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Federal Cartel Office obtains powerful yet restricted "New Competition Tool"

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Alongside other new competencies, the German Federal Cartel office is gaining the power to impose the behavioral and structural remedies needed to fight a considerable and continuous competition disturbance, even on undertakings that are fully compliant with competition law. This "New Competition Tool" is powerful, yet restricted by far-reaching conditions and limitations, meaning its future practical significance may turn out to be limited.

On 6 July 2023, the German parliament granted final approval to an act that amends the **German Act against Restraints of Competition** (ARC) for the 11th time since its inception in 1958 (11th ARC Amendment). The 11th ARC Amendment expands the enforcement powers of the German Federal Cartel Office (FCO) in several respects.

Introduction of "New Competition Tool"

A powerful addition to the FCO's competition law toolbox

The centerpiece of the 11th ARC Amendment is the introduction of a new competence for the FCO to counteract, following a sector inquiry, a **considerable and continuous competition disturbance** (CCCD) by imposing **behavioral or structural remedies**, which may even include the **breaking up of companies**. This new competence is supposed to complement the traditional competition law tools and can thus be called a "New Competition Tool" (NCT).

The NCT **aims to close the enforcement gaps** allegedly left by the traditional competition law tools: According to the reasoning provided in the 11th ARC Amendment, Articles 101 and 102 TFEU and their national equivalents leave gaps in, for example, digital markets with strong network and scale effects and leave unchecked "tacit collusion" in oligopolistic markets.

Similarly, merger control allegedly fails to consider internal company growth, market exits and small concentrations that do not meet the merger control thresholds.

Because traditional competition law tools are seen as inherently unsuited to closing these gaps, the NCT takes a **fundamentally different approach** (called by some a "paradigm shift"). The traditional tools target competition disturbances indirectly by penalizing companies for violations (for example, the anti-competitive agreements targeted by Article 101 TFEU, the abusive behavior targeted by Article 102 TFEU and the anti-competitive concentrations targeted by merger control). In contrast, the NCT directly addresses the disturbed competition itself. The only substantive requirement for the application of the NCT is a CCCD—there is no need for any illegal behavior to have taken place.

In effect, the NCT constitutes a **competition "blanket clause"** allowing the FCO, following a sector inquiry, to address competition disturbances that may have occurred for whatever reason.

The flip side of the increased effectiveness of the NCT as compared to the traditional competition law tools is that it encroaches more heavily on the fundamental rights of the undertakings concerned. This is because, under the NCT, the FCO will typically impose **remedies on undertakings that have been fully compliant** with all competition laws. Doing so constitutes a more severe intervention than imposing remedies on non-compliant undertakings.

In view of both its increased effectiveness and the greater burden it places on undertakings, the NCT is a **powerful addition to the FCO's competition law toolbox**. This is illustrated by comments made by the German Minister for Economic Affairs, whose ministry conceived the NCT.

When **publicly announcing** a near-final draft of the 11th ARC Amendment, he called it as a whole "the largest ARC reform in decades, possibly even since Ludwig Erhard" (the German Minister for Economic Affairs from 1949 to 1963) and specifically the NCT "too sharp a sword to relate to only one market" (namely the fuel-gas market, in the context of which it was **initially politically debated**). He added that the NCT is designed to spur competition and innovation by opening up markets which suffer from entrenched market power.

Restricted by far-reaching conditions and limitations

At the same press conference, the German Minister for Justice agreed with the Minister for Economic Affairs, and added that, following the first published draft of 20 September 2022, additions have been made to the 11th ARC Amendment that ensure its **compatibility with the German constitution**, in particular with the principles of proportionality, legal certainty and judicial control, and with the fundamental right to property. He concluded by stating that the 11th ARC Amendment fosters long-term investments in the German economy. The additions comprise most of the following **far-reaching conditions and limitations**:

The NCT is **subsidiary** to the abovementioned traditional competition law tools, i.e., the FCO may use it only where the traditional tools are expected to be insufficient to effectively and permanently remove the competition disturbance.

