

FCO Publishes Guidelines on Domestic Effects in German Merger Control

On September 30, 2014, the German Federal Cartel Office ("FCO") published new guidelines on domestic effects in merger control (the "Guidelines").¹ The Guidelines follow the publication of a draft at the end of 2013 on which the FCO had solicited public comments (see our Alert Memorandum dated December 18, 2013).

Pursuant to the German Act against Restraints of Competition ("ARC"), German merger control rules, including the notification and approval requirements, apply only to transactions that have domestic effects in Germany. The Guidelines confirm that, despite the recent amendment to the ARC adding a second domestic turnover threshold, this doctrine continues to apply also in respect of transactions where the parties meet the German filing turnover thresholds, according to which transactions are covered by German merger control only where at least two participants achieve certain minimum turnovers in Germany.² The Guidelines aim to assist companies and their lawyers in determining whether or not a transaction should be deemed to produce domestic effects, and therefore requires notification if the turnover thresholds are met.

The Guidelines are structured such that the FCO, after setting out the legislative framework, identifies transactions which it considers clearly have domestic effects (see *infra* I), transactions which it considers clearly do not have domestic effects (see *infra* II), and then provides general guidance for conducting the necessary case-by-case analysis in all other cases (see *infra* III). Finally, the FCO discusses some practical considerations, including the possibility that in cases with no substantive issues, a precautionary notification may be more expedient than attempting to resolve the sometimes complex question of whether there are domestic effects.

¹ Available in English at http://www.bundeskartellamt.de/SharedDocs/Publikation/EN/Merkblaetter/Leaflet%20-%20Guidance%20document%20domestic%20effects%202014.pdf?__blob=publicationFile&v=2.

² A merger notification requirement is triggered under the German rules if in the last financial year (i) the parties concerned had a combined worldwide turnover exceeding €500 million, and (ii) at least one of the parties concerned had a turnover in Germany exceeding €25 million, and (iii) another party had a turnover in Germany exceeding €5 million.

I. TRANSACTIONS THAT CLEARLY HAVE DOMESTIC EFFECTS

The FCO assumes that transactions involving only two parties (*i.e.*, primarily the acquisition of full control by one party over another) will always have the requisite domestic effect on the German market if both domestic filing thresholds are met, as in such cases both parties have meaningful activity in Germany. Therefore, the FCO's interpretation leaves no room to argue that a transaction lacks domestic effect even if, for example, the parties' activities are in completely unrelated markets so long as both parties achieve meaningful turnover in Germany.

According to the Guidelines, where a transaction triggers both domestic turnover thresholds, domestic effects can therefore only be excluded if more than two parties are involved, for example in the creation of joint ventures (or of companies that are not co-controlled but in which two companies hold at least 25%). However, where the joint venture (or target company) generates a German turnover exceeding €5 million (or has a market share >5% on a geographic market that includes Germany), the FCO considers that such transactions clearly have domestic effect, irrespective of whether there are competitive overlaps.

II. TRANSACTIONS THAT CLEARLY LACK DOMESTIC EFFECTS

The Guidelines then define a category of transactions which are deemed clearly to lack domestic effect, even though the turnover thresholds may be met. Consistent with the view that two-party transactions meeting the turnover thresholds will always have domestic effect, this concerns only transactions with more than two parties, notably the creation of joint ventures (or jointly owned companies). Such transactions are expected to lack domestic effects if the following cumulative conditions are met:

- The joint venture (target company) is not and will not foreseeably be active in Germany (or on any wider geographic market that includes Germany), and
- Spill-over effects between the parent companies can be excluded. This requires that none or only one³ of the parent companies is actually or potentially active on the same (product) market as the joint venture (target company), or is actually active on any upstream or downstream market, in each case where the relevant geographic market includes Germany.⁴

³ The rationale here seems to be that if the joint venture is active on a market that does not comprise Germany, activities of only one parent company on the same (product) market or upstream or downstream markets should not affect competition in Germany even if the market in which the parent company is active comprises Germany.

⁴ While the Guidelines discuss this in the "in between" section (see below), it seems that even where such spillover effects existed, they would only be considered to be sufficiently appreciable if the joint market share of the parents exceeded 20%.

III. CASE-BY-CASE ANALYSIS IN ALL OTHER CASES

The Guidelines then discuss “in between” cases that fall in neither of these two categories, noting that they require case-by-case analysis. The FCO largely discusses in this regard the same criteria identified under II above in relation to transactions that clearly have no domestic effects.

