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Phonak/GN: Federal Court of Justice further specifies collective dominance test under German law

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On April 20, 2010, the German Federal Court of Justice quashed the Düsseldorf Court of Appeal's decision in Phonak/GN, which upheld the FCO's merger prohibition of the acquisition of GN ReSound by Phonak, both active in hearing aids in Germany. The merger would have combined number two and four in the market, with aggregated market shares between 25-35%, and would have reduced the main players from five to four. The FCO's prohibition was based on the strengthening of collective dominance among the top three. The parties abandoned the deal and unsuccessfully appealed the decision. They brought the case to Federal Court of Justice (the review of which is limited to legal grounds).

The case illustrates that access to judicial review in merger cases is still more difficult in Germany than at EU level. The Federal Court of Justice dealt with the admissibility of an appeal when the parties have abandoned the deal (which typically happens after a prohibition). Unlike at EU level, it is not generally recognized that because the decision might have been unlawful and thus violated the parties' rights, the parties have a legitimate interest for judicial review in these cases. Under German law the parties need to demonstrate a special interest, for example because they intend to re-do the same deal in the future. (The test was difficult to meet in the past, and the Federal Court only facilitated access to judicial review in Springer/ProSieben in September 2007.) The Federal Court now ruled that there is no longer a sufficient interest to remove a negative precedent for the future, if market conditions have changed so significantly by the time of the court hearing that the prohibition decision's reasons would no longer be decisive for the future assessment. While this was not the case in Phonak/GN, the decision may limit (again) the possibility for judicial review in abandoned transactions, which would be unfortunate.

The Federal Court clarified that notifying parties may withdraw a filing at any time during the merger proceedings prior to the final decision. In Phonak/GN, the parties withdrew the initial filing and re-notified, in order to give the FCO more time for review but to avoid a second phase (which is not uncommon in practice). (It is noteworthy that under German law third parties are not entitled to appeal Phase-I clearances.) The Court of Appeals found that the strict time limits in merger control (one-month period for Phase I) were not at the disposal of the parties or of the FCO, and should not be circumvented by the withdrawal exercise. The Federal Court quashed this position, and explicitly recognized the benefits and efficiencies of the withdrawal exercise in practice.

In substance, the ruling in particular deals with collective dominance. Traditionally, the FCO (and the courts) followed a twofold collective dominance test:

(i) sufficient internal competition between the oligopoly members and
(ii) effective external competition. The Federal Court only endorsed the Airtours-criteria as accepted by the Community Courts in its landmark decision E.ON/Eschwege in November 2008 (BGHZ 178, 285, para. 39), where it held that transparency and effective sanction mechanism are "decisive elements" in assessing whether the market structure is prone to tacit collusion. The other Airtours-criteria form part of a bundle of additional elements that may be taken into account in the overall assessment, also including the symmetry of the product portfolio and the parties' actual competitive conduct.

The Federal Court now ruled that similarly high market shares of oligopoly members are not per se an indication for tacit collusion sufficient to preclude effective internal competition. The Court of Appeals had referred to similarly high market shares post merger as a symmetry increase between the oligopoly members (and thus as a strengthening of collective dominance). The Federal Court held this overrated the significance of market shares and misinterpreted the symmetry criterion. It clarified that market shares have per se no bearing on the question of tacit collusion. The symmetry of market shares is not relevant, but rather the symmetry of the product portfolio, cost, and technology. This is a welcome clarification, both with respect to further convergence between the EU and the German collective dominance test (but also because market shares often still play a predominant role in the FCO's practice). In addition, the Court of Appeals had erred because it did not take into account that the fluctuating market shares found prior to the merger typically speak against collective dominance. However, the Federal Court conceded that market shares that have been stable over a longer period might be taken into account as an aspect in support of a dominant oligopoly in the overall assessment.

The Federal Court also dealt with the Court of Appeal's approach towards transparency vs. effective competition. The Court of Appeals recognized existing rebate competition between the oligopoly members, but did not consider this as effective competition, because the market was transparent. (It argued rebates would only lead to effective price competition if there were sufficient delay between the rebate offer and a possible competitive reaction, so that the offer could result in a market share increase). The Federal Court found that the effectiveness of actual competition does not depend on the existence of market transparency. Transparency is a decisive element in assessing tacit collusion. However, the Federal Court stressed that if the investigation reveals actual competition, such competition cannot be considered as ineffective, simply because the structural elements indicate that the market is prone to tacit collusion. Whether quashing the Court of Appeal's somewhat twisted approach was the only rationale for the Federal Court's clarification is unclear – as is the impact of the ruling in practice. It seems that effective actual competition may serve as counterevidence to a market structure susceptible to tacit collusion. I doubt that the Federal Court intended to undermine the only recently endorsed Airtours-criteria. On the other hand, the ruling could result in the structural elements (Airtours criteria) playing a secondary role in the analysis in the future, for example they may only be analyzed in detail once the investigation has not revealed effective actual competition.

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