The NCT may be used only where a **CCCD** exists. As this term has been deliberately chosen to be completely new under German competition law, in order to avoid any connection to the traditional competition law tools, the 11th ARC Amendment describes it to some extent:

- The law contains a non-exhaustive exemplary list of **elements of theories of harm** that can lead to a CCCD, namely (i) unilateral supply or demand power; (ii) barriers to market entry or exit, limitations of undertakings' capacities, barriers preventing switching to another supplier or customer; (iii) uniform or coordinated behavior; and (iv) input or customer foreclosure through vertical relationships.
- The law contains a detailed non-exhaustive list of **relevant factors** that the FCO should take into account when checking for a potential CCCD. The list essentially contains all the elements of market structure, company links, product characteristics and competitive factors and gives special mention to market dynamics and "claimed efficiencies, in particular cost savings and innovations, provided consumers receive a fair share."
- A competition disturbance is "**continuous**" if it has persisted or recurred for at least three years and is not likely to disappear within the next two years.
- A competition disturbance is "**considerable**" if it has "more than minor negative effects" on at least one Germany-wide market, on several individual markets, or across several markets.

Under the NCT, a **divestiture remedy** is permissible only if very strict conditions are met:

- The undertaking concerned is either market **dominant** or an undertaking of **paramount significance for competition across markets** under section 19a ARC.
- The divestiture **completely removes or at least considerably reduces** the CCCD (i.e., a slight reduction is insufficient).
- **Non-divestiture remedies** would be either **impossible or less effective or more burdensome** for the undertaking concerned than the divestiture remedy.
- The selling price that the undertaking concerned can realize for the divested assets is at least 50% of the actual value of the divested assets. In addition, the undertaking concerned receives **compensation** from the State calculated at 50% of the difference between the two amounts. Thus, the potential damage resulting from a forced divestiture is capped at 25% of the actual value.
- None of the assets to be divested were acquired by the undertaking concerned based on an EU or national **merger control clearance** that was granted within the last ten years.
- The undertaking concerned may **re-acquire** the divested assets as soon as it proves that the CCCD has ceased to exist or at the latest five years after the divestiture.

Non-divestiture remedies must also meet considerable conditions, including that:

- The undertaking concerned **contributes considerably** to the CCCD through its **market behavior** and its **significance for the market structure**.
- The non-divestiture remedy is suitable and necessary to **remove or reduce** the CCCD and proportionate in particular to the market position of the undertaking concerned.
- The law contains a non-exhaustive exemplary list of **non-divestiture remedy types**, namely (a) access to data, interfaces, networks and other facilities; (b) requirements for business relationships between undertakings; (c) obligation on undertakings to establish transparent, non-discriminatory and open norms and standards; (d) requirements for contracts, including information disclosure; (e) prohibition of unilateral disclosure of information fostering parallel behavior; and (f) splitting up divisions and business units of an undertaking with regard to organization or accounting.

There are also far-reaching **procedural requirements**:

- Shortly before using the NCT, the FCO must have completed a **sector inquiry** covering the relevant markets. NCT decisions shall be taken within 18 months of the publication of the final sector inquiry report, which in turn shall occur within 18 months of the launch of the sector inquiry. (However, these are "soft" deadlines, the violation of which does not trigger sanctions.)
- The NCT is applied in **two stages**: First, the FCO issues a formal decision against the undertaking concerned in which it finds that there is a CCCD. Second, taking into account (but not bound by) any remedy proposals submitted by the undertaking concerned, the FCO issues a formal decision imposing a remedy on the undertaking concerned.
- The undertaking concerned **can challenge each of the formal decisions before the courts**, but only the court challenge to the second-stage decision imposing a remedy has suspensory effect.
- An oral hearing is optional for the first stage of the procedure and mandatory for the second stage, unless the undertaking concerned waives its right to a hearing. The oral hearing shall include all interested stakeholders and be public, unless this would jeopardize business secrets or other important legal rights.
- The **Monopolies Commission** has a right to be heard in any oral hearings, and before imposing a divestiture remedy, the FCO must consult the Monopolies Commission in writing, as well as the competent regional cartel authority.
- The **Federal Network Agency** must approve any remedy that the FCO wants to impose on an undertaking in a regulated sector (railways, postal services, telecommunications, electricity, gas).

Analysis

As regards the NCT's political and legal context and its conceptual precursors, in particular in the legal systems of the EU and UK, we refer to our **previous client alert**, which commented on the first published draft of the 11th ARC Amendment of 20 September 2022. As expected, this first draft, which contained hardly any of the abovementioned conditions and limitations, raised fierce criticism from **industry associations**, legal practitioners and academics alike (see for example the references **here**), while only few comments were (on balance) supportive. The subsequently added **conditions and limitations have addressed most of the concerns** that were raised, albeit **to varying extents**:

- Reasonable safeguards have been implemented to deal with the concerns about **proportionality**. Imposing a remedy under the NCT is only permissible where the traditional competition law tools may not suffice and considerable conditions are met. In turn, divestiture remedies are only permissible where non-divestiture remedies are insufficient and very strict conditions are met.
- Also, with regard to **compensation for divestitures**, capping the potential damage at a maximum of 25% of the actual value of the assets is, as argued by the Monopolies Commission, a workable solution because compensation should be granted only for lost innovation and efficiency profits, but not for the monopolist's excess profits.
- The concern that the NCT will **discourage innovation and efficiency** by preventing innovators from reaping the benefits of their innovation was addressed by the special mention in the list of factors that the FCO shall take into account of market dynamics and "claimed efficiencies, in particular cost savings and innovations, provided consumers receive a fair share". The reasoning provided in the 11th ARC Amendment clarifies that because the NCT requires a "continuous" competition disturbance, it shall not apply to start-ups reaping first-mover advantages.
- The concern that the FCO receives a **quasi-regulatory "market design" competence** has been somewhat mitigated by requiring for divestiture remedies a public oral hearing including all stakeholders, ensuring consultation of the Monopolies Commission, requiring approval by the Federal Network Agency for remedies in regulated sectors, and enabling full court review of all FCO decisions.
- The concern that the NCT undermines **legal certainty** has been somewhat mitigated by all of the abovementioned conditions and limitations, especially by the description of the CCCD and by the procedural requirements, in particular full court review.
- However, the more **fundamental criticisms** that reject the "paradigm shift" brought about by the NCT in its entirety have not been addressed. The most vociferous of these criticisms argues that the paradigm shift violates the fundamental principles of competition law and that the alleged gaps left by the traditional competition law tools do not exist. Another argues that, in view of EU law, the German legislator is not competent to introduce any new competition law tools. A third postulates, based on both the German constitution and the fundamental principles of competition policy, that if market design is acceptable at all, then it must be carried out by the legislator rather than by a mere executive authority such as the FCO.

In sum, from a legal and competition policy point of view, despite the added conditions and obligations, the NCT remains problematic. Even leaving aside the abovementioned fundamental criticisms, the **definition of a CCCD is very broad**. Almost every market comprises "more than minor negative effects" caused by one or several elements of theories of harm that are listed in the law, i.e., unilateral supply or demand power, barriers to market entry or exit, uniform or coordinated behavior, or vertical relationships. Therefore, in theory, the FCO can use the NCT whenever it considers a market result (prices, rate of innovation etc.) to fall short in any way.

This overly broad substantive test **creates excessive legal uncertainty**, which will likely persist for decades, namely until the courts have created meaningful case law. Rather than providing only a non-exhaustive list of elements of theories of harm that can lead to a CCCD, the law should have included a precise economic description of the market phenomena that are supposed to be caught. Even though it is understandable that the legislator wanted the FCO to be flexible with regard to future market constellations, such complete flexibility should be available only to the legislator itself and not to a competition authority.

Next steps

While from a legal and competition policy point of view, the NCT is highly problematic, its **practical significance may turn out to be limited**, not only because of its abovementioned far-reaching conditions and limitations but also in view of its protracted timeline and the FCO's limited resources.

Given that the NCT is applied in two stages, **future NCT proceedings will likely take a very long time**. At an **event on 17 April 2023**, the president of the FCO announced that in order to avoid incalculable legal risks, the FCO will—at least in the beginning of its decision-making practice with regard to the NCT—treat court challenges to first-stage FCO decisions finding that there is a CCCD as if they had suspensory effect (which they do not). This means that the FCO will not take any second-stage decision imposing a remedy as long as a court challenge against the preceding first-stage FCO decision is still pending. Taking into account that in turn, a first-stage FCO decision will typically be taken only approx. two to three years after the start of the respective sector inquiry (cf. the abovementioned two consecutive 18-month periods), the overall time span between the start of an FCO sector inquiry and a second-stage remedy decision will likely be in the range of three to five years. Further years may pass before a remedy is actually implemented, given that the court challenges to the second-stage decisions imposing remedies have suspensory effect.

