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Case No COMP/M.2824 - ERNST & YOUNG / ANDERSEN GERMANY

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REGULATION (EEC) No 4064/89
MERGER PROCEDURE

Article 6(1)(b) NON-OPPOSITION
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COMMISSION OF THE EUROPEAN COMMUNITIES

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PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

To the notifying parties

Dear Sir/Madam,

Subject: Case No COMP/M.2824 – Ernst & Young / Andersen Germany
Notification of 23/07/2002 pursuant to Article 4 of Council Regulation No 4064/89

1. On 23/07/2002, the Commission received a notification of a proposed concentration pursuant to Article 4 of Council Regulation (EEC) No 4064/89[1] (the "Merger Regulation") by which the global Ernst & Young network ("Ernst & Young") through its German undertakings Ernst & Young Deutsche Allgemeine Treuhand AG Wirtschaftsprüfungsgesellschaft, Aktionärsgemeinschaft von Partnern der Ernst & Young Deutsche Allgemeine Treuhand AG Wirtschaftsprüfungsgesellschaft GbR, Treuhand-Süd GmbH and Ernst & Young Stiftung e.V (collectively "Ernst & Young Germany") merge within the meaning of Article 3(1)(a) of the Merger Regulation with both parts of the German entities of the Andersen network (i.e. Arthur Andersen Wirtschaftsprüfungsgesellschaft/Steuerberatungsgesellschaft mbH, Andersen Luther Rechtsanwaltsgesellschaft mbH, Gesellschaft des bürgerlichen Rechts der Gesellschafter von Andersen Luther Rechtsanwaltsgesellschaft mbH, Gesellschaft des bürgerlichen Rechts der deutschen Arthur Andersen Partner, Arthur Andersen Corporate Finance Beratung GmbH, Arthur Andersen Real Estate GmbH; collectively "Andersen Germany") and the German undertaking Menold & Aulinger.

2. After examining the notification, the Commission has concluded that the notified operation falls within the scope of the Council Regulation No 4064/89 and that it does not raise serious doubts as to its compatibility with the common market and with the EEA Agreement.

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[1] OJ L 395, 30.12.1989 p. 1; corrigendum OJ L 257 of 21.9.1990, p. 13; Regulation as last amended by Regulation (EC) No 1310/97 (OJ L 180, 9. 7. 1997, p. 1, corrigendum OJ L 40, 13.2.1998, p. 17).

I. THE PARTIES

3. Ernst & Young Germany is a member of the global Ernst & Young network of accounting and professional services firms, which employs over 83,000 people in 125 countries. Before the implosion of the network Andersen Germany was active as member firm of the Andersen Worldwide international network of accounting and professional services firms ("Andersen Worldwide"). Until recently the Andersen Worldwide member firms collectively employed approximately 85,000 people. Ernst & Young Germany as well as Andersen Germany (both consisting of several entities under the authority of one Managing Partner and a Partnership Council) are therefore the German branches of two of the so-called Big Five global accounting and professional services organisations. Apart from Andersen Worldwide and Ernst & Young, the other Big-Five firms are PricewaterhouseCoopers ("PwC"), Deloitte Touche Tohmatