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# Germany considers sweeping new FCO powers including breaking-up of companies

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## Proposed legal amendments

On 20 September 2022, the German Federal Ministry for Economy and Climate Protection (the "Ministry") published a draft "Competition Enforcement Act" (the "Draft Act") that provides for the following main amendments to the German Act against Restraints of Competition ("ARC"):

### Strengthening of the existing sector inquiry instrument

Since 2005, when the German Federal Cartel Office ("FCO") received the power to conduct general sector inquiries, the FCO has published more than 15 reports on sector inquiries in the field of competition law. However, most of the sector inquiries have remained inconsequential because the FCO has had no specific competences following sector inquiries. Further, because most sector inquiries took several years to complete, the relevant reports were already outdated when published and thus not suitable to inform any enforcement action by the FCO or legislative proposals. Against this backdrop, the Draft Act proposes several measures:

- **Acceleration (new Sections 32e (3), 32f (7) ARC).** The FCO will be obliged to publish the fact that it opens a sector inquiry. Once a sector inquiry is opened, the FCO must complete it within 18 months and take any of the measures under Sections 32f (2) to (4) ARC (described below) within another 18 months. Both 18-month deadlines are not legally binding but rather only legal recommendations.
- **Specific legislative proposals (new Section 32e (4) ARC).** The FCO will be obliged to publish the results of its sector inquiries and it will be authorized to include in its sector inquiry reports specific legislative proposals, which it passes on to the government.
- **Tightened merger control for individual undertakings (new Section 32f (2) ARC).** If in one of the sectors covered by a sector inquiry report, the FCO sees "objectively comprehensible indications" that future mergers could significantly impede effective competition, then the FCO can lower to almost zero the merger control notification thresholds for individual undertakings in that sector. The FCO can order, for a period of three years (and if deemed necessary, repeated), individual undertakings with a German annual turnover exceeding EUR 500 million to notify all their future proposed acquisitions of targets with annual turnover in Germany of at least EUR 0.5 million. This provision will replace the existing Section 39a ARC, which was introduced only in 2021 and provides for a similar but less far-reaching order.

- **Behavioral or structural remedies to "remove or reduce" a considerable competition disturbance (new Section 32f (3) ARC).** If following a sector inquiry, the FCO finds that there is a "considerable continuous or repeated disturbance of competition on at least one market or across markets", the FCO can impose all remedies that are required in order to "remove or reduce" such competition disturbance. Undertakings can offer certain remedies but the FCO can also impose remedies on its own motion. Based on the principle of proportionality, behavioral remedies are normally preferable but structural remedies are also possible. The provision contains the following non-exhaustive list of subject matters of potentially suitable remedies:
    - granting access to data, interfaces, networks or other facilities,
    - supplying other undertakings, including granting of IP rights,
    - regulatory or comparable licenses or approvals,
    - horizontal or vertical supply relationships between undertakings,
    - common standards,
    - obligations regarding certain contract types of contractual provisions including information disclosure provisions,
    - organizational separation of company or business divisions.
- **Structural divestment as a last resort to "remove or significantly reduce" a considerable competition disturbance new Section 32f (4) ARC).** If in the abovementioned situation, the FCO finds that no less invasive remedy is available, the FCO may order undertakings to divest shares or assets, provided that the divestiture "can be expected to remove or significantly reduce" the competition disturbance. Such a divestiture order is inadmissible in the first five years following a potential clearance, under EU or German merger control, of the acquisition of the relevant shares or assets. For five years following the forced divestiture, the undertaking concerned is prohibited from reacquiring the divested shares/assets.

## Facilitation of disgorgement of profits (new Section 34 (4) ARC)

If profits resulting from illegal anti-competitive behavior are not removed by way of damages, fines or other measures, the FCO may disgorge them under the existing Section 34 ARC. However, because of the strict requirements of this provision, the FCO has not used it to date. To change this, the requirement that the illegal conduct was based on willful intent or negligence shall be dropped. In addition, a legal presumption will be added according to which the illegal conduct resulted in an economic advantage in the amount of 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. An undertaking can only rebut this presumption by showing that neither the legal entity directly involved in the illegal behavior nor its entire group of undertakings has realized a worldwide profit in the said amount.