In addition, the **NCT proceedings will likely be quite rare**. The reasoning of the 11th ARC Amendment provides for only up to seven new positions to be created at the FCO for the application of the NCT. Considering the number, breadth and depth of the abovementioned conditions and limitations, with so few dedicated NCT enforcers, the FCO will likely be able to handle only very few NCT procedures at a time. The expectation in the 11th ARC Amendment that two NCT procedures can be completed per year seems unrealistic, unless additional resources are devoted to it.

Explicitly pointing to the protracted timeline and the FCO's limited resources, the president of the FCO characterized the NCT as a "**tool for the very big things**." Thus, the FCO will likely restrain itself and apply the NCT only in few sectors it regards as being particularly problematic. While such serious concerns will often require a divestiture remedy, the FCO may choose to also start some investigations relating to sectors where non-divestiture remedies will likely be sufficient, given that such remedies are easier to defend in court and that the FCO may want to initially create a successful track-record for the NCT.

Throughout the legislative process, independent experts have been speculating about the **potential candidate sectors** for the use of the NCT. One expert pointed out that over the past decade the FCO's sector inquiries have identified structural problems in refineries, online advertising, household waste, cement, submetering and food retail. Of these five sectors, online advertising has recently been taken up by the Commission, and submetering has been partially addressed through interoperability regulation. Another expert considered that non-divestiture remedies opening up markets by creating interoperability and data portability may be of great practical significance, given that they obviate the need for regulation (as has been implemented with regard to Apple Pay, for example). A third expert identified submetering and price parity clauses in the hotel booking sector as past use cases. All three experts pointed to an FCO merger prohibition in the ticketing sector that the acquirer allegedly circumvented by setting up a new company which poached most of the target's personnel.

Further legal changes

In addition to the introduction of the NCT, the 11th ARC Amendment also provides for further changes to the ARC, which can be summarized as follows:

- **Tightened merger control for individual undertakings**. If a sector inquiry indicates that even small future acquisitions by a certain undertaking could significantly impede effective competition, the FCO can lower the merger control thresholds for future acquisitions to be made by this individual undertaking as follows: The EUR 500 million threshold for the parties' combined worldwide turnover is suspended, and the threshold for the target turnover in Germany is lowered to EUR 1.0 million (from EUR 17.5 million). A decision lowering the thresholds applies for three years and can be renewed up to three times without the need for a new sector inquiry.
- **Strengthened sector inquiries. FCO sector inquiries**, which were previously slow and largely inconsequential, are strengthened. A recently completed sector inquiry becomes a mandatory prerequisite for decisions applying the NCT and/or tightening merger control for individual undertakings. Such decisions shall be taken within 18 months after the publication of the final sector inquiry report, which in turn shall occur within 18 months after the launch of the sector inquiry. (However, as already mentioned, these are "soft" deadlines.)
- **Facilitation of disgorgement of profits**. Legal presumptions are introduced according to which (i) a violation of competition law has resulted in an economic advantage and (ii) this advantage amounted to at least 1% of the turnover that the undertaking concerned realized in Germany with the products or services that were subject to the illegal behavior. The presumptions provide for only very limited exceptions and possibilities for rebuttal.
- **National enforcement of the DMA**. The FCO is designated as the German national authority that is entitled to investigate cases of possible non-compliance with Articles 5, 6 and 7 DMA until the EU Commission in its role of "sole enforcer" of the DMA takes on the same case. In addition, private enforcement of the DMA before German courts is facilitated by means of procedural provisions similar to those relating to cartel follow-on litigation.

For an analysis of these changes and their practical significance, we refer to our **previous client alert**, which commented on the first published draft of the 11th ARC Amendment of 20 September 2022.

Compared to that draft, only the provisions on disgorgement of profits, which also triggered a lively debate, have been considerably changed: The requirement that the illegal conduct was based on willful intent or negligence, which the first published draft intended to drop, has been retained. In addition, a planned extension of the limitation period has been scrapped. Moreover, the exceptions to and the possibilities for rebuttal of the newly introduced legal presumptions have been slightly changed. These changes do not alter our assessment that the new presumptions will in practice be virtually impossible to rebut, so that the provisions on disgorgement of profits will likely have considerable practical importance in the future.

Outlook

The German Ministry for Economic Affairs has already announced the 12th amendment of the ARC for the current parliamentary session (which ends in 2025). It is supposed to increase legal certainty on sustainability issues for undertakings and to expand the FCO's competences in consumer protection.

If you have any questions on this matter and its possible implications please reach out to Josef Hainz, Maren Tamke, Rene Grafunder and Jan Heithecker.

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