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ROUNDTABLE ON FAILING FIRM DEFENCE

-- Note by Germany --

This note is submitted by the Delegation of Germany to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 21-22 October 2009.

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1. Introduction

1. The OECD Competition Committee debated the failing firm defence in merger review in May 1995.[1] The following submission seeks to further contribute to the discussion, building on the German submission from 1995.[2]

2. The main goal of German merger control is to safeguard the competitive structure of markets against the potential anticompetitive effects of mergers. Consequently, according to Section 36 (1) of the German Act against Restraints of Competition (*Gesetz gegen Wettbewerbsbeschränkungen*; hereinafter: ARC), any merger that creates or strengthens a dominant position has to be prohibited by the Bundeskartellamt. An exception to this rule applies if one party to the transaction is a struggling company that will likely fail in the imminent future. However, the failing firm defence (*Sanierungsfusion*), as this exception is called, has very stringent requirements.

3. In German competition enforcement practice, the failing firm defence has predominantly been invoked in times of economic crisis. This holds true in particular for the period following German unification (early 1990s).[3] Since then the failing firm defence has only rarely been invoked and – even more rarely – granted.[4] However, it has recently gained attention and practical relevance in enforcement practice.[5]

4. This submission seeks – from a German perspective – to contribute to the clarification of the requirements of the failing firm defence.

2. Statutory provisions and relevant enforcement practice

5. The German competition act ARC does not contain any specific provisions regarding the failing firm defence. The German legislature has deliberately decided not to introduce such provisions.[6] In a competition-based market economy, the market exit risk is a basic feature of the market process. Consequently, from a competition point of view, the market exit of any company is not to be seen in a more unfavorable light than a takeover. Mergers where at least one of the undertakings involved would otherwise exit the market are therefore subject to the same legal provisions as all other mergers. In spite of the fact that they need to be dealt with speedily, the general procedural and material requirements apply to them as to all other merger cases.

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1 See OECD, Failing Firm Defence, Paris, 2006, Doc. OCDE/GD(96)23.

2 *Ibid*, page 55/56.

3 See for example BKartA, Tätigkeitsbericht 1989/1990, page 113 – *Lufthansa/Interflug* (merger clearance denied); BKartA WuW 1992, 317 – *Schott Glaswerke/Fernsehglas Tschernitz* (merger clearance granted based on failing firm defence); BKartA WuW 1992, 496 – *Vereinigte Schmiedewerke/Radsatzfabrik Ilsenburg* (merger clearance granted based on failing firm defence); BKartA WuW 1992, 606 – *Suhler Verlagsgesellschaft / Südthüringer Verlag* (merger clearance granted based on failing firm defence).

4 Cases, in which merger clearance was granted based on the failing firm defence include, for example, BKartA, Tätigkeitsbericht 1997/1998, page 88/89 – *DuMont Schauberg/Kölnische Rundschau*; BKartA WuW/E DE-V 848 – *Imation/EMTEC* (2003) and BKartA WuW/E DE-V 1226 – *RTL/n-tv* (2006).

5 See, for example, BKartA B6 – 67/09 (*Eberbacher Zeitung/Rhein-Neckar-Zeitung*) (not published; German case summary available at http://www.bundeskartellamt.de/wDeutsch/download/pdf/Fusion/Fusion09/Kurzberichte/B6-67-09-Fallbeschreibung.pdf?navid=47).

6 See the official rationale for the relevant laws (Begr. RegE 2. GWB-Novelle, BT-Drucks. VI/2520, page 29); see also *Schmidt*, Die Sanierungsfusion im Zielkonflikt zwischen Unternehmenserhaltung und Wettbewerbssicherung, in: Die Aktiengesellschaft, 1982, page 169 (170).

6. According to Section 36 (1) ARC, any merger that creates or strengthens a dominant position has to be prohibited by the Bundeskartellamt. However, the prerequisites for a prohibition are only met if the dominant position is created or strengthened explicitly through the merger. In other words, there has to be a causal link (*Kausalität*) between the merger and the creation or strengthening of the dominant position. In failing firm scenarios, this causal link might be missing, as the competitive situation in the market absent the proposed merger – in case of the insolvency and/or market exit of the failing firm (i.e. the relevant "counterfactual") – may not differ from the competitive situation following the merger. Against this background, the failing firm defence can generally be dealt with as a case of missing causality. The relevant prerequisites have been shaped by past enforcement practice and are explained in more detail below.

7. The failing firm defence can principally also be dealt with under the balancing clause (*Abwägungsklausel*) of Section 36 (1) clause 2 ARC and under the provisions for a ministerial authorisation (*Ministererlaubnis*), Section 42 ARC. However, for reasons explained in more detail below, both the balancing clause and the ministerial authorisation have – at least for the last 20 years – not played a significant role in the evaluation of failing firm cases. Consequently, the subsequent analysis will focus primarily on the "causal link criterion".

