other jurisdictions, the question may arise as to whether the availability of management liability for antitrust fines should be made conditional on regulatory intervention in D&O insurance to ensure that it does not undermine the deterrent effect of managerial liability.

So far, we have not seen sufficient evidence for this. Given the deficiencies in the design of D&O insurance and the regulatory framework applicable to it, there may be reasonable doubt that management liability is translated into incentives to avoid liability in the best possible way. However, from the point of view of the deterrent effect intended by antitrust fines, not every imperfection in the shareholders' control of management through liability should be taken to mean that the deterrent effect of the fines is to be regarded as having failed. Two considerations seem to us to be essential for the assumption that, despite all plausible criticisms of the status quo, it should not be interpreted as allowing inappropriate relief of shareholders and a failure of the deterrent effect of antitrust fines.[169]

First, for all the valid criticism of the lack of individual risk classification in D&O insurance, one should be cautious about jumping to conclusions regarding the availability of managerial liability at all. Inaccurate risk assessment, especially in the case of group D&O insurance, will make D&O insurance more expensive, and there is no reason to believe that these costs will not be passed on to the companies that take out these policies. The shortcomings of D&O insurance may thus lead to suboptimal, inefficient incentives for individual managers – but not to inappropriate relief for shareholders. In other words, there may be a market failure in the design of D&O insurance that would justify regulatory intervention. However, it does not then follow that managerial liability for antitrust fines should be restricted. Owing to these deficiencies in D&O insurance, the deterrence mechanism of antitrust fines may not play out perfectly, but it would be wrong to speak of a failure.

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[167] Wagner and Klein (n 119) 197–198, para 141.

[168] Wagner (n 159) 273 and 280.

[169] This is in line with LG Dortmund 8 O 5/22 (Kart) , order of 14.8.2023, sub 4.b), Juris, ('Construction Cartel'), and Kersting and May (n 100) 535–536 and 539.

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Second, although not required by law for D&O insurance where the insured persons (the managers) and the policyholder (the company) are not identical,[170] policies regularly exclude coverage for losses caused by a deliberate or knowing breach of the law by the insured managers.[171] Insurers are forced to make such an exclusion to reduce moral hazard to a manageable level. This means, however, that for participation in hardcore cartels and, thus, for a large proportion of the antitrust infringements fined, the question of an excessively restricted liability effect due to D&O insurance seems not to arise.[172] This was apparently the case in *Heiploeg*,[173] and in *Thyssenkrupp,* one may speculate that an exclusion of coverage for deliberate infringements was a major reason why the company agreed to a settlement with the insurer that included reimbursement of only a small fraction of the antitrust fine.[174] However, the outcome in the *Stainless Steel Cartel* case appears to be indeed quite problematic from the point of view of the necessary deterrent effect, as the court denied a knowing violation of antitrust law and thus affirmed D&O coverage despite the apparent participation in meetings in which price-sensitive information was exchanged.[175]

It has been argued that the exclusion of coverage for knowing antitrust violations could easily be circumvented by the company choosing a manager who could only be accused of negligent breach of supervisory duty, so that the company could claim compensation from the D&O insurance taken out for her.[176] Apart from the fact that in such a situation the insurance company could, in any case take recourse against the managers who knowingly violated the antitrust laws, we doubt that the exclusion for intentional violations could be systematically circumvented in this way; otherwise, the insurance company could not reasonably cope with the moral hazard problem. Besides, the regulatory limitation of D&O insurance, rather than the exclusion of managerial recourse liability, would be the preferable regulatory response.

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[170] In any case, this is the legal situation according to German insurance law, and apparently also in the UK. See Wagner and Klein (n 119) 205 para 173; and Morfey and Patton (n 29) 63.

[171] See A-7.1 AVB-D&O (General Conditions of Insurance for D&O Insurance provided by the German *Gesamtverband der Versicherer*, individual insurance contracts may differ; published, e.g., in Oliver Lange, *D&O-Versicherung und Managerhaftung* (2nd edn, C.H. Beck 2022) 2277). This commonly used term excludes coverage to a greater extent than the exclusion for intentionally caused damage as stipulated under section 103 of the German Insurance Contract Act. In the *Heiploeg* case (above section 2.1), it was reported that the insurance company considered not covering the former directors' liability for the antitrust fine because the insurance policy excluded 'deliberate intent'. Beetstra and Van De Sanden (n 56) 5.

[172] For scenarios where relevant legal uncertainty may exist, see section 6.2.

[173] See above n 21.

[174] See above n 57.

[175] See above n 62 and accompanying text.

[176] Florian Wagner-von Papp, 'Managerial Liability, Managerial Duties, and Liability Within Corporate Groups: Optimal Competition Law Sanctions by Rearranging the Deckchairs Within the Undertaking?', Chapter 23 in this Handbook, 494, text accompanying note 81; Stefan Thomas, 'Bußgeldregress, Übelszufügung und D&O-Versicherung' (2015) Neue Zeitschrift für Gesellschaftsrecht 1409, 1419.

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5.3 Conclusion

All in all, we see no convincing evidence that the availability of D&O insurance, despite its deficiencies, would render impossible or undermine on a broad scale the deterrent effect of managerial liability for antitrust fines. To exclude managerial liability for antitrust fines because the design of D&O insurance weakens its preventive effect would be to throw the baby out with the bathwater. Thus, depending on the prevailing practice of D&O insurance and the applicable regulatory framework under company and insurance law, there may be good reasons to limit the coverage of managers' liability by law. However, as far as we can tell from D&O practice and the regulatory status quo, we see no need to make managers' liability for antitrust fines dependent on such regulatory intervention.