### National implementation of the DMA

The Draft Act contains several provisions to authorize the FCO as the German national authority in the meaning of Article 38 (7) of the Digital Markets Act ("DMA"). Thus, the FCO will be 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 opens its own proceedings with regard to the same case. The Draft Act also contains several provisions that facilitate private enforcement of the DMA before German courts and are similar to existing procedural provisions facilitating cartel follow-on litigation before German courts.

## Analysis

When the German Minister for Economic Affairs, who is a member of the Green party, first announced the upcoming Draft Act on 13 June 2022, he characterized its aim as creating "a competition law with claws and teeth". Indeed, the Draft Act falls squarely in line with the current trend towards stronger enforcement, which has been visible already in previous changes of the ARC, for example in the introduction in 2021 of Section 19a ARC to address Big Data, which the FCO will continue to apply alongside the DMA, and in EU competition law, for example in the recent expansion of the scope of application of Article 22 EU Merger Regulation.

All of the proposed ARC amendments will likely have considerable practical importance. This is true for the facilitation of disgorgement of profits because it will in practice be virtually impossible to rebut the new legal presumption under Section 34(4) ARC. It is equally true for the provisions implementing the DMA in Germany because they add an entirely new sector to the enforcement activities not only of the German courts but also of the FCO.

The same applies to the FCO's new competences following a sector inquiry. Among these, the only conceptually straightforward one is the tightening of the existing Section 39a ARC by way of the new Section 32f (2) ARC. Section 39a ARC was introduced less than two years ago, and the FCO has not applied it yet. The fact that it is further tightened regardless shows the Ministry's strong intent to strengthen competition law enforcement.

This intent is even more visible in the proposed new Sections 32f (3) and (4) ARC, which are clearly the most significant part of Draft Act. Therefore, the following discussion focuses on these planned new provisions.

## Expanding the competition law toolbox

So far most competition law systems worldwide provide for only three instruments, namely provisions targeting:

- anti-competitive agreements (in the EU Article 101 TFEU and its national equivalents),
- abuses of a dominant positions (in the EU Article 102 TFEU and its national equivalents) and
- proposed anti-competitive concentrations (in the EU the EU Merger Regulation and the member state merger regimes).

To these three established instruments, the new Sections 32f (3) and (4) ARC would add a fourth one, which would enable the FCO to address competition disturbances by way of remedies even in the absence of any concentration or (proven) anti-competitive agreement or abuse of a dominant position.

According to the Draft Act, the fourth competition instrument is needed because the existing three competition instruments leave important gaps. The existing merger control provisions allegedly leave gaps with regard to internal company growth, market exits and small concentrations that do not meet the merger control thresholds. Similarly, Articles 101 and 102 TFEU and their national equivalents allegedly have gaps, for example on digital markets with strong network and scale effects and with regard to "tacit collusion" on oligopolistic markets, where the few remaining competitors watch each other's market behavior carefully and have little interest in competing against each other.

## Precursors

For a detailed description of the theories of harm that allegedly require the introduction of a fourth competition instrument, the Draft Act refers to pages 8-21 of an expert report by Professors Motta and Peitz provided to the EU Commission during its consultation on the proposed "New Competition Tool" ("NCT") in 2020. The Draft Act specifies that the proposed new Sections 32f (3) and (4) ARC are similar to the third of the four NCT policy options that the EU Commission contemplated in 2020 but to date only "folded into" what is today the DMA. Thus, the proposed new Sections 32f (3) and (4) ARC would in essence introduce a national NCT.