Minimal activity of joint venture in Germany. In cases where a joint venture has some German turnover, but less than €5 million (*i.e.*, where the turnover thresholds are met only by the parents), the transaction may still lack domestic effect if the joint venture’s activities in Germany are “marginal”. The Guidelines suggest that this might be the case where the joint venture’s market share is below 5% and where the transaction does not involve the transfer of significant resources to the joint venture, such as intellectual property rights or know-how, which can be expected to contribute to an increased market presence in the future. In the case of newly formed joint ventures, the expected level of future activity is relevant. This may be established using, for example, business plans for the coming years.

Spill-over effects. In cases where a joint venture itself is not or is only marginally active in Germany (or in markets that include Germany), the FCO considers that domestic effects could still be produced by potential spill-over effects between the parent companies. Where the parent companies are actual or potential competitors on the joint venture’s product market or actual competitors on any up- or downstream market that (geographically) includes Germany, domestic effects should, however, only be sufficiently appreciable if the joint market share of the parents exceeds 20%.⁵

Interestingly, the FCO deleted a paragraph from the draft Guidelines that discussed potential domestic effects resulting from situations where the parents are competitors only on product markets that are (horizontally and vertically) unrelated to the joint venture. Such competitive relationships between the parents should thus generally not be deemed to give rise to domestic effects.

Precautionary notification. Finally, the FCO (correctly) notes that the assessment of whether a particular transaction has domestic effects may in many “in between” cases be more complex than the actual substantive assessment of the transaction. In such cases, the FCO suggests that a (precautionary) notification, which can be fairly lean under German rules, may in fact be the most efficient and fastest means to obtain legal certainty, as the issue of domestic effects can be left open if there are no substantive issues. The Guidelines also refer to the possibility of informal contacts with the FCO to discuss the issue.

⁵ This market share threshold was increased from 10% provided for in the draft Guidelines.

IV. COMMENTS

The FCO's effort to provide guidance on an issue that arises frequently in foreign-to-foreign transactions is generally to be welcomed. The most important aspect of the Guidelines is that the FCO continues to view domestic effects as a requirement for the application of German merger control rules despite the introduction of a second domestic turnover threshold. The FCO has thus refrained from copying the European Commission's approach, which requires automatic notification whenever the (European) turnover thresholds are met, irrespective of whether a transaction could conceivably produce any effect on the European market.⁶

Unsurprisingly, the Guidelines interpret the concept of domestic effects broadly, although less broadly than in the draft Guidelines. Notably, it is worth mentioning that the Guidelines consider domestic effects (potentially) to arise not only if a company is active in Germany itself, but also if it is active outside of Germany but in a market that geographically covers Germany. This would mean that activities in Europe-wide or worldwide markets could be deemed to produce domestic effects in Germany, even though the companies' specific activities may be in remote parts of the world. It is to be welcomed that in the context of joint ventures, the FCO deems cases to have clear domestic effects only if the joint venture has an actual turnover in Germany of at least € 5 million, or a market share of at least 5%. Cases where these thresholds are not met are in the "in between" category, and require case-by-case determination. In this regard, where for example a joint venture might be considered to have domestic effects only because the geographic market is worldwide, the analysis should still take into account the actual geographic proximity of the joint venture's activities to Germany.

It should also be welcomed that the FCO has cut back the overly broad interpretation contained in the draft Guidelines of the circumstances where spill-over effects between the parents of a joint venture that is not (or is only marginally) active in Germany could give rise to domestic effects. Notably, the Guidelines have abandoned the concept that domestic effects could be possible even if the parent companies compete on markets that are entirely unrelated to those of the joint venture. In the same vein, the FCO has increased the combined market share threshold for deeming domestic effects where the parents are active in markets that are (horizontally or vertically) related to the joint venture from 10% in the draft Guidelines, to 20%. As before, it seems that these market shares could be met in respect of sales outside of Germany if the market is Europe- or world-wide.

⁶ Note that the Commission's recent White Paper Toward More Effective EU Merger Control proposes an amendment to the EU Merger Regulation that would exempt joint ventures that have no effect in Europe from notification under the EU Merger Regulation.

The Guidelines should now permit a fairly straight-forward assessment of whether or not a particular transaction is likely to be considered to produce domestic effects in at least a good portion of potentially relevant cases. The FCO has even added a flow-chart listing the key questions in determining whether there are domestic effects, and providing a path to determine whether or not a notification is required.

The Guidelines have important practical effects: The description of categories of transactions under II above that “clearly” do not produce domestic effects should provide a safe harbor for not notifying such transactions. Conversely, transactions described under I above, that the FCO considers “clearly” have domestic effects, will have to be notified as a practical matter, as the guidance provided in this regard may well be material to the FCO’s determination of whether to impose a fine for any failure to notify such transaction. This leaves the “in between” category described under III above. For transactions in this category, parties and their advisors will continue having to determine whether there are domestic effects, although the discussion of relevant criteria in the Guidelines is helpful also in this regard.

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