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Working Party No. 3 on Co-operation and Enforcement

ANTITRUST ISSUES INVOLVING MINORITY SHAREHOLDING AND INTERLOCKING DIRECTORATES

-- Germany --

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ANTITRUST ISSUES INVOLVING MINORITY SHAREHOLDINGS AND INTERLOCKING DIRECTORATES

1. Introduction

1. Minority shareholdings and interlocking directorates may reduce competition between companies and result in significant anti-competitive effects. There may be various reasons for this, in particular a firm's strategical interest in a (potential) competitor with the effect that actual or potential competition between the companies involved is "muted". Furthermore, a minority shareholding may enable a company to obtain information relevant to the competitive behaviour of its competitor. Interlocking directorates may also facilitate information exchange between competitors and thus enable companies to set up and successfully maintain anticompetitive agreements. Furthermore, the bundling of interests in one undertaking may result in the anti-competitive foreclosing of markets to (potential) competitors.

2. To address these potential anti-competitive effects, German merger control law has, since its entry into force in 1973, contained provisions that address the acquisition of minority shareholdings. These provision have been amended since to prevent circumvention. Furthermore, minority shareholdings may be subject to review under provisions addressing anticompetitive agreements.

3. The following focuses on the experience of the *Bundeskartellamt* as regards, in particular, minority shareholdings by introducing representative case examples in the areas of merger control law and anti-competitive agreements.

2. Merger control law and minority shareholdings/interlocking directorates

2.1 General remarks

4. In Germany, in recent years, merger control proceedings concerning the acquisition of minority shareholdings have been of particular importance in the energy sector. Since the beginning of the liberalization of the energy markets in Europe and Germany, the major players in the German energy markets, in particular RWE and E.ON, have pressed ahead with the acquisition of shareholdings in regional as well as local gas and electricity suppliers (municipal utilities). The *Bundeskartellamt* therefore critically examines whether even minority shareholdings can lead to a strengthening of a dominant position and would thus have to be prevented or cleared only subject to effective remedies. In view of the highly concentrated market structures of the gas and the electricity markets and the low degree of residual competition, even small strengthening effects may be of relevance and lead to structural changes in the market conditions. The *Bundeskartellamt* has investigated in detail a number of such merger projects in the last years, of which it has prohibited several and cleared others only subject to strict remedies. In the following, the relevant provisions of German merger control law will be described and important cases highlighted.

2.2 Transactions covered by German merger control law

5. Under German merger control law, the acquisition of minority shareholdings may be subject to merger control if the respective transaction is caught by the merger control provisions (provided that the

thresholds are met and no exception applies[1]). Transactions relevant in the context of minority shareholdings are, firstly, the acquisition of at least 25% of the shares (capital or voting rights) in another undertaking (§ 37 (1) No. 3 lit. b Act against Restraints of Competition (ARC)), and secondly, other transactions enabling one or several undertakings to directly or indirectly exercise a competitively significant influence on another undertaking (§ 37 (1) No. 4 ARC)[2].

6. While the former type of transaction, the acquisition of at least 25% of the shares, is quite straightforward, the latter (§ 37 (1) no. 4 ARC) merits some more explanation: This catch-all clause was introduced into the ARC with effect from January 1, 1990. The practice of the *Bundeskartellamt* had shown that some undertakings intended to circumvent merger control by structuring acquisitions so that participations below 25% would be acquired but coupled with special rights with respect to the target undertaking. The newly introduced subsidiary provision § 37 (1) no. 4 ARC has closed this gap.

7. A competitively significant influence on another undertaking may exist due to any kind of link between two or more undertakings that allows the acquiring party to influence the competitive behaviour of the target in such a way that it is likely to reduce competition between the undertakings, to the degree that they will no longer act independently on the market. For a competitively significant influence it may also suffice for the target to adapt its competitive behaviour to the interests of the acquirer. A competitively significant influence may also arise from agreements on pre-emption rights, sales strategies and financial structures, as well as from legal possibilities to exert influence, such as the right to be consulted, information and disclosure rights, and not least the right to appoint representatives to the management bodies of the target. Personal interlocks in the form of having the same persons on the management boards of both companies may also lead to a competitively significant influence where these persons are entitled to exercise influence. A further possibility is the transfer of entrepreneurial responsibility for certain sub-divisions of the company. Decisive in all cases is the factual possibility to exercise influence that is granted to the acquirer.

2.3 Case examples

2.3.1 Acquisition of at least 25% of shares

E.ON/Eschwege (2003)

8. In September 2003 the *Bundeskartellamt* prohibited EAM Energie AG, Kassel, a firm which belongs to the E.ON group, from acquiring a 30% share in the municipal utility Stadtwerke Eschwege GmbH. The merger was the first in a series of E.ON projects to acquire stakes in municipal utilities. The in-depth examination carried out by the *Bundeskartellamt* has shown that the planned participation would have been likely to strengthen the dominant positions held by the E.ON group both in the electricity and gas sales markets. Thus, the participation would have resulted in further market foreclosure effects.

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1 See § 35 Act against Restraints of Competition (ARC). An English version of the ARC is available at http://www.bundeskartellamt.de/wEnglisch/download/pdf/06_GWB_7__Novelle_e.pdf.

2 In exceptional cases the acquisition of minority shareholdings may also, together with special rights, confer control on another undertaking (§ 37 (1) No. 2 ARC. The provision corresponds to Article 3 (1) lit. b EC Merger Control Regulation. In that regard, a minority shareholding alone does not suffice to acquire control. Rather, e.g. rights or contracts must confer decisive influence on the target to enable the acquirer to decide upon fundamental questions of competitive relevance concerning the target.

9. The Düsseldorf Higher Regional Court confirmed the decision in June 2007 on appeal[3]. Central to the proceedings were the fundamental questions of whether Germany's electricity markets are still dominated by a powerful duopoly of the two large energy companies E.ON and RWE and whether this duopoly is foreclosing markets and expanding its market power by a joint strategy of acquiring successive shares in municipal utilities. The court stated that "[t]here is no substantial competition against E.ON and RWE in the domestic electricity markets which could control the scope of action emanating from their paramount market position." In the proceedings before the court the *Bundeskartellamt* based its opinion on two national surveys which it conducted on the market situation in the electricity markets in Germany. According to these surveys both companies hold a paramount position in the generation and distribution of electricity. More than 60% of the electricity consumed by industrial and household consumers in Germany is generated, imported and distributed by E.ON and RWE. Since electricity cannot be stored, these companies with their paramount position, both at the generation and distribution level, control the distribution of electricity to the consumers. This is possible because of the companies' large electricity parks with a broad mix of different plant technologies. Unlike municipal utilities and independent generators, they are in a position to cover all load levels such as base, medium and peak. By securing sales through acquisitions of stakes in municipal utilities the companies would be able to expand their dominant position and ultimately foil endeavours towards promoting competition in the transmission of electricity in regulated networks.

10. The findings of the court as to the market position of E.ON and RWE underline the importance of a thorough review of the acquisition of minority shareholdings to prevent mergers that would be competitively harmful.

EnBW/Ludwigsburg (2005)

11. In another case a subsidiary of EnBW AG (EnBW) planned to acquire a 35 % interest in Stadtwerke Ludwigsburg GmbH (Stadtwerke Ludwigsburg), a municipal utility. The parties to the merger project withdrew the notification after they had been informed about competitive concerns by the *Bundeskartellamt*. The *Bundeskartellamt*, in its preliminary findings had concluded that the merger would have been likely to result in the strengthening of a dominant position on the market for the supply of local gas distributors. It had to be expected that, out of consideration for its new partner, Stadtwerke Ludwigsburg would acquire gas from this partner with the effect that the local market for the supply of gas to end customers would *a priori* be closed to competitors of EnBW. Moreover, there would have been the danger of Stadtwerke Ludwigsburg strengthening its dominant position in the market for gas end customers due to the fact that the competitive pressure hitherto resulting from a potential market entry by EnBW would have ceased.

2.3.2 Competitively significant interest

Axel Springer/Stilke (1997)

12. The leading case on transactions that confer a competitively significant influence on other companies is Axel Springer/Stilke.

13. Axel Springer Verlag (ASV) is a major media group which is active in the publishing business with newspapers, magazines and books. Although ASV's intended participation in Stilke, a chain of railway station bookshops, only involved a minority participation of 24%, it still created a competitively significant influence due to the factual possibilities to exercise influence: Since another company

[3] Düsseldorf Higher Regional Court, decision of 6. June 2007, WuW/E DE-R 2094 *et seq.*, *E.ON/Stadtwerke Eschwege.*

participated in Stilke only for investment interests, ASV would have been able to pursue its strategic interests in a joint venture. The *Bundeskartellamt* prohibited the intended minority participation of ASV in Stilke because it would have strengthened ASV's dominant positions on several reader and advertising markets. ASV's dominant position would have been strengthened because with the participation it would have gained a right to information, and thus could have used information on the situation in the sales markets to its benefit and to promote the sale of its own products.