The Draft Act also points out that introducing such a fourth competition law instrument is not unprecedented. In that regard, it refers to the expert report by Professor Whish provided during the EU NCT consultation. This report mentions additional competition law instruments in Greece, Iceland, Mexico, and South Africa but focuses on the competence of the Competition and Market Authority under Part 4 of the UK Enterprise Act to conduct market investigations and subsequently impose far-reaching remedies "to remedy any features of the market causing adverse effects on competition or any detriment arising from those features, including the power to order the divestiture of assets". The Draft Act mentions this UK system as its inspiration for combining accelerated sector inquiries with the subsequent competence to impose far-reaching remedies. Previously, the German Monopolies Commission (a permanent, independent expert committee advising the German government and legislature in the areas of competition policy, competition law and regulation) had already pointed out the UK system as a successful model even though it lacked a compensation mechanism that might be required under German constitutional law (see para. 379 of its 2022 expert report).

Besides the draft EU NCT and the UK Enterprise Act, the Draft Act also mentions a third important precursor of the proposed national NCT, namely another draft ARC amendment act that the Ministry had proposed in 2010. That draft act would have given the FCO the power to impose behavioral or structural remedies on undertakings that are, and will likely be for the foreseeable future, market-dominant "if this can be expected to significantly improve competitive conditions and is proportionate". Even though at the time, the Monopolies Commission in principle endorsed this draft act, it was ultimately politically dropped due to constitutional and economic concerns that were raised in particular by the German industry.

## Criticisms

The design of the proposed national NCT is clearly informed by the criticisms that have been levelled against the EU NCT and the 2010 German draft act (according to an informal disclosure on Twitter of 22 September 2022, several acclaimed German competition policy and law experts contributed to the Draft Act, many of whom – Professors Kühling, Duso, Wambach, Haucap and Zimmer – are current or former members of the Monopolies Commission and one of whom – Professor Schnitzer – also provided an expert report during the EU NCT consultation). For example, the substantive conflict between the NCT and merger control has been mitigated by the provision according to which the national NCT must not be applied to shares/assets whose acquisition was subject to a merger control clearance in the past five years (the forecast period under merger control is generally limited to 3-5 years). Even so, it appears that some of the previous criticisms have not been fully addressed, most importantly:

- **No compensation mechanism.** The proposed national NCT does not contain any provisions regarding compensation for the damage resulting from a forced divestiture. Such a compensation mechanism is advisable not only for legal reasons but also for reasons of competition policy:
    - From a legal point of view, a forced divestiture is an encroachment upon fundamental rights, in particular the right of ownership under Article 14 of the German constitution. Some (for example a leading German industry association on page 16 of its position paper) argue that a forced divestiture of an existing business constitutes an outright expropriation, which under Article 14(3) of the German constitution always requires a compensation that is prescribed by law. Others (for example the Monopolies Commission in para. 95 of its expert report of 2010) argue that competition law defines the scope and limits of the ownership right under Article 14(1) of the German constitution so that individual measures to enforce it require a compensation only in the event where they burden the owner excessively or in an unreasonable way, for example if they violate the principle of equal treatment (cf. paras. 267 et seq. of this judgment by the German Federal Constitutional Court of 2016). Based on this opinion, if the FCO orders a divestiture of shares or assets, it must carefully consider the principle of equal treatment, which may reduce the effectiveness of this new instrument in the hands of the FCO.
    - From a competition policy point of view, the instrument of forced divestiture removes the incentive for undertakings to innovate and to invest in realizing efficiencies, because they have to fear that if they grow as a consequence of successful innovation or efficiency-enhancing investments, they will ultimately be forced to divest parts of their business. This is a very serious competition policy concern because innovation is the key driver of competition, which is why – as the Draft Act repeatedly points out – the very purpose of the proposed national NCT is to open up markets so as to enable innovation-based competition. Therefore, from a competition policy point of view, it is indispensable to grant compensation for forced divestitures. However, according to paras. 59 et seq. of the abovementioned 2010 expert report of the Monopolies Commission, compensation should be granted only for lost innovation and efficiency profits but not for lost monopolist's excess profits, as these are anti-competitive and thus undesirable.