6. AVOIDING OVER-DETERRENCE OF THE COMPANY'S MANAGEMENT: SHOULD MANAGERIAL LIABILITY FOR ANTITRUST FINES BE LIMITED?

If a company that has been fined for an antitrust violation is allowed, as a governance instrument, to bring recourse actions against the managers who have breached their antitrust compliance duty, the question arises: Should managers really be threatened with having to reimburse the company for the *entire* fine? Or should the amount of recourse be limited? To answer these questions, we first shed light on the actual risk of over-deterrence and mitigating factors, and then assess whether, against this background, principles of EU law compel a limitation of managerial liability. Lastly, we discuss possible mechanisms for implementing such a limitation.

6.1 Managerial Liability for Antitrust Fines and the Risk of Over-Deterrence

The management of a company acts in the economic interest of the shareholders. While directors and officers may share in the economic success of their companies through variable compensation components (which create incentives for loyal, profit-maximizing conduct), they may at best only partially internalize the benefits of their activities.[177] Rather, it is the nature of a company that its success or failure is reflected in its shareholders' wealth.

Against this background, it is clear that a fine set at a level that effectively dissuades an undertaking from infringing the antitrust rules may, if passed on in full to its management, easily exceed the level that would be necessary to deter it from doing so. For the plausibility of this insight, one need not even think of the fines amounting to several billions of euros that the Commission has occasionally imposed in cartel cases[178] and abuse proceedings.[179] It is safe to

[177] Certainly, this is different if they are at the same time the company's only shareholders. However, in such a scenario, the agency problems, which are the reason for the discussion about how recourse actions might affect the preventive effect of fines, do not arise in the first place.

[178] *Trucks* (Case AT.39824) [2017] OJ C 108/6; [2020] OJ C216/9.

[179] *Google Search (Shopping)* (Case AT.39740) [2018] OJ C9/11; *Google Android* (Case AT.40099) [2019] OJ C402/11.

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assume that the EUR 191 million for which ThyssenKrupp sued its former managing director to indemnify for an antitrust fine in the same amount[180] exceeded his assets several times over.

If the liability of managers for breach of antitrust compliance obligations may thus easily exceed the optimal level and, indeed, may threaten to destroy their economic existence, there is a risk of an excessive deterrent effect. However, these risks materialize only under certain conditions, and, in practice, they may also be limited by countervailing factors and effects. Before discussing these aspects in more detail,[181] one might ask: why are these (potential) risks of excessive liability even of relevance when evaluating and controlling the deterrent effect of antitrust fines?

The threat of excessive liability creates an incentive for managers to be unduly risk-averse. They may invest excessively in compliance measures,[182] avoid business activities simply because they are in the vicinity of antitrust law, or even avoid activities in business lines just because they have proven to be susceptible to antitrust infringements. On the face of it, if the company fails to exploit its business potential in this way, this would appear to be a problem (only) for the shareholders: shouldn't they, in their own best interests, take steps to avoid these effects? Yet, for one thing, depending on the applicable company law, liability may be mandatory or, even if designed as a default rule, may prove 'sticky' because of information problems or transaction costs. Moreover, if one is prepared to derive from antitrust fines' deterrence objective restrictions on managerial liability to avoid under-deterrence, one should consequently also keep in mind the risks of over-deterrence.[183] After all, it is not only in the shareholders' interest but also in the general interest that companies do not forgo business activities that are, in fact, perfectly legal and may thus be regarded as socially desirable but from the firm's perspective might be viewed as legally unclear.[184] In other words, there is no trade-off between maximizing shareholder value and overall social welfare[185] when allowing companies to effectively and efficiently address their agency problems in order to prevent antitrust infringements. If there is indeed a substantial risk of over-deterrence (which will be discussed next), managers should not have to bear the full damage caused to a company by an antitrust fine.

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[180] See above n 50 and accompanying text.

[181] See section 6.3.

[182] Bruce H Kobayashi, 'Antitrust, Agency, and Amnesty: An Economic Analysis of the Criminal Enforcement of the Antitrust Laws Against Corporations' (2001) 69 George Washington Law Review 715, 735–37; Douglas H Ginsburg and Joshua D Wright, 'Antitrust Sanctions' (2010) 6 Competition Policy International Autumn 2010, 3, 8; Gregory J Werden, Scott D Hammond and Belinda A Barnett, 'Deterrence and Detecting of Cartels: Using All the Tools and Sanctions' (2011) 56 The Antitrust Bulletin 207, 210–11.

[183] On the principle of proportionality as an EU law basis for the protection against over-deterrence effects, see below section 6.4.

[184] See Connor and Lande (n 108) 431 n 16.

[185] For an overview of the discussion of which normative objectives should guide company law, see John Armour, Henry Hansmann, Reinier Kraakman and Marianna Pargendler, 'What Is Corporate Law?' in Reinier Kraakman et al (eds), *The Anatomy of Corporate Law* (3rd edn, OUP 2017) 22–24.

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6.2 Are Risks of Over-Deterrence Only Theoretical as Managers May Simply Ensure Legal Compliance?

Managers can avoid liability by acting lawfully towards their company. Therefore, at first glance at least, over-deterrence might seem only a theoretical problem.[186] On closer inspection, however, it becomes clear that only personal activities carried out with the knowledge of illegality can be safely reduced to zero. Over-deterrence remains a real problem because, first, the line between what is and what is not legal under antitrust law is not always precisely predictable.[187] In *Google Shopping*, the Commission imposed a fine of EUR 2.4 billion[188] for conduct when its illegality, from an ex ante point of view, seemed to quite a few observers at least doubtful.[189] Second, it is also not precisely defined which antitrust compliance measures management is legally required to take in order to prevent infringements by a company's employees or by a subsidiary for whose infringements the parent company could be fined.[190] Thus, given the uncertainties regarding both the antitrust laws and the antitrust compliance efforts legally owed, managers cannot always simply choose to act legally; in these scenarios, an excessive threat of liability can result in socially undesirable overcaution on the part of management.

6.3 Mechanisms Hedging Against (Potential) Over-Deterrence

6.3.1 Discretionary powers in case of (ex ante) legal uncertainty and regarding compliance organization

The potential over-deterrence effect of management liability for antitrust fines discussed above can be mitigated by granting the directors and officers certain discretionary powers. However, as will be shown, the law appears to provide only a rather uncertain and wide-meshed safety net against the risks of over-deterrence.

Dealing with uncertain antitrust standards. While company laws routinely limit judicial review of management's business decisions via the 'business judgment rule',[191] the adequate handling of uncertainties in the management's assessment of the legal situation appears less clear. German stock corporation law provides a good example of this. Board members have a

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[186] This was implicitly assumed, for example, in the context of cartelists' liability for umbrella damages by AG Kokott, Case C-557/12 *Kone and Others* ECLI:EU:C:2014:45, para 68. See Franck (n 110) 143–44.

[187] See, e.g., Thomas (n 176) 1418 (referring inter alia to uncertainties as to the scope of Article 101(3) TFEU).

[188] Case AT.39740 *Google Search (Shopping)* [2018] OJ C 9/11.

[189] See Christian Bergqvist, 'Google and the Search for a Theory of Harm' (2018) 39 *European Competition Law Review* 149. Against this background, it has been doubted whether the infringement was committed intentionally or negligently, as required under Article 23(2) of Regulation 1/2003 (n 73). This argument was rejected by the General Court. See Case T-612/17 *Google Search (Shopping)* ECLI:EU:T:2021:763, paras 605–20.

[190] Case C-97/08 P *Akzo Nobel and Others v Commission* ECLI:EU:C:2009:536, paras 54–63.

[191] See, for instance, section 93(1) of the German Stock Corporation Act. Before this 'business judgment rule' was included in the Stock Corporation Act, it had already been recognized in the case law of the German Federal Court of Justice. See BGH 21.4.1997, II ZR 175/95 *ARAG/Garmenbeck* BGHZ 135, 244, 253; Juris, para 22.

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strict duty to examine the legal situation, to obtain legal advice from qualified lawyers, and to check the plausibility of the advice given. If these duties have been observed, liability can be excluded for lack of negligence, even if the conduct is subsequently found to be in breach of antitrust law.[192] The real problem, however, is when the antitrust assessment remains uncertain ex ante, either because a particular scenario has not yet been adjudicated or because the actual or potential effects of conduct are not readily discernible. In individual cases, legal or economic advice may reduce uncertainty but it cannot ultimately eliminate it; it may only make it more apparent to board members.

One conceivable approach in the face of such a state of uncertainty would be to require board members to rigorously avoid taking legal risks (or to accept liability). With regard to the imposition of fines on the company, Advocate General Kokott appears to have suggested such a strict position:

> [An] undertaking … acts at its own risk if the legal opinion obtained by it shows that the legal situation is unclear. In that case, the undertaking is at least negligent in accepting that by its market behaviour it infringes the rules of European competition law.[193]

While there is no legal precedent on the related liability of board directors under German stock corporation law, most academic writers reject such a strict approach. The question that arises, of course, is: what level of risk of illegal action should a board member be allowed to impose on her company? It seems to be widely accepted that, where uncertainty arises from a lack of precedent, it should be permissible to rely on any one of several equally plausible alternative interpretations of the law. However, it has also been argued that a legal risk could be regarded as permissible even where a particular practice is contrary to the precedents of the highest courts, provided that their authoritative power has been weakened, for example, if the court has indicated by obiter dictum its willingness to reconsider its precedent, because of changes in the legal or factual environment, or because of well-founded and widespread criticism in the academic literature.[194] In addition, it was noted that consideration should also be given to possible disadvantages for the company if the legal position adopted by the director is subsequently found to be incorrect (e.g. the imposition of an antitrust fine).[195]

It is therefore quite possible that a company may be fined but have no recourse against its board members if it deliberately engages 'in a particular cause of action [that] is more likely

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[192] See BGH 20.9.2011, II ZR 234/09 *ISION,* Juris, para 18.

[193] AG Kokott, Case C-681/11 *Schenker & Co. and Others* ECLI:EU:C:2013:126 para 71. The court did not take up this point but contented itself with the statement that 'the fact that the undertaking concerned has characterized wrongly in law its conduct upon which the finding of the infringement is based cannot have the effect of exempting it from imposition of a fine in so far as it could not be unaware of the anti-competitive nature of that conduct'. Case C-681/11 *Schenker & Co. and Others*, ECLI:EU:C:2013:404, para 38.

[194] Dirk A. Verse, 'Organhaftung bei unklarer Rechtslage – Raum für eine Legal Judgment Rule?' *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 2017, 174, 191; Hans Christoph Grigoleit and Lovro Tomasic in Hans Christoph Grigoleit (ed), *Aktiengesetz* (2nd edn, C.H. Beck 2020) § 93 para 22. See also Gerald Spindler in Wulf Goette and Mathias Habersack (eds), *Münchener Kommentar zum Aktiengesetz* (5th edn, C.H. Beck 2019) § 93 para 99.

[195] Holger Fleischer in Gerald Spindler and Eberhard Stilz (eds), *Kommentar zum Aktiengesetz* (4th edn, C.H. Beck 2019) § 93 para 31.

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to be permissible than not'.[196] In the absence of a clear legal precedent, however, this remains unresolved under German law, while under Dutch law, managers are only liable in the event of serious culpability.[197]

Duties to ensure antitrust compliance by employees and the 'business judgment rule'. Illegal conduct by employees – with the resulting adverse effects on the company, such as fines and damages to be paid, as well as a loss of reputation – is, from the company's perspective, a business risk whose handling by the company should be assessed by the courts on the basis of the 'business judgment rule'. So, while there seems to be a consensus among legal writers that the board members should have wide discretion in the measures they take to achieve this,[198] there is no clear precedent for this either.[199] The fact that an antitrust violation has occurred, possibly even a hardcore cartel initiated by employees, must not in itself justify the conclusion that the measures taken were inadequate. Given this obvious risk of hindsight bias, even the recognition of broad discretionary powers for board members can only be expected to provide partial protection against over-deterrence.

6.3.2 D&O insurance

Given the availability and widespread use of D&O insurance, liability risks of directors and officers for misconduct to the detriment of the company are now largely hedged. Therefore, if there is a risk of an excessive deterrent effect on management due to the (full) passing on of the company's antitrust fine in the event of a negligent breach of duty by directors and officers, this is substantially mitigated by insurance coverage. However, the potential for over-deterrence may still exist, albeit to a limited extent, mainly due to three factors.

First, antitrust fines imposed on a company may well exceed the coverage limits of D&O insurance. It has been reported that in Germany, for example, coverage limits of between EUR 75 million and 300 million were common prior to 2010, depending on the size of the balance sheet total.[200] For the largest companies, it is probably safe to assume that managers are protected from personal liability in the high hundreds of millions.[201]

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[196] Douglas W. Haws and Thomas J. Sherrard, 'Reliance on Advice of Counsel as a Defense in Corporate and Securities Cases' (1976) 62 Virginia Law Review 1, 33–34 (defining an 'odds opinion' as reflecting 'an attorney's belief that a particular cause of action is more likely permissible than not, although there is no clear legal precedent directly on point'). See for an Austrian perspective, Daniel Madari, 'Die Regressfähigkeit von Kartellgeldbußen' (2021) 50 Der Gesellschafter 14, 16–17.

[197] See Rechtbank Noord-Nederland (n 6) para 4.9.

[198] Holger Fleischer (n 195) § 93 para 56; Gerald Spindler (n 194) § 93 para 115.

[199] In Germany, as far as can be seen, there is only one (though well-known) judgment by a lower court that considered an inadequate compliance organization in a recourse action directed against a former board member. In this ruling, the court did not assess the conduct of the board member against the 'business judgment rule' but found that the defendant had acted negligently regarding the inadequacies of the compliance system. LG München I 10.12.2013, 5 HKO 1387/10 *Siemens/Neubürger,* Juris, para 105.

[200] Wagner (n 159) 235.

[201] See, e.g., LG Hannover 12.10.2022, 23 O 63/21, Juris, para 112 (according to terms agreed in 2015 and 2021, respectively, the Volkswagen AG's board of management in total was apparently insured for up to around EUR 500 million).

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Second, despite D&O insurance, there may be a risk of over-deterrence if the policy provides for a deductible that exceeds the level of optimal deterrence. Whether this possibility is of any practical significance remains uncertain to us. At least in Germany, the opposite phenomenon can be observed: managers are practically not subject to any deductible. While German stock corporation law provides for a mandatory deductible, in practice this provision is usually empty because managers cover the insurance gap with personal insurance, which may even be (indirectly) financed by the company.[202]

Third, D&O insurance policies generally exclude coverage for damages caused by a deliberate or knowing infringement of the law on the part of the insured managers.[203] In line with this policy, it was reported that in the *Heiploeg* case, the insurer considered that the defendant director's liability was not covered because the policy excluded deliberate intent.[204] In the *Safeway Stores* case, however, coverage was apparently not thought to be precluded despite managers' direct involvement in an illegal exchange of pricing information,[205] and in the *Thyssenkrupp* case, it was reported that the insurance company paid part of the claim despite the company's initial argument that the defendant manager had been directly involved in the cartel.[206]

It is true that, in theory, the exclusion of cover for deliberate or knowing infringements may not provoke over-deterrence because the insured can simply refrain from illegal behaviour. In practice, however, there is a grey area where it is not certain whether a court will, in hindsight, assume that the illegality had to be considered merely possible (not excluding coverage) or that there was in fact a knowing breach of the law. Furthermore, a D&O policy may exclude coverage even if a director or officer merely considered a breach of antitrust law to be possible but accepted the risk of illegal dealings.[207]

6.3.3 Conclusion

The discretion granted by the courts in the face of uncertainty as to the applicable antitrust standard and as to the measures that need to be taken to ensure compliance by the employees, as well as the availability of D&O insurance, provides protection against over-deterrence risks that may arise from liability for antitrust fines.[208] However, depending on how these mechanisms are developed, designed, and used in a given legal framework, risks of over-deterrence may remain in individual cases.

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[202] See above n 166 and accompanying text.
[203] See above n 1671.
[204] See above n 21 and accompanying text.
[205] See above n 29 and accompanying text.
[206] See above n 57 and accompanying text.
[207] Wagner (n 159) 250.
[208] See for further mitigating factors Andrea Lohse, '§ 50 Zivilrechtliche Sanktionen' in Gerhard Wiedemann (ed), *Handbuch des Kartellrechts* (5th edn, C. H. Beck 2025, forthcoming), paras 85 and 88.

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6.4 Does EU Antitrust Law Force a Limitation of Managerial Liability for Antitrust Fines to Avoid Over-Deterrence?

Whenever a fine is imposed for a violation of EU antitrust law, whether by the Commission or by national authorities or courts, it must be compatible with the principle of proportionality. This is recognized in case practice, explicitly stated in the ECN+ Directive,[209] and essentially a matter of course, because the imposition of a fine substantially interferes with the fundamental rights of the addressees. Therefore, if a company is fined by a national authority for an infringement of EU antitrust law,

> the Member States must ensure … that infringements … are penalised under conditions, both procedural and substantive, which are proportionate and dissuasive … [T]he principle of proportionality requires, first, that the penalty imposed should correspond to the gravity of the infringement and, second, that when setting the amount of the fine, account should be taken of the individual circumstances of the particular case.[210]

This, however, says little about whether EU law must concern itself if a fine for violation of EU antitrust law discloses an *indirect* effect of excessive deterrence on management via recourse actions provided for under (national) company law. In any event, in its adjudication on fines as an enforcement instrument, the ECJ has made clear that the appropriateness of a sanction must be measured against the objective of the law to be enforced.[211] On this basis, in the context of antitrust enforcement, it would seem consistent if EU law kept an eye on the risks of indirectly excessive deterrence caused by national law insofar as those effects might ultimately undermine antitrust law's regulatory objective. Since EU law uses the general principle of effectiveness to examine whether national law hinders the adequate deterrence of EU law infringements,[212] it seems consistent to use the principle of proportionality to examine whether there is a risk of over-deterrence measured against the objective of the provisions to be enforced. If a fine for an infringement of EU antitrust law results in companies being unnecessarily[213] prevented from exploiting their economic potential because of the effects of excessive recourse liability under national law, this may be seen as frustrating the objective of antitrust law. In this scenario, such an indirect consequence cannot easily be regarded as

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[209] Article 13 and recital 40 of the ECN+ Directive.