2.1 Causal Link (Kausalität)

8. The prerequisites for the failing firm defence have taken shape during the past enforcement practice of the Bundeskartellamt.[7] They were also laid down in the "Principles of Interpretation of Market Dominance in German Merger Control" issued by the Bundeskartellamt in 2005 (*Auslegungsgrundsätze zur Prüfung von Marktbeherrschung in der deutschen Fusionskontrolle*; hereinafter: Interpretation Principles)[8]. According to the prerequisites, a merger that invokes the failing firm defence can be cleared, if the following conditions are cumulatively met:

a) One of the merging parties would – absent the merger – likely fail in the imminent future;

b) there is no alternative merger to the proposed merger between the failing and the acquiring firm; and

c) it is to be expected that the market shares of the failing firm would fully accrue to the acquiring firm even absent the proposed merger (i.e. in case of a market exit by the failing firm).

9. The burden of proof regarding the fulfillment of all these prerequisites rests with the merging entities.[9] The Bundeskartellamt sets the level of proof to be provided by the merging entities quite high. It has in particular emphasized that a mere assertion about the fulfillment of the prerequisites was not sufficient. Instead, it has pointed out that all prerequisites have to be proven with "appropriate documents".

10. Regarding prerequisite (a), appropriate documents may in particular include accounting documents (e.g., annual reports).[10] In assessing whether these documents sufficiently prove that one of the

7 Recent enforcement practice that has taken up the following prerequisites includes, for example, BKartA WuW/E DE-V 695 (704/705) – *Tagesspiegel/Berliner Zeitung* (2002); BKartA WuW/E DE-V 777 (784) – *Ajinomoto/Orsan* (2003); BKartA WuW/E DE-V 848 (852) – *Imation/EMTEC* (2003); BKartA WuW/E DE-V 1087 (1102/1103) – *Rhön/Grabfeld* (2005); BKartA WuW/E DE-V 1226 (1233) – *RTL/n-tv* (2006); BKartA WuW/E DE-V 1407 (1421/1422) – *LBK Hamburg/Mariahilf* (2007).

8 Please note that the Interpretation Principles are currently under review and have been taken from the Bundeskartellamt's homepage.

9 However, the Bundeskartellamt has in some cases – without any legal obligation to do so – initiated research on its own (see, e.g. BKartA DE-V 1407 (1421) – *LBK Hamburg/Mariahilf* (2007)).

10 See, for example, BKartA DE-V 1226 (1234)– *RTL/n-tv* (2006).

merging parties would – absent the merger – likely fail in the imminent future, the Bundeskartellamt has in the past not established general evaluative criteria. In contrast, it has put emphasis on the specific circumstances of each individual case. Recently, it has held in an individual case that it was sufficient, if the documents showed that the failing company had for more than 10 years almost consistently incurred a deficit and that there were no serious prospects of reorganization.[11]

11. As far as prerequisite (b) is concerned, the merging parties have to provide evidence that the failing firm has unsuccessfully sought out alternative – and less anticompetitive – purchasers.[12]

12. Although it was often difficult enough in the past for the merging parties to demonstrate that the prerequisites set out under (a) and (b) were met, even more problems can arise with regard to prerequisite (c). The reason is that the "causal link criterion" generally requires that the market shares of the failing firm would *fully* accrue to the acquiring firm absent the merger.

13. As long as the only two competitors in a given market merge, the Bundeskartellamt has so far regularly assumed that the criterion was fulfilled.[13] However, if there are more than two market participants, this cannot be easily assumed because it is likely that some of the market shares of the failing company will also fall to the other market participants.[14] In such cases, other evaluative criteria – like the effect the market exit of the failing firm has on the market structure – could be taken into account. This approach has in particular been favored by the Monopolies Commission (*Monopolkommission*).[15] The Bundeskartellamt has so far not had to explicitly decide this question in its enforcement practice.

14. As far as the so-called "failing division defence" is concerned, the Bundeskartellamt has stated in its Interpretation Principles that it would recognize this defence neither for "failing divisions" nor for "failing affiliates".[16] However, it has so far not had to explicitly decide this question in its enforcement practice.

2.2 Balancing Clause (Abwägungsklausel)

15. Under the balancing clause, a merger that would lead to the creation or strengthening of a dominant position can be cleared if the undertakings concerned demonstrate that it would lead to improvements on third markets that more than outbalanced (*überwiegen*) the disadvantages of market dominance. This clause can generally also be applied to failing firm scenarios.[17] The relevant companies would then in particular have to demonstrate that the rescue merger would lead to improvements on third markets that more than outbalanced the disadvantages of market dominance. Given that the improvements must generally be demonstrated on *third* markets, the hurdles for merger clearance based on the balancing

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11 BKartA WuW/E DE-V 1226 (1234) – *RTL/n-tv* (2006).

12 See, for example, BKartA, Tätigkeitsbericht 1997/1998, p. 87 (89) – *DuMont Schauberg/Kölnische Rundschau*; BKartA DE-V 1407 (1421) – *LBH Hamburg/Mariahilf* (2007).

