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GERMAN COMPETITION LAW UPDATE

Recent Developments Regarding the Application of German Merger Control to International Transactions

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This note summarizes a number of recent developments concerning the application of German merger control rules to international transactions.

First, an amendment was passed to the German Act Against Restraints of Competition according to which mergers will only be subject to German merger control if at least two undertakings concerned have a turnover in Germany of at least € 5 million. This limits the jurisdictional reach of German merger control over transactions with little connection to Germany, as under the present rules, a merger could be subject to notification if only one party had significant activities in Germany, even if the other party or parties had virtually no sales in Germany.

Second, the German Federal Cartel Office (FCO) demonstrated its intention to enforce notification requirements by imposing substantial fines in two cases (one of which related to a non-German transaction) for the breach of the prohibition under German law to consummate the mergers prior to clearance by the FCO. However, both cases involved rather exceptional circumstances and blunt violations of the merger control rules.

Third, the Düsseldorf Court of Appeals recently rendered a decision addressing the powers of the FCO to prohibit non-German mergers. According to this decision, the FCO is entitled to prohibit non-German mergers even if the focus of the merger is outside of Germany, provided that the German part of the merger cannot be prohibited separately from the remainder of the merger in order to address the competition concerns in Germany, and provided that there are no important interests of foreign states considerably outweighing the German interest in a prohibition of the transaction. (The decision is under appeal to the German Federal Court.)

I. INTRODUCTION OF A SECOND DOMESTIC TURNOVER THRESHOLD

On February 13, 2009, legislation was passed amending the merger control rules in the German Act Against Restraints of Competition (ARC) by introducing a second domestic turnover threshold. Under the revised law, mergers will only be subject to German merger control (both under procedural and substantive aspects) if at least two parties involved in the merger have a group-wide turnover in Germany of at least € 5 million. The amendment is expected to come into effect in the next few weeks.

Under the current rules, a merger is subject to German merger control rules if the combined worldwide turnover of the parties to the transaction exceeds € 500 million and if the turnover of only one participating undertaking was higher than € 25 million in Germany. These thresholds are often fulfilled by one party to a merger alone, *e.g.*, by large international companies with substantial activities in Germany. Transactions involving such companies were in principle notifiable even if the other party or parties to the transaction had only minimal or even no sales in Germany. The amendment leaves the € 500 million and € 25 million threshold requirements untouched, but adds as a third requirement that one other participant in the transaction must have a German turnover of at least € 5 million. The amendment does not affect the continuing validity of the *de minimis* exceptions.

The introduction of a second domestic turnover threshold aligns German merger control rules more closely with those of many other jurisdictions (as well as with recommendations of the International Competition Network and the OECD), which also require that at least two participants in a merger reach a minimum domestic turnover threshold. While this change is certainly welcome, it is notable that the € 5 million threshold is substantially lower than the domestic turnover thresholds in most other Western European jurisdictions, which range from € 15 million to € 60 million (and concern national markets that are generally smaller than Germany). According to estimates by the German legislator, it is expected that the change in the law could nevertheless reduce the number of notifications dealt with by the FCO (currently in the order of 1,800 to 2,500 per year) by roughly one third.

The amendment does not affect the basic requirement that the German ARC is applicable only to transactions that have an effect on the German market (see also the discussion below under Section III). In the past, this requirement allowed companies to avoid notification in certain cases where the current thresholds were only met because one of the parties had significant operations in Germany and where the other party or parties had no activities in Germany. However, the FCO interpreted this requirement very strictly and usually considered that even the slightest potential effect on the German market was sufficient to satisfy this requirement and trigger a notification obligation. It must now be expected that the FCO will take the position that mergers fulfilling the new requirements because two parties have significant sales in Germany will be deemed *per se* to have also the required effect on the German market. Nevertheless, it may still remain possible to argue the absence of effects on the German market in exceptional cases (*e.g.*, where the activities of the two parties on the German market are entirely unrelated and will not be influenced by the merger, or where two parties with significant activities in Germany create a joint venture elsewhere in the world which will not be active in Germany and has no effect on the parties' German activities).

Pending the entry into force of the amendment, the FCO has advised companies to try to delay the closing of mergers that would benefit from the change until the amendment is implemented (expected to occur in a few weeks) or, alternatively, to discuss the filing with the FCO, noting that transactions concerned should in principle still be notified. While that may be true as a technical matter, it appears unlikely that the FCO would pursue parties for not notifying a transaction that could be (re-)consummated only a few weeks later without notification and clearance.[1]

II. FINES FOR CONSUMMATION OF MERGERS WITHOUT CLEARANCE

In parallel to the legislative change described above, the FCO demonstrated its determination to enforce the notification and approval requirement by imposing substantial fines in two recent cases where mergers were consummated prior to obtaining the required clearance from the FCO ("gun jumping").

In the first case, US food company Mars was fined € 4.5 million[2] for completing its acquisition of US pet food producer Nutro Products before obtaining the FCO's approval. This is the highest fine ever imposed by the FCO for gun jumping, and, as far as is known, the first case where such a fine was levied against a non-German transaction.

The second case concerned a German transaction. The FCO fined printing and publishing house Druck und Verlagshaus (DuV) € 4.1 million after it completed its

[1] It may still be advisable to notify transactions taking place in Germany or being subject to German law in order to avoid the potential invalidity of the transaction because of the failure to notify and obtain clearance.

[2] Fines for breach of the notification and clearance requirement can theoretically go up to 10% of the turnover of the party concerned. The specific amount of the fine was calculated in both cases on the basis of the FCO's fining guidelines from 2006.

acquisition of the publisher Frankfurter Stadtanzeiger without meeting its obligation to notify the transaction. Although the transaction was completed in 2001, the FCO only became aware of it in 2008 in the context of another notification.