[210] Case C-385/21 *Zenith Media Communications* ECLI:EU:C:2022:866, paras 34–35.

[211] Case C-418/11 *Texdata Software* ECLI:EU:C:2013:588, para 52 ('measures provided for under national legislation must not exceed the limits of what is appropriate and necessary in order to attain the objectives legitimately pursued by the legislation in question: where there is a choice between several appropriate measures, recourse must be had to the least onerous, and the disadvantages caused must not be disproportionate to the aims pursued').

[212] See for one the doctrine of so-called *Rewe* effectiveness, pursuant to which national law must not be 'framed in such a way as to make it in practice impossible or excessively difficult to exercise the rights conferred by EU law (principle of effectiveness)'. Case C-505/14 *Klausner Holz Niedersachen* ECLI:EU:C:2015:742, para. 40. See for another the requirements for effective sanctioning as developed following the *Greek Maize* case (above n 103), stating that Member States must provide for sanctions that ensure a 'genuinely dissuasive effect'. Case C-81/12 *Asociaţia Accept* ECLI:EU:C:2013:275, para 63. See also Advocate General Kokott Case C-387/02 *Berlusconi and Others* ECLI:EU:C:2004:624, para 89.

[213] Measured against the level of sanction that would be necessary for effective deterrence.

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merely remote or accidental. Given that a company's supervisory body or (new) management, which may be competent for recourse actions, is obliged to maximize the company's profits, it seems entirely predictable that a legal opportunity to pass on an antitrust fine to the (former) management by way of a damages action will be used in practice.

However, if this argument is accepted, there should be no doubt that the national legislatures enjoy a wide margin of regulatory discretion. Given the complexity of the interplay between the different legal frameworks (antitrust law and company law) that determine the practical effect of antitrust fines and given that the rules on management's recourse liability can have at most an indirect effect on the effectiveness of antitrust fines, judicial review of the national rules on recourse liability should be exercised with restraint. A breach of a general EU law principle should only be presumed where it can clearly and manifestly be shown that the liability regime is likely to have an overly dissuasive effect on management that is unacceptable in the light of the objectives of EU antitrust law.

We have seen that, on the one hand, the recourse liability of managers for antitrust fines imposed on the company carries the risk of counterproductive over-deterrence. On the other hand, a limited judicial review of business decisions can effectively mitigate those risks. In addition, the availability of D&O insurance protects against the excessive impact of recourse liability to a large extent, although not always completely. In the light of the above and the wide margin of discretion left to national legislators, we do not see that a general principle of EU law should compel a general limitation of directors' liability for a fine imposed on a company for a breach of EU antitrust law.

6.5 How Could a Limitation on Managers' Personal Liability Be Implemented?

Even if, as we conclude, general principles of EU law do not compel a cap on the liability of managers for antitrust fines, such a cap provided for in national law may be a good mechanism to protect against excessive deterrence. It could be implemented through either legislative or judicial intervention.

6.5.1 Legislative intervention: liability cap based on variable compensation

In outlining a statutory cap on managers' liability,[214] the challenge is to achieve a convergence of interests between shareholders and management, providing the latter with sufficient incentives to fulfil their obligations to the company (including ensuring compliance with the law) without inducing overly risk-averse behaviour. Ideally, managers should expect to receive an appropriate share of the profits and losses resulting from their decisions.

The question of what a sensible and robust (general) statutory upper limit for the liability of managers would have to look like in this context is beyond the scope of this chapter. It should be noted, however, that it is in the logic of the above that the cap should be calculated in relation to the variable remuneration. Consequently, if a cap for liability for breach of compliance obligations and the resulting antitrust fines were considered, the recourse liability could be limited to the amount of the variable components of the compensation during the period of the antitrust infringement or (in order to prevent circumvention[215]), if higher, to 50 per cent of

[214] For an overview of the discussion in Germany, see Gregor Bachmann, 'Reform der Organhaftung?' in *Verhandlungen des 70. Deutschen Juristentages* (C.H. Beck 2014) E62–E66.

[215] See Wagner (n 159) 274–75.

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the average fixed salary during this period. In addition, in the case of cartels, the liability cap could be subject to a multiplier in recognition of the limited likelihood of detection.

6.5.2 Judicial intervention based on equity considerations

As an alternative to a statutory (fixed or variable) limit on managerial liability, the law may grant the court discretion to reduce the amount of damages recoverable. In the UK, section 1157 of the Companies Act 2006 allows the court to exonerate managers (in whole or in part) from liability for breach of duty if they acted 'honestly and reasonably and … ought fairly to be excused'. Article 6:109 of the Dutch Civil Code allows for judicial intervention if a full award of damages would lead to manifestly unacceptable results in view of the specific circumstances, including the nature of the liability, the legal relationship between the parties, and their financial resources.[216] The introduction of such a provision allowing the judge to reduce the damages to be compensated was also suggested for Germany.[217]

It seems doubtful, however, that a reduction based on equity considerations is a sound approach to avoiding risks of excessive deterrent effects. When weighing their options ex ante, directors and officers cannot reliably consider such a reduction if, ex post, courts have discretion to reduce liability in individual cases (or not).[218] That the possibility of ex post reduction by courts cannot well calibrate the deterrent effect of liability should not be surprising. Its legitimacy derives from equity considerations, i.e., from notions of distributive justice. In view of managers' liability for antitrust fines, the concept is meant to address whether the distribution of the burden of the antitrust fine between company (shareholders) and managers is fair and equitable,[219] not whether managers' liability creates optimal incentives to avoid antitrust fines.