14. The prohibition decision was confirmed as final by the Federal Court of Justice.[4]

Mainova/Aschaffenburger Versorgungs AG (2004)

15. In July 2004 the *Bundeskartellamt* prohibited the electricity and gas provider Mainova AG (Mainova) from acquiring a 17.5% stake in Aschaffenburger Versorgungs GmbH (AVG), the energy subsidiary of the Aschaffenburg municipal utilities. Mainova is a regional gas supplier, AVG a local distributor of gas.

16. The examination of the project showed that the planned participation was likely to result in a strengthening of the dominant positions of Mainova and AVG. In particular, the markets for the supply of gas to distributors and to small customers were affected, both horizontally and vertically. According to the consortium agreement, the participation of Mainova in AVG was meant to establish a "long-term strategic partnership". The partnership was aimed at finding mutual solutions for all competition-related and other economic questions. The planned cooperation was in the corporate interest of both parties to the merger who would no longer have acted independently on the market. Mainova's possibility to influence AVG's activities was also secured under corporate law through supervisory board mandates and pre-emption rights. Mainova held a dominant position in the regional market for the distribution of gas, AVG was dominant in the downstream local market for the supply of end customers with gas. The *Bundeskartellamt* came to the conclusion that the merger would have strengthened these positions. Mainova would, due to information rights resulting from its 17.5 % interest in AVG, have been in a position to influence negotiations for new contracts to its advantage. Mainova would have been able to obtain comprehensive knowledge of the supply offers of competitors. Consequently, it would have been possible for Mainova to make a counter-offer. Furthermore, it was to be expected that AVG and its municipal majority shareholder would respect the interests of its minority shareholder, Mainova, when concluding new contracts for the supply of gas. In turn, the dominant position of AVG would be strengthened through the connection with Mainova because it could be expected that Mainova, a potential competitor of AVG, would no longer contest AVG's market position by entering the market herself. A further strengthening of dominance would have increased the companies' scope for action, and thus also their leeway for setting prices, to the detriment of the consumers.

17. The decision was confirmed by the Düsseldorf Higher Regional Court in November 2005[5].

2.4 Distinction between minority shareholdings representing a passive financial investment and minority shareholdings that allow some form of control

18. In principle, the reasons why an undertaking plans to acquire an interest in another undertaking are irrelevant for the application of German merger control law. An exception applies in the context of the so-called banking clause, § 37 (3) ARC. Irrespective of the level of participation, this clause exempts the

4 Federal Court of Justice, decision of 21 November 2000, WuW/E DE-R 607 *et seq.*, *Minderheitsbeteiligung im Zeitschriftenhandel*.

5 Düsseldorf Higher Regional Court, decision of 23. November 2005, WuW/E DE-R 1639 *et seq.*, *Mainova/StW Aschaffenburg*.

acquisition of shares in an undertaking from merger control if the acquirer is a credit or financial institution or an insurance company which intends to resell the shares within a period of one year, does not exercise the voting rights attached to the shares, and definitely resells the shares within this period. This rule largely corresponds with Article 3 (5) lit. a of Council Regulation (EC) No 139/04. Its purpose is to facilitate the transactions and dealing in securities by financial service providers. By acquiring shares within the context of their general operations these companies do not normally pursue any objectives which would be relevant to competition. The time limit of one year may, upon application, be extended by the *Bundeskartellamt*, if it can be shown that the resale was not reasonably possible within this period. If resale does not take place within one year and the time limit is not extended, the acquisition is subject to merger control. The same applies if the original plan to resell is abandoned or if the voting rights attached to the shares are exercised.

2.5 Specific legal provisions dealing with interlocking directorates

19. Specific legal provisions dealing with the anticompetitive effects of interlocking directorates do not exist in German competition law, *i.e.* the general rules as described above apply.

20. German competition law does, however, mention "links with other undertakings" as a factor to be taken into account when assessing dominance[6].

2.6 Remedies

21. According to § 40 (3) ARC clearance may be granted subject to conditions and obligations. These shall not aim at subjecting the conduct of the undertakings concerned to a continued control. Thus, only structural remedies may be employed, in particular the divestiture of participations, operations or assets to third parties not associated with the merging companies. One of the main reasons why the legislator has refrained from allowing behavioural commitments is that a permanent supervision of whether behavioural remedies are observed would involve considerable problems for the competition authority.

3. Anticompetitive Agreements, § 1 ARC and Article 81 EC

3.1 Horizontal agreements

22. The *Bundeskartellamt* also assesses the acquisition of minority shareholdings under § 1 ARC (anticompetitive agreements) or, respectively, Article 81 EC if the respective agreement may affect trade between Member States of the EC.

23. So far the *Bundeskartellamt* has examined such agreements predominantly in the context of mergers that had been notified under merger control law. In its "Ostfleisch" decision the German Federal Court of Justice confirmed that the creation of joint ventures may not only be subject to merger control but may also constitute a restrictive agreement under § 1 ARC[7]. According to the decision of the Federal Court of Justice, § 1 ARC is applicable if, after the creation of the joint venture, the parent companies and their joint venture are active on the same product and regional market. The Federal Court of Justice has stated that in this situation it would have to be expected from undertakings acting in a commercially reasonable way not to pass on to consumers all cost advantages arising from the cooperation. Rather, they would be expected to coordinate their pricing behaviour with the effect that price competition between the undertakings would be reduced or eliminated[8]. In practice the *Bundeskartellamt*, if feasible, assesses a

6 See § 19 (2) No. 2 ARC. Note that the scope of the provision is general and not limited to merger control law.

7 Federal Court of Justice, decision of 8. May 2001, WuW/E DE-R 711 *et seq.* - *Ostfleisch*

8 *Ibid.*, at page 716.

transaction under both merger control law as well as § 1 ARC/Article 81 EC in one proceeding. If this is not possible, the assessment under § 1 ARC/Article 81 EC will be reserved for subsequent examination.

3.1.1 Case example – Xella/Nord-KS (2006)

24. A case that was assessed exclusively under § 1 ARC and Article 81 EC concerned the minority shareholding of Xella Deutschland GmbH (Xella) in the joint venture Nord-KS GmbH + Co. KG (Nord-KS).

25. Xella belongs to the Haniel Group and is, both worldwide and in Germany, a leading producer of sand-lime brick and certain masonry materials. Xella (as well as another company that held a minority shareholding in Nord-KS) and the joint venture Nord-KS are active on the same product and geographic market, a regional market in northern Germany.

26. In the joint venture Nord-KS, Xella held an interest of 17.5%. Under the partnership agreement a large number of business policy decisions relating to the joint venture, e.g. the adoption of the annual investment and financial plan, required the approval of an advisory council in which Xella held 17.5% of the votes. The council's records revealed that Nord-KS's price and rebate policy had also been discussed within the council and that decisions had already been made to raise prices and reduce rebates. Although, with 17.5% of the votes, Xella did not have the possibility to block the council's decisions, its presence in this council gave the company an opportunity to gain knowledge of all the business strategy decisions of its competitor Nord-KS, and to influence these to its own benefit. The *Bundeskartellamt* concluded that it was to be assumed that the parent companies of the joint venture, which continued to be active in the market, coordinated their market behaviour. No dynamic price competition was to be expected from Nord-KS vis-à-vis its parent companies as secret competition had been eliminated. As a result the market position of the market leader Xella was strengthened by its minority participation in its competitor Nord-KS.

27. In 2006, in its decision based on § 1 ARC and Article 81 EC, the *Bundeskartellamt* concluded that the implementation of the partnership agreement violated these rules and, based on § 32 ARC[9] (which is similar to Article 7 Council Regulation (EC) 1/2003), ordered Xella to withdraw from the joint venture within a time period of one year from service of the decision. The *Bundeskartellamt* also ordered as interim measures that Xella was not to participate in Nord-KS council meetings, exercise its voting rights in the council or request the submission or inspection of minutes of council meetings. It was also ordered that the other shareholders in Xella should not provide Xella with minutes of the council meetings.

28. The Düsseldorf Higher Regional Court confirmed the decision that the agreement was in violation of § 1 ARC but found that as it would not affect trade between Member States, the agreement was not in contradiction of Article 81 EC[10]. The court has also confirmed the interim measures ordered by the *Bundeskartellamt*.

29. On the other hand, the court also held that is was not proportionate to order Xella to withdraw from the joint venture. Rather, it held that is was Xella's decision how to react to the finding that the joint venture agreement was in violation of § 1 ARC and thus void.

30. The case is currently under appeal before the Federal Court of Justice.

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9 Note that under § 32 ARC behavioural as well as structural measures to bring to an end the infringement are, in principle, possible, subject to the principle of proportionality.

10 Düsseldorf Higher Regional Court, decision of 20 June 2007, WuW/E DE-R 2146 *et seq.*, *Nord-KS/Xella*.

3.2 Vertical agreements

31. In principle, § 1 ARC and Article 81 EC are also applicable if an undertaking acquires a minority shareholding in a firm that is active not on the same market but where a vertical relationship exists. In such a situation, a firm may in particular use its influence on another firm in which it has an interest to foreclose rivals from the output or input of products or services. However, the *Bundeskartellamt* has not yet issued a decision on such a case.