Antitrust and Competition

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The Long Arm of the German Merger Control Rules: Two Important Developments

Given the worldwide proliferation of merger control regimes in recent years, companies contemplating M&A transactions are increasingly familiar with having to file in multiple jurisdictions worldwide. Still, the jurisdictional reach of national merger control systems can often be surprising. The German filing thresholds are particularly significant in that they are not only comparatively low, but also can be met by the acquirer alone: a company with global revenues of more than €500 million and German revenues in excess of €25 million must report **any** planned transaction with appreciable effects in Germany to the German Federal Cartel Office (FCO), regardless of the target's size and location.[1]

Following is a discussion of two recent developments that so far have received surprisingly little attention outside of Germany despite their significance for international transactions:

- In late October 2006, the FCO prohibited Coherent's proposed acquisition of Excel Technology. Like *GE/Honeywell*, this deal involved only US parties, concerned worldwide markets and had been cleared by US authorities months earlier. The decision illustrates the FCO's willingness to intervene in transactions that have their center of gravity outside of Germany. It also highlights potential differences in approach between the FCO and the US agencies, as well as other competition authorities.
- The interpretation of the "*de minimis* market clause"—by far the most important exception to the reportability with minimal impact on Germany—is now pending before the German Supreme Court after the Düsseldorf Appellate Court rejected the FCO's interpretation of the clause on 22 December 2006. The Supreme Court ruling, expected in late 2007, will have a significant impact on the reportability of deals in Germany.

Coherent/Excel–Echoes of *GE/Honeywell*

On 25 October 2006, the FCO prohibited California-based Coherent, Inc., from acquiring New York–based Excel Technology, Inc., in the laser area.[2] This was a relatively small deal with a purchase price of $76 million. Coherent had 2005 global revenues of €420 million and Excel had global revenues of €110 million.

The FCO has an established track record of prohibiting mergers, having issued four prohibition decisions in 2006 and six in 2005. But, in this case, the FCO prohibited a US-US merger that the US Department of Justice (DOJ) had already cleared months earlier.[3] The FCO did so, moreover, based on a worldwide market definition, rather than focusing on competitive conditions in Germany, which may have been different from those in the United States. Thus, like *GE/Honeywell*,[4] this is a case of real transatlantic divergence.

In *GE/Honeywell*, the principal sources of the divergent outcomes were well-publicized differences in the EU and US approaches to conglomerate and vertical mergers. By contrast, *Coherent/Excel* was a classic horizontal merger case, making the reasons for the divergent outcomes puzzling—particularly with the extensive redactions in the published version of the FCO's decision and the absence of any DOJ statement explaining its decision not to challenge the transaction.[5]

It is conceivable, though, that product market definition was the root cause of the different competitive assessments. During the proceedings, Coherent appears to have proposed both wider (to dilute the parties' market shares) and narrower (presumably to show that the parties' lasers are largely complementary—rather than competitive—and/or to benefit from the *de minimis* market clause) product market definitions. In any event, although the product market definition that the FCO adopted ("sealed-off radio

frequency induced carbon dioxide lasers up to 600 Watts") is fairly narrow, the US DOJ has often applied narrow market definitions in cases it reviews.

Another possible cause for divergence may have been the FCO's more "structural," as opposed to the DOJ's more "effects-based," approach to merger control cases. The FCO tends to focus more on abstract, longer-term risks resulting from high combined market shares, rather than engage in a detailed, fact-intensive analysis of how specifically the transaction would harm competition in the more immediate term. In its decision, the FCO focused on the parties' combined market share in excess of 50%, as well as the "very large" market share gap between the merged entity and its next largest competitors. It also emphasized the breadth of the merged entity's product portfolio and competitors' relative weakness in the areas of scale and scope efficiencies, brand reputation and R&D resources. The FCO gave short shrift to the parties' argument that their products are not particularly close substitutes, asserting that the parties' products either were part of the same market–or, if they were not, that differences in product attributes, marketing focuses or other factors might cause the parties to compete against each other less frequently than the market shares might suggest.[6] At one stage, the FCO explicitly rejected the suggestion that merger control should be primarily concerned with post-merger price increases.[7]

There is no public information about the DOJ's analysis of the deal, but the DOJ may have focused more on customers' views concerning the substitutability of the parties' products, internal company documents, sophisticated analysis of the likely price effects of combining the parties' product portfolios, and dynamic factors such as market entry, market expansion or repositioning in response to any post-merger price increase. The summary of the notifying party's arguments in the decision suggests that the FCO may have been influenced by the submissions of competitors with an obvious interest in blocking the transaction, and may have ignored neutral or even positive customer opinion.[8] If this was indeed the case, it might also help to explain the different outcome in the US investigation.

Although one needs to be careful not to overstate what *Coherent/Excel* may portend for future cases, there is reason to believe that we could see a repeat of the circumstances of *Coherent/Excel* and *GE/Honeywell*. While the FCO and some German academics[9] continue to defend a primarily structural approach to merger analysis, such an approach is increasingly out of step not only with the US agencies' approach but also the European Commission's merger policy.[10] The *Coherent/Excel* decision suggests that the FCO will not be shy about imposing its structural approach even for transactions that originate outside of Germany. Notably, the FCO also rejected various remedies proposals made by the parties, either because they were behavioural approaches (and thus explicitly prohibited under German competition law[11]) deemed insufficient to address the FCO's concerns or offered too late in the process.