While these fines show the FCO's determination to enforce the notification and clearance requirements, it must also be said that both cases presented rather exceptional circumstances. Mars had in fact notified the transaction to the FCO, but then decided to close the transaction in the midst of the merger control proceeding and apparently despite the FCO having raised substantive objections. In fact, the FCO ultimately insisted on the sale of the rights to the target's brand in Germany and certain production formulas and know-how to a competitor of Mars.[3] In the other case, DuV had carried out its transaction shortly after the FCO had raised substantive issues with respect to a similar acquisition by DuV, on the basis of which the FCO considered DuV to have breached the consummation prohibition intentionally in order to avoid a potential prohibition. Moreover, DuV had used a trustee structure that the FCO considered to have constituted an attempt to conceal the transaction.

It therefore does not necessarily follow from these decisions that the FCO would also impose fines in cases where the notification requirement may not be entirely clear and that do not raise substantive issues.

III. THE PHONAK DECISION OF THE DÜSSELDORF COURT OF APPEALS

The Düsseldorf Court of Appeals' (Oberlandesgericht Düsseldorf) decision in the Phonak matter was recently published. The case concerned an appeal of the FCO's prohibition of the acquisition of the Danish company GN ReSound by the Swiss company Phonak. Both companies are mainly active in the production and sale of hearing aids. The FCO considered the merger to result in the creation or strengthening of a dominant oligopoly in the market for the sale of hearing aids to hearing aid retailers. It thus prohibited the merger, despite the fact that the transaction was primarily a non-German transaction. The Court confirmed the prohibition and elaborated in its decision on a number of important aspects concerning the applicability of German merger control law to foreign-to-foreign transactions.

3 It is interesting to note that the FCO considered insufficient in this regard Mars' attempt to exclude the impact of the consummation of the transaction on the German market by leaving the distribution rights for Nutro's products in Germany with the seller. The FCO noted in this regard that Mars still obtained control over Nutro's competitive potential in Germany by having acquired the brand rights and the production facility in the US, from which apparently also the German market was supplied.

The prohibited transaction had only limited links to the German market. Both parties to the transaction were non-German companies. Phonak's activities in Germany were limited to sales. GN ReSound's core business of developing and producing hearing aids was also mainly based outside of Germany. GN ReSound also had primarily sales of hearing aids in Germany, although it also had some production in Germany. The two companies achieved less than 10% of their combined worldwide turnover in Germany. Given the modest size of the transaction, it was notifiable only in the U.S., Germany, and Austria.

Direct and appreciable effects on the German market as a requirement for a prohibition. German merger control rules are applicable to all restraints of competition that have an effect in Germany, even if they originate from outside of Germany. The Court stated in this regard that with respect to the prohibition of a merger, this means that a merger would be subject to prohibition under German merger control rules only if it directly and appreciably impaired free competition in Germany.[4] This was presumed to be the case in the matter decided as both companies were active on the relevant German market and Phonak would have gained 5-10% market share as a result of the merger.

No requirement for prohibition that the merger be centered in Germany. According to the Court, if a merger had the required direct and appreciable effect on the German market, it is, in principle and subject to the international public law implications discussed below, subject to German merger control rules, including a potential prohibition, regardless of whether the merger had its focus in Germany or elsewhere. The Court disagreed in this regard with the Swiss state, which had argued that the fact that the transaction was centered in Switzerland and Denmark would prevent the application of German merger control rules.

Public international law limitations for prohibitions. The Court confirmed that international public law places limitations on the FCO's ability to prohibit a non-domestic merger, although it considered these limitations inapplicable to the present case.

First, the Court reiterated the already recognized principle that the prohibition of an international merger under German merger control rules must be limited to the

[4] This standard pronounced by the Court for the prohibition of a merger is of course higher than the standard applied by the FCO in determining whether a notification requirement with respect to a non-German transaction exists, where the FCO lets suffice any, even only slight and not necessarily anticompetitive, effects on the German market (see above under Section I). It is recognized, however, that the level of effects necessary to trigger the application of German antitrust law may differ depending on the content of the substantive provision concerned.

German part of the merger if the merger was divisible in a German and a non-German part, and if such limitation was suitable to remedy the anti-competitive effects on the German market. In the present case, the court agreed with the FCO, however, that the merger was not divisible in this way, since the target company's market position in Germany was in large part derived from its non-German production capacities, know-how, and patent portfolio.

Second, the Court examined whether the prohibition under public international law of abusive behavior and the principle of non-intervention in the internal affairs of another state would limit the FCO's power to prohibit a non-German transaction. It acknowledged that the interest of a state in the enforcement of its own legal order and antitrust laws has, as a general matter, to be balanced against conflicting interests of the state or states primarily affected by the enforcement. However, according to the Court, only in extreme cases, where important interests of a foreign state considerably outweigh the German interest to protect its competitive order, will German merger control not be applicable.

In the case decided, the Court saw no need for a balancing of such interests, since it considered that no valid interest had been raised by Switzerland or Denmark (the home countries of the parties). The Court noted that it was not apparent that the merger was of importance to the Danish or Swiss economy and that it could not identify negative economic effects that would follow if the merger was not consummated. While the Swiss government had argued that the German state lacked the power to prohibit the transaction because the focus of the merger was outside of Germany, the Düsseldorf Court considered this an expression of a legal view, but not of a relevant interest of the Swiss state. The fact that the merger had not been subject to control under the Swiss and Danish merger control regimes would not amount to a sufficiently important antitrust policy interest of these countries that could outweigh the German interest in prohibiting the transaction under German merger control rules.

The decision is currently under appeal to the German Federal Court.

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