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GERMANY LIMITS THE REACH OF ITS MERGER CONTROL LAW BUT IS EXPECTED TO INTRODUCE NEW FOREIGN INVESTMENT SUPERVISION

Also imposes high fines on companies that violate the merger filing and stand-still obligations

On 13 February 2009, the German Parliament adopted a long-awaited legislative amendment that will significantly reduce the number of mergers and acquisitions that fall under the German merger control regime. In the future, a transaction will require merger notification in Germany only if two parties generate German turnover of more than €25 million and €5 million, respectively.

At the same time, an emerging fining practice of the Federal Cartel Office (FCO)—two recent fines in excess of €4 million—indicates that implementing a transaction that has not (yet) been cleared by the FCO is likely to become significantly more costly for companies in the future.

Separately, an amendment to the German external trade and foreign investment laws passed the main parliamentary hurdle on 13 February 2009. The amendment grants the German government the power to block acquisitions of German companies by non-European companies for reasons of public policy or public security. These developments are discussed below.

SECOND DOMESTIC TURNOVER THRESHOLD OF €5 MILLION INTRODUCED IN MERGER REGIME

Following the amendment to Germany's Act against Restraints of Competition (German acronym: GWB), it will be necessary for two, rather than one, of the parties to the transaction to have minimum turnover in Germany. More specifically, in the future, a concentration that does not fall within the European Commission's jurisdictions will require notification in Germany if, in the last completed financial year prior to the transaction:

- one party generated German turnover of more than €25 million;
- another party generated German turnover of more than €5 million; and
- the combined worldwide turnover of all parties together exceeded €500 million.

In addition, the transaction must produce appreciable domestic effects in Germany, but this will normally be the case for transactions that meet the above thresholds.

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The two existing filing exemptions remain applicable, but their practical relevance will likely diminish because transactions that meet the new threshold test are less likely to meet the conditions for exemption. Under the exemptions, as interpreted by the FCO, a merger filing is not required if:

- one party (in the case of the target, this includes the seller) had worldwide turnover of not more than €10 million in the last completed financial year; or
- the transaction only affects markets with a total German market size of €15 million in the last calendar year (provided that these markets have existed for at least five years).

The amendment is part of a wider law aimed at cutting red tape for the benefit of Germany's *Mittelstand* composed of small and medium-sized enterprises, but it will be at least as beneficial to large companies whose German turnover exceeds €25 million. In the past, these companies often notified acquisitions of target companies that had no, or only minimal, activities in Germany, because the FCO's broad interpretation of the "domestic effects" test did not allow these situations to be firmly excluded from the filing requirement. This led to unnecessary costs and delays for the merging parties.

In line with the Recommended Practices for Merger Notification Procedures adopted by the International Competition Network (ICN) in 2003 and the regime that applies at EU level (and in most EU Member States), the new second domestic turnover threshold ensures that only transactions with a more appreciable impact on the German economy will require notification in the future.

The thresholds of €25 million and €5 million are still relatively low given the size of Germany's economy (Belgium requires two parties to have domestic turnover of €40 million, the Netherlands requires two parties with €30 million). Accordingly, the number of transactions falling under the German rules, which peaked at 2,231 in 2007, will remain high by international standards, even if the German government expects a decrease of up to one third as a consequence of the new threshold.

The high number of notifications is also due to the fact that the German law captures a wider range of transactions than the laws of many other jurisdictions. It applies not only to acquisitions of majority interests, but also to acquisitions of non-controlling minority stakes of 25% or even less.

The amendment will enter into force the day after its publication in the *Federal Gazette*, which is expected for the coming weeks.

SIGNIFICANT FINES FOR VIOLATING THE FILING AND STAND-STILL OBLIGATION

Separately, the FCO recently imposed record fines on companies for implementing transactions without first obtaining the required merger clearance from the FCO (gun-jumping).

US-based company Mars Inc. was fined €4.5 million in December 2008 for acquiring the shares of another US-based company while the FCO was still reviewing the case upon notification by Mars. The FCO rejected as ineffective the parties' carve-out structure, under which Mars did not acquire the German distribution rights for the target's products when proceeding with the international closing of the transaction.

Earlier this month, the FCO also imposed a fine of €4.13 million on a German printing and publishing house for acquiring a German competitor without making the necessary merger filing in 2001.

By a wide margin, these are the highest fines ever imposed on companies for violating the filing and stand-still obligations. The fines were, for the first time, calculated on the basis of Fining Guidelines that the FCO adopted in 2006 after the GWB's maximum possible fining level for gun-jumping had been increased to 10% of worldwide consolidated group turnover of the companies in question.

In both cases, the level of fines was impacted by the fact that the transaction raised substantive concerns and that the parties proceeded in full knowledge of the filing and stand-still obligations. But more generally, the decisions also demonstrate that the FCO is prepared to vigorously enforce the German merger control rules and impose higher fines than in the past for gun-jumping.

The Mars decision also highlights the difficulties of validly carving Germany out from an international closing. In other jurisdictions, the risk exposure is lower in this regard. Finally, it should be kept in mind that the FCO will not limit its merger analysis to the impact on competition in Germany, but rather evaluates competition in what it determines to be the proper geographic market, which can be European-wide or worldwide. Indeed, the FCO has prohibited transactions in the past that had anti-competitive effects on worldwide markets (but arguably not within Germany if considered separately).

NEW FOREIGN INVESTMENT SUPERVISION FOR REASONS OF PUBLIC POLICY OR PUBLIC SECURITY

On 13 February 2009, the German Parliament also took a major step towards the adoption of a highly controversial amendment to Germany's external trade and foreign investment laws (the *Aussenwirtschaftsgesetz* and the *Aussenwirtschaftsverordnung*). The amendment creates a new power for the government (not for the FCO, which is in charge of merger control) to block the acquisition of voting shares in a German company by a company that is located outside the EU, Iceland, Liechtenstein, Norway, or Switzerland for reasons of public policy or public security.

The new rule applies as soon as the total percentage of voting shares held by the acquirer reaches 25% after the transaction. Acquisitions by European-based acquirers fall under the rule only if a non-European company owns at least 25% of the voting rights in the acquirer and the latter is essentially a vehicle set up by the non-European parent to circumvent the government's new blocking power.

Companies do not need to inform the German government about the transaction, but the government can request the submission of detailed information within three months of the conclusion of the acquisition agreement or the launch of a public bid. After receipt of complete information, the government has two months to decide whether or not to prohibit or require modifications to the transaction.

The new rule raises many issues of interpretation and it remains open whether it would withstand scrutiny under the EC Treaty provisions on the freedom of establishment and the free movement of capital. In the press, it has been portrayed as a law against the buy-out of German industry by state-owned funds of countries like China or Singapore, but its scope of application is obviously much broader and it raises significant concerns of growing protectionism in times of economic crisis.

Many future acquisitions of German companies by non-European acquirers that trigger merger control risk also falling under the new foreign investment supervision. While the German government expects to substantively review only "very few" cases per year, given that the substantive issues must relate to the relatively narrow areas of public policy or security, the fact that the government has three months from the conclusion of the acquisition agreement to decide whether or not to start a review procedure may add timing complications for a transaction. Unlike the merger rules, the new foreign investment rule does not require companies to delay the implementation of a transaction, but the implementation is at the companies' own risk if the German government later raises concerns of public policy or public security. To limit this uncertainty, the parties can ask the government for confirmation that it will not review the transaction, which the government must respond to within one month.

The amendment has been adopted by the first legislative chamber (*Bundestag*) on 13 February 2009. The second chamber (*Bundesrat*) is expected to agree given that it did not voice significant opposition upon a first reading, although it theoretically can initiate an additional consultation procedure with the *Bundestag* before 6 March 2009.

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