Supreme Court to Settle Geographic Scope of *de minimis* Markets

A significant exception to the very low German filing thresholds is the so-called *de minimis* market clause (*Bagatellmarktklausel*).[12] Under this provision, the FCO is precluded from assessing the transaction's effects on relevant product markets in which total annual sales were less than €15 million in the preceding calendar year. A transaction that concerns only a *de minimis* market(s) need not be reported at all.

The law is, however, silent on a key point, namely whether the €15 million ceiling applies to the relevant geographic competition market (which could be Europe-wide or even worldwide) or to sales of the relevant products in Germany only. The latter interpretation substantially increases the number of transactions that benefit from the *de minimis* market clause and consequently fall outside the FCO's jurisdiction. It is thus not surprising that following a 2004 German Supreme Court ruling that stressed the importance of examining market conditions outside of Germany,[13] the FCO adopted the view that the application of the *de minimis* market clause should follow geographic market definition rather than being limited to Germany.

However, on 22 December 2006, the Düsseldorf Appellate Court (which hears all appeals of FCO decisions) rejected the FCO's newfound interpretation of the *de minimis* market clause,[14] holding that the purpose of the *de minimis* market clause is two-fold: to reduce the FCO's workload, and to avoid disproportionate regulatory burdens for mergers affecting only very small markets. Both objectives would be undermined by the FCO's interpretation of the clause.

The FCO's reaction was immediate. On 9 January 2007, it announced that it had appealed the Düsseldorf Court's decision to the German Supreme Court (*Bundesgerichtshof*).[15] Until the German Supreme Court rules on its appeal (which is expected in mid-to-late 2007), the FCO will continue to

base its enforcement practice on its own interpretation of the *de minimis* market clause. Referring to a pending case in which the parties—based on the Düsseldorf Court's decision—closed the transaction without awaiting the FCO's clearance, the FCO warned that companies doing so were proceeding at their own risk. The FCO even stated that it will consider proceedings to unwind such transactions and may fine companies and their lawyers that fail to notify and await the FCO's clearance in such situations.

Given the FCO's statements, companies anticipating the Supreme Court upholding the Düsseldorf Court's ruling are thus running a considerable risk if they fail to report transactions based on the wider interpretation of the *de minimis* market clause. At the same time, however, it appears doubtful whether the FCO would now be willing to block properly reported transactions over which it would have jurisdiction only under its own interpretation of the *de minimis* market clause.[16] Thus, until the Supreme Court rules, one might expect the FCO to pursue one of two possible options. First, it could look for ways to clear the transaction without taking a position on the legal question, e.g., by arguing that the geographic market is in any event limited to Germany so that the Supreme Court's ruling is not decisive. Second, it could seek to put pressure on the parties to agree to extend the FCO's statutory review period until the Supreme Court decides. However, parties are under no obligation to do so and might well want to test the FCO's resolve on the issue.

In any case, hopefully the Supreme Court will soon resolve the issue once and for all. Clearly, companies that currently need to file even the smallest transactions in Germany would benefit from an interpretation that imposes at least modest limits on the FCO's jurisdiction.

1. The FCO even takes the view that under certain conditions, the acquisition of targets without any German revenue can be reportable. See the FCO's Notice on domestic effects, available in English at www.bundeskartellamt.de/wDeutsch/download/pdf/Merkblaetter/Merkblaetter_englisch/99_Inlandsauswirkung_e.pdf.

2. Available (only in German) at www.bundeskartellamt.de/wDeutsch/download/pdf/Fusion/Fusion06/B7-97-06.pdf.

3. On 9 May 2006.

4. Commission decision of 3 July 2001 in Case COMP/M.2220. In its judgment of 14 December 2005 in Case T-210/01, the Court of First Instance upheld this decision even though it held that the Commission had made several errors of assessment, in particular in its analysis of conglomerate effects.

5. The DOJ had issued a second request on 27 March 2006.

6. Para. 107.

7. Para. 109.

8. Para. 23.

9. *See* e.g. Böge, Der "more economic approach" und die deutsche Wettbewerbspolitik, WuW 2004, 726; Ewald, Paradigmenwechsel bei der Abgrenzung relevanter Märkte?, ZWeR 2004, 512.

10. *See* e.g. former Commissioner Monti's speech of 28 February 2004 on "Convergence in EU-US antitrust policy regarding mergers and acquisitions: an EU perspective," available at http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/04/107&format=HTML&aged=0&language=EN&guiLanguage=en.

11. *See* Section 40 (3) of the German Act against Restraints of Competition.

12. Section 35 (2) no. 2 of the German Act against Restraints of Competition.

13. WuW/E DE-R 1355 – Staubsaugerbeutelmarkt.

14. Available (only in German) at www.justiz.nrw.de/nrwe/olgs/duesseldorf/j2006/VI_Kart_10_06__V_beschluss20061222.html.

15. Available at www.bundeskartellamt.de/wDeutsch/aktuelles/2007_01_08.php.

16. In such a situation, the FCO could even be liable for damages if the Supreme Court subsequently confirms the Düsseldorf Court's ruling.

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