  The lack of a compensation mechanism in the proposed national NCT potentially not only violates the German constitution and removes innovation and efficiency incentives but also limits the scope of application of the proposed national NCT. This is because in the event that in an individual case, the FCO has identified a suitable remedy but considers it to be proportionate only if a compensation is granted, it will not be able to impose that remedy because it has no legal basis to grant compensation.
- **Quasi-regulatory "market design" competence.** The proposed national NCT authorizes the FCO to impose any remedies that are suitable and necessary to address any "considerable continuous or repeated disturbance of competition". The legal text

contains no definition of a "disturbance of competition", so that the FCO will have to distinguish between disturbed and undisturbed competition entirely on the basis of its own notions. This potential quasi-regulatory competence of the FCO to design markets at its own discretion is very problematic from the point of view of the traditional approach to competition policy according to which in a market economy, it is the "invisible hand of the market" and not any authority who knows best how productive resources should be allocated.

- **Overbroad substantive test.** The aforementioned overbroad substantive test may also conflict with the German constitutional principle of legal certainty. Even more importantly, it will have to be interpreted by the courts over time (cf. page 18 of the expert report by Professors Crawford, Rey and Schnitzer provided during the EU NCT consultation). The iterative way of creating legal foundations of new legal instruments by way of incremental jurisprudence is feasible, as for example the decision-making practice of the EU courts has shown. However, as also the EU courts constantly demonstrate, this way of creating law is very slow. In contrast, if the alleged enforcement gaps indeed exist, they need to be closed quickly and effectively.

- **Insufficient proportionality safeguards.** In general terms, the Draft Act acknowledges the significance of the principle of proportionality for the application of the national NCT. However, to observe this principle, the Draft Act apparently considers it to be sufficient that a divestiture order under the new Section 32f (4) ARC is permissible only if it can be expected to "remove or significantly reduce" a considerable competition disturbance, while less invasive remedies under the new Section 32 f (3) ARC are already permissible if they only "remove or reduce" such disturbance. This gradation by simply adding the word "significantly" appears to be insufficiently concrete. Moreover, the Draft Act does not address the question how proportionality can be ensured where the business to be divested is active not only in Germany but rather throughout Europe or the entire world.

## Next steps

As shown above, the proposed national NCT shares with the draft EU NCT of 2020 and the 2010 German draft act several of the flaws that caused these proposals to fail. Even so, we consider it to be more likely than not that the entire Draft Act, including the proposed national NCT, will ultimately be passed into law, likely after amendments. This is because already on page 31 of their coalition agreement of 24 November 2021, the three parties that make up the current German government agreed to advocate in the long term an abuse-independent divestment option at European level as a last resort in entrenched markets.

The Ministry included the same aim in item 9 of its "Competition Policy Agenda until 2025" of 21 February 2022, which aims to comprehensively reform Germany's regulatory and competition policy. The subsequent Ukraine war crisis turned the pre-existing long-term political goal of creating an NCT on the EU level into the short-term goal to create an NCT on the national level. While we consider it likely that at least one of the coalition partners, namely the Liberal Democrats, will ask for some amendments to the Draft Act, in particular to reduce the quasi-regulatory character of the national NCT, we deem it unlikely that the national NCT will be rejected in its entirety, given that an NCT on an EU level was already agreed in the coalition agreement.

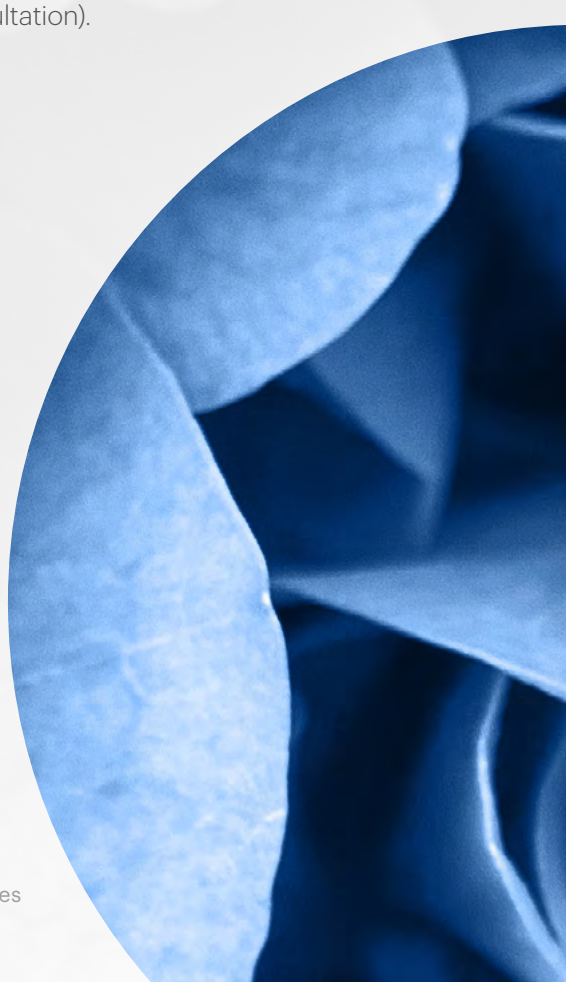
Due to the imminence of the Ukraine war crisis, it is also likely that the Draft Act will receive expedited parliamentary treatment, so that it could enter into force in late 2022 or early 2023. Once the Draft Act including the national NCT will be implemented, the FCO will likely start with the following implementation measures:

- The FCO will likely divert further resources away from individual ad-hoc cases and towards sector inquiries (as it has already did following the 2021 increase of the German merger notification thresholds). The Draft Act talks about creating eight new positions for the conduct of sector inquiries. Given that sector inquiries typically cover dozens, often more than 100 undertakings, this means that many more companies will be in contact with the FCO than in the past.

- The FCO will also likely start to apply the national NCT sooner rather than later. The Draft Act expects on average two such administrative procedures per year and wants to create seven new positions to conduct them. The likely first candidates for application of the national NCT are undertakings in sectors where the FCO has in the past completed sector inquiries and identified competition concerns that it was unable to address with its existing three competition tools. Given that the transitional provision in the new proposed Section 187 (11) ARC does not apply to the proposed national NCT, the FCO will have to reopen and update its pertinent sector inquiries, but this can happen rather quickly. Some of the particularly likely targets for the national NCT are:
    - Even though the sector inquiry regarding car fuel was already completed in 2011, the car fuel sector has since then constantly stayed on the FCO's radar and recently moved back into the FCO's focus as a consequence of the Ukraine war energy crisis. In fact, in its press release of 13 June 2022 announcing the upcoming Draft Act, the Ministry mentioned the car fuel sector as the only example of a sector where the national NCT is needed to bring down prices.
    - The sector inquiry regarding online advertising is the latest sector inquiry to have been completed by the FCO. More importantly, in its pertinent report of August 2022, FCO contemplated "more fundamental, large scale, perhaps also structural interventions".
- As regards disgorgement of profits, the Draft Act expects two procedures per year and wants to create three new positions for them.
- The FCO will likely strive to use its competences under Article 38 (7) DMA to the fullest. This can be concluded from the legislative process that led to the DMA, during which the FCO pressed (without success) for far-reaching national competences to enforce the DMA. However, as these competences are quite limited, the Draft Act wants to create only 1.5 new positions for the use of these competences.

Once it enters into force, the Draft Act will be the 11th amendment of the ARC since its inception in 1958 (the 10th amendment entered into force in early 2021). To further implement its abovementioned Competition Policy Agenda, the Ministry has already announced the 12th amendment of the ARC, which is supposed to increase legal certainty in competition law with regard to sustainability and improve the FCO's competences. The Ministry expects to pass the 12th amendment into law still during the current parliamentary session, which ends in 2025.

Another related possible next step could take place on the EU level. From 30 June to 6 October 2022, the EU Commission conducted the first consultation with a view to updating EU Regulation 1/2003. The questionnaire to be answered by interested parties asked inter alia whether the EU Commission's powers are "adequate to address situations where the Commission concludes at the end of an antitrust investigation or a sector inquiry that a market presents economic features leading to structural competition concerns". This question indicates that the EU Commission could follow up on its 2020 plans for an NCT on an EU level as well, rather than to only fold them into the DMA. A system involving parallel NCTs on the EU level and on the EU member states level had already been contemplated during the 2020 EU NCT consultation (see page 14 of the Professor Schweitzer's expert report delivered during that consultation).



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