In the absence of statutory authorization, courts might be inclined to establish ad hoc limitations on managers' recourse liability.[220] A notable example is the first-instance decision of the labour court in the *Thyssenkrupp* case, which considered limiting the liability of the managing director for the company's antitrust fine to EUR 1 million. The court based this ceiling for managerial liability on section 81(4) of the German Competition Act, according to which a fine imposed on natural persons for antitrust infringements must not exceed EUR 1 million.[221] In the end, the court did not have to commit itself to this position, as it did not consider the

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[216] In the *Heiploeg* case, the courts rejected such a judicial intervention because the director did not sufficiently substantiate the presence of manifestly unacceptable results, Rechtbank Noord-Nederland (n 6) paras 4.71–4.74; Gerechtshof Arnhem-Leeuwarden (n 7) paras 7.11–7.15.

[217] Gregor Bachmann (n 215) E32 and E123.

[218] Wagner (n 159) 277.

[219] Whether and in which scenarios a reduction of liability appears to be necessary for reasons of corrective or distributive justice is beyond the scope of this contribution. In Germany, some authors recognize a duty of care of the company towards its directors and officers, which would require a limitation of liability; others strictly reject this approach. For the former position, see, e.g., Walter Bayer, 'Legalitätspflicht der Unternehmensleitung, nützliche Gesetzesverstöße und Regress bei verhängten Sanktionen' in Georg Bitter and others (eds), *Festschrift für Karsten Schmidt* (Otto Schmidt 2009) 85, 97; for the latter position, see, e.g., Wagner (n 159) 276–77.

[220] This might also be the case if courts understand that the weakening of shareholder deterrence is the predominant effect, so that EU law requires a limitation of management liability. See section 4.4.

[221] ArbG Essen 19.12.2013, 1 Ca 657/13, Juris, para 140.

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requirements for managerial liability to be met. While the court in its judgment was obviously concerned with equity considerations, the liability ceiling can also be understood as a pragmatic, albeit crude, approach to avoiding risks of over-deterrence. Conceptually, this approach does not fit well, mainly because, in the context of antitrust fining, EUR 1 million does not serve as a cap but marks the upper limit of a fining range.[222] In other words, a fine of this amount would be imposed on an individual only for the most serious conceivable case of antitrust infringement. At any rate, it only applies in cases of intentional injury; in cases of negligence, the upper limit for an antitrust fine is EUR 500,000.[223] These maximum limits for individual cartel fines bear no relation to the factors that should determine a cap on managerial liability. It would be completely arbitrary to apply them to recourse liability for antitrust fines.

6.5.3 Equalization of benefits

Although not designed with the impetus to calibrate the deterrent effect of liability, under German law[224] the principle of equalization of benefits (*Vorteilsausgleichung*) may give courts leeway to reduce managers' liability for antitrust fines that have been imposed on the company. Under this doctrine, if a person who has suffered a recoverable damage also benefits from the event giving rise to the underlying liability, the liable party may deduct that benefit if two conditions are met: first, there must be a causal link between the event giving rise to the liability and the benefit; and, second, the equalization of the benefit must not be contrary to the purpose of the underlying liability for damages, i.e. it must not unduly burden the aggrieved party or unduly benefit the liable party.[225] In principle, the onus is on the liable party to prove that the aggrieved party has received a benefit that can be set off, and the amount of that benefit.[226]

Thus, in the context of managerial liability for antitrust fines, the question arises as to whether a manager who is liable for the damage caused to the company by the antitrust infringement can claim that the company made additional profits as a result of the antitrust infringement, which can be deducted from the antitrust fine in accordance with the principle of equalization of benefits. In the *Thyssenkrupp* case, the Düsseldorf Regional Labour Court considered the principle to be applicable, but without committing itself to this position. In fact, the court emphasized that the issue is controversial in the academic literature, where it is also argued that equalization should be rejected because it is seen as an undue discharge of the liable party, namely the liable manager.[227]

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[222] See Walter Bayer and Philipp Scholz, 'Zulässigkeit und Grenzen des Kartellbußgeldregresses' (2015) GmbH-Rundschau 449, 454.

[223] Section 17(2) of the German Act on Regulatory offences (Gesetz über Ordnungswidrigkeiten).

[224] For a comparative overview of equivalent legal institutions in European legal systems, see Christian von Bar and Eric Clive (eds) *Principles, Definitions and Model Rules of European Private Law*, Vol. 4 (Oxford University Press 2009) 3750–59. The corresponding model provision under the Draft Common Frame of Reference is 'VI. – 6:103: Equalisation of benefits.'

[225] BGH 6.6.1997, V ZR 115/96, Juris, para 7.

[226] BGH 31.1.1991, IX ZR 124/90, Juris, para 9.