13 See, for example, BKartA WuW/E DE-V 848 (852) – *Imation/EMTEC* (2003) and the Interpretation Principles (please note that the Interpretation Principles are currently under review).

14 See, for example, Federal Court of Justice (*Bundesgerichtshof*) WuW/E BGH 1655 (1660) – *Zementmahlanlagen II* (1979) and Higher Regional Court of Dusseldorf (*OLG Düsseldorf*) VI-Kart 6/05(V) – *Rhön/Grabfeld* (2007), para. 141.

15 See *Monopolkommission*, Sondergutachten 42, Die Pressefusionskontrolle in der Siebten GWB-Novelle, para. 140. The Monopolies Commission is an independent, evaluative and advisory body assessing the development of competition law in Germany (see http://www.monopolkommission.de/).

16 Please note that the Interpretation Principles are currently under review.

17 See, for example, OLG Düsseldorf VI-Kart 6/05(V) – *Rhön/Grabfeld*, para. 140/141 and *Emmerich*, Fusionskontrolle 2005/2006, in: Die Aktiengesellschaft 2006, page 861 (870).

clause remain relatively high.[18] Nevertheless, there have in the past been failing firm cases, in which merger clearance was granted based on the balancing clause.[19] Recently, however, there have been no such cases.[20]

2.3 Ministerial Authorisation (Ministererlaubnis)

16. Under the provisions for a ministerial authorisation, the Federal Minister of Economics and Technology can authorize a merger prohibited by the Bundeskartellamt if the restraints of competition resulting from it are outweighed (*aufwiegen*) by advantages to the economy as a whole or if the concentration is justified by an overriding public interest. Generally, a ministerial authorisation can also be applied for in failing firm cases. The merging parties would then have to demonstrate that the rescue merger would lead to advantages to the economy as a whole that outweighed the restraints of competition or that the merger would be justified by an overriding public interest.

17. In the few cases, in which the failing firm defence was brought, the provisions for a ministerial authorisation have been applied very restrictively.[21] Nevertheless, as is the case with the balancing clause, there have been failing firm cases in which (partial) merger clearance was granted based on a ministerial authorisation.[22] It needs to be emphasized, though, that the relevant companies could in all these cases demonstrate that the proposed merger would lead to additional advantages to the economy as a whole that outweighed the restraints of competition resulting from it or that the concentration was justified by an overriding public interest. Recently, there have been no failing firm cases in which a ministerial authorization was applied for.

18. As far as the failing division defence is concerned, the Federal Minister of Economics and Technology has emphasized that it was primarily the duty of the parent company to support the failing division in any economically reasonable way.[23] However, specific criteria that could be used in determining whether the potential support was economically reasonable or not, have not yet been devised. Given the fact that the Interpretation Principles[24] do not recognize the failing division defence,[25] no such criteria have emerged during the enforcement practice of the Bundeskartellamt.

3. Conclusion

19. The failing firm defence (*Sanierungsfusion*) has in the past been an important enforcement tool for the Bundeskartellamt, especially in times of economic crisis. The Bundeskartellamt has thereby generally dealt with it as an issue of causality (*Kausalität*). In other words, it has recognized the failing firm defence particularly in those cases where the competitive effects of the proposed merger would equal the competitive situation absent the merger (i.e. in case of a market exit by the failing firm). However,

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18 Regarding this prerequisite, see for example, BKartA, WuW/E DE-V 1407 (1423) – *LBK Hamburg/Mariahilf* (2008) and OLG Düsseldorf VI-Kart 6/05 (V) – *Rhön/Grabfeld*, para. 141.

19 See for example BKartA, Tätigkeitsbericht 1976, page 79 – *Karstadt/Neckermann*.

20 For a recent (non-failing firm) case that deals with the balancing clause see BKartA B7-200/07 – *KDG/Orion* (available at http://www.bundeskartellamt.de/wDeutsch/download/pdf/Fusion/Fusion08/B7-200-07.pdf.

21 See, for example, WuW/E BWM 177 (180) – *IBH/WiBau* and WuW/E BWM 159 (162) – *Thyssen-Hüller*.

22 WuW/E BWM 155 (157) – *Babcock/Artos* (1976; ministerial authorisation granted subject to obligations); WuW/E BWM 159 (162) – *Thyssen/Hüller* (1977; ministerial authorisation partially granted); WuW/E BWM 177 – *IBH/WiBau* (1981; ministerial authorisation granted).

23 WuW/E BWM 177 (181) – *IBH/WiBau* (1981). See also WuW/E BWM 165 (173) – *Veba/BP* (1979).

24 Please note that the Interpretation Principles are currently under review.

25 See above, section 2.1.

there are stringent prerequisites for this criterion to be fulfilled. These prerequisites have emerged during the past enforcement practice of the Bundeskartellamt and were also laid down in the Interpretation Principles issued in the year 2005.[26]

[26] Please note that the Interpretation Principles are currently under review.