[227] LAG Düsseldorf 20.1.2015, 16 Sa 459/14, Juris, para 169. However, the majority of observers, including the two authors cited by the court, consider the set-off of benefits to be permissible. See Holger Fleischer, 'Kartellrechtsverstöße und Vorstandsrecht' (2008) Betriebs-Berater 1070, 1073; Frank Sebastian Hack, *Vorstandsverantwortlichkeit bei Kartellrechtsverstößen* (Peter Lang 2012)

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Indeed, if a company benefits from increased profits as a result of an antitrust infringement, this benefit is a direct consequence of the very event that gives rise to managerial liability. However, insofar as managerial liability is necessary to address the agency problem inherent in a company and thus to enable the deterrent objective of an antitrust fine imposed on a company to be realized in the first place, i.e., to be translated into compliance efforts on the part of the management, this objective of managerial liability would be undermined by equalization. On the other hand, insofar as the antitrust fine for which a manager is to be held liable exceeds the amount of the threat of liability necessary to discipline her effectively,[228] there is nothing in the objective of managerial liability to prevent the equalization of cartel profits accrued by the company. Therefore, depending on the fact that the liable manager can show sufficiently high benefits on the part of the company, courts may, in fact, use the principle of equalization of benefits to allocate an antitrust fine imposed on the company between shareholders and management in such a way that the latter's compliance violations are sufficiently deterred but the former are not unduly relieved of the antitrust fine. However, this would probably only become relevant in practice if the courts were to grant the liable managers certain evidentiary relief, possibly even shifting the burden of proof to the company.[229] Otherwise, it will often not be possible for the defendant manager to prove and quantify the benefits linked to an antitrust infringement.

6.6 Conclusion

The prospect of unlimited managerial liability for antitrust fines carries the risk of undesirable over-deterrence. These risks are not merely theoretical, because, given the uncertainties surrounding both antitrust law itself and antitrust compliance obligations, managers may not simply choose whether or not to breach their legal obligations to the company. However, the law can help mitigate these risks by allowing managers to exercise discretion. In addition, the availability and indeed widespread use of D&O insurance provides comprehensive, albeit imperfect, protection against excessive liability risks. Thus, while the latter may remain a serious problem in individual cases, this is not expected to be the case across the board. Therefore, given that the rules on managerial liability have at any rate only an indirect impact on the dissuasive effect of antitrust fines, the need for a liability cap cannot be derived from general principles of EU law requiring proportionate sanctioning. If, however, the national legislator decides to introduce such a limitation, it should, ideally, be based on the variable components of the managers' remuneration.

82–84; Walter Bayer and Philipp Scholz, 'Zulässigkeit und Grenzen des Kartellbußgeldregresses' (2015) GmbH-Rundschau 449, 454–55.

[228] See above section 6.4.1.

[229] See Kersting (n 150) 1274. Note that such a shift of the burden of proof was rejected by the Düsseldorf Higher Regional Court in the *Stainless Steel Companies* case. See OLG Düsseldorf 27.7.2023, 6 U 1/22 (Kart), Juris, paras 153 and 188.

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7. MANAGERIAL LIABILITY IN THE FOLLOW-UP OF ANTITRUST DAMAGES ACTIONS

If managerial misconduct leads to the company having to pay antitrust damages to aggrieved parties, the question of whether the company may seek contribution from its (former) directors and officers arises in the same way as in the case of an antitrust fine.[230] Although this is not the subject of this chapter, the parallel nature of the questions warrants a brief side glance.

Antitrust damages and fines share the objective of deterring competition law infringements. The deterrent rationale of damages actions for breach of the EU antitrust rules is based on the ECJ's effet utile interpretation of Articles 101 and 102 TFEU, as emphasized in its seminal *Courage* judgment[231] and constantly reaffirmed since then.[232] Thus, insofar as the objectives of antitrust fines and damages are congruent, the question of possible under-deterrence of the company or over-deterrence of its management by recourse liability may arise – but also be answered – in the same way.

However, given the widespread acceptance that damages actions also serve to 'compensate' victims of antitrust violations, an instrumental distinction may be observed. Thus, in addition to deterring antitrust infringements, the ECJ has identified the pursuit of corrective justice as an objective in its own right.[233] The right to full compensation as enshrined in Articles 1(1) and 3 of the Antitrust Damages Directive[234] is often viewed as an endorsement of this objective.[235]

However, to the extent that it is the company that compensates aggrieved parties for inflicted damage – which is, in fact, the most common scenario in antitrust liability cases – issues of internal allocation between the company and its management are irrelevant. Only in the exceptional case that the company is insolvent at the time of an antitrust action for damages could managerial liability be relevant to the compensation of cartel victims. This can be illustrated by the *Heiploeg* case:[236] while this dispute concerned the liability of (former) managers

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230 Robertson (n 32) 326.

231 Case C-453/99 *Courage and Crehan* ECLI:EU:C:2001:465, para 27.

232 Case C-882/19 *Sumal* ECLI:EU:C:2021:800, paras 35–37.

233 Case C-536/11 *Donau Chemie* ECLI:EU:C:2013:366, para 24. See Jens-Uwe Franck and Martin Peitz, 'Cartel Effects and Component Markets' Right to Damages' (2020) 43 World Competition 209, 209–10. The crucial question, though, remains how the notion of corrective justice can meaningfully be employed to define the (legitimate) limits of antitrust damages liability. Jens-Uwe Franck and Martin Peitz, 'Suppliers as Forgotten Cartel Victims' (2018) 15 NYU Journal of Law & Business 17, 46–49.

234 Directive 2014/104/EU of the European Parliament and of the Council of 26 November 2014 on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union [2014] OJ L349/1. See also recital 12 of the Antitrust Damages Directive.

235 It should be noted, however, that the principle of full compensation as enshrined in Articles 1(1) and 3 of the Antitrust Damages Directive 2014/104/EU tells us little about which damages related to an antitrust infringement should (or should not) be compensated and which policy objectives should guide this decision. See Jens-Uwe Franck, 'Private Enforcement in Germany' in Ferdinand Wollenschläger et al (eds), *Private Enforcement of European Competition and State Aid Law* (Wolters Kluwer 2020) 77, 82–83.

236 See section 2.1.

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for an antitrust fine, it is equally conceivable that Heiploeg's bankruptcy trustee could seek compensation from former managers to indemnify the company against an antitrust damages obligation it owes to victims. Admittedly, it is not clear that, in the event of the insolvency of an antitrust infringer, managerial recourse liability can and/or must play an essential role in compensating aggrieved parties: on the one hand, in the insolvency scenario, a successful recourse action by a bankruptcy trustee would arguably benefit all of the company's creditors, not just the antitrust damages creditors. On the other hand, where an antitrust infringement results from joint conduct, undertakings involved are jointly and severally liable for the inflicted harm.[237] Thus, in cartel cases, even in the event of the insolvency of one of the antitrust infringers, the full compensation of a cartel victim will only rarely depend on managerial recourse liability.

In the light of the above, we see no compelling reason why management's recourse liability for antitrust damages claims should be different from that for antitrust fines. In both cases, it should be designed to best address the agency problems faced by the company.

Those who see a need to effectively increase the chances of full compensation for victims of antitrust infringements through managerial liability should instead advocate direct personal liability for those who have participated in cartelization or otherwise facilitated an antitrust infringement.[238] To be sure, such direct antitrust liability of managers vis-à-vis third parties could risk having an overly dissuasive effect on management, depending in particular on the apportionment of damages between the company and the managers and on the risk of bankruptcy of the company, an aspect that we need not go into here.

8. CONCLUSION

This contribution has examined the impact that the protection of the deterrence objective of antitrust fines should have on managerial liability towards the company. We support the view that the civil justice system should not decide on the recourse liability of managers in isolation from the law on antitrust fines. It is therefore conceivable that, contrary to conventional principles of company law, the liability of directors and officers to the company might have to be excluded or limited if the policy of fining would otherwise be undermined. When the European Commission, a Member State competition authority, or a Member State court imposes a fine for an infringement of Article 101 or 102 TFEU, it is a matter not only of national (company) law but also of EU law, in view of the principle of effectiveness, to take due account of the rationale behind antitrust fines. National courts, in particular courts of last instance, which have to decide on the availability of recourse liability in these situations, must therefore consider a referral to the ECJ under Article 267 TFEU in order to clarify the requirements to be derived from the EU principle of effectiveness.

In the light of the above, there are three main findings. First, while we recognize that antitrust fines are intended to have a deterrent effect by affecting the shareholders of a company held responsible for an infringement and that this deterrent effect is (possibly) reduced below the optimal level by passing on (part of) the fine to management, it is not necessary to bar recourse actions against managers responsible for antitrust infringements in order to avoid

[237] See Article 11(1) of the Antitrust Damages Directive 2014/104/EU.

[238] See above n 133 and accompanying text.

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under-deterrence of antitrust violations. Rather, managerial recourse liability must be maintained as an indispensable governance tool for solving the agency problems associated with the risk that management will be prepared to commit cartel violations or not invest adequately in antitrust compliance. Therefore, there are good reasons to believe that, even if shareholder deterrence is reduced, this reduced deterrence is more effective in terms of preventing antitrust violations. Moreover, the availability of managerial recourse liability functions as a deterrence mechanism in its own right, at least partly compensating for the weakened shareholder deterrence it brings. Otherwise, disagreement with key assumptions of ours should be grounds for limitation, not elimination, of recourse liability.

Our findings are in line, for example, with the view of Flaux J on the policy of antitrust penalties as endorsed in the first-instance judgment in the *Safeway Stores* case:

> The suggestion that undertakings will only be deterred from breaching the [Competition] Act [1998] if they are prevented from suing the individuals who caused the breach is completely illogical. I accept [counsel for the claimants'] submission that passing on the penalty to the very people who caused the unlawful acts would not be inconsistent with the 1998 Act.[239]

Second, this also holds true when considering the availability of D&O insurance. We recognize that, given the practice of group insurance, for example, and other shortcomings in the design of D&O insurance, managerial recourse liability is often not ideally translated into incentives to reduce the risk of antitrust violations. Nonetheless, given the deterrent purpose of antitrust fines, the availability of recourse liability against management, even in combination with imperfect (or at least imperfectly regulated) D&O insurance, is preferable to the exclusion of recourse liability. In any event, it should be a reason to limit or otherwise regulate D&O insurance but not to exclude recourse liability per se, if it is assumed that insurability would undermine the deterrent effect of antitrust fines on the company.

Third, we recognize that the risks of over-deterrence inherent in managerial recourse liability may be legally relevant, particularly in light of the general principles of sanctioning in EU law, and that the existence of such risks cannot be denied given the level of antitrust fines. On the other hand, we see mitigating mechanisms at work: the acceptance of managerial discretion under the business judgment rule and the availability of D&O insurance. While there may be scenarios in which significant risks of over-deterrence remain, these findings do not make it necessary to derive a mandatory limitation of managers' recourse liability from the deterrence objective of antitrust fines. Whether or not managers' liability is limited should rather be seen as a policy decision within the discretion of company law legislation and jurisprudence.

Against this background, EU (antitrust) law does not therefore impose any restrictions on the liability of managers for antitrust fines under (national) company law. To the extent that German courts, for example, have argued to the contrary, this is unconvincing.

Finally, it should be emphasized that this chapter, starting from the question of whether the deterrent rationale of antitrust fines requires a denial or limitation of directors' and officers' liability or D&O insurance, has only provided a partial analysis of how directors' and officers' liability for antitrust fines should be designed. In addition to the key findings of our analysis, we have noted that there may be good reasons in a particular jurisdiction to limit managerial recourse liability – be it to avoid excessive deterrence of management or possibly to satisfy

[239] *Safeway Stores Ltd v Twigger* [2010] EWHC 11 (Comm), [2010] 3 All ER 577, at para 130.

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considerations of corrective or distributive justice. A useful benchmark for such a limitation may be the amount of profit-related compensation paid to management during the period of the infringement. In addition, depending on the prevailing practice of D&O insurance and the respective corporate and insurance law framework, there may be good reasons to legally limit the coverage of managerial liability by D&O insurance. Thus, while we do not believe that the deterrence rationale of antitrust fines necessarily requires a limitation on managerial recourse liability or D&O insurance, we do not purport to have conclusively settled how managerial liability should ideally be designed in any particular jurisdiction to achieve the deterrence objective associated with antitrust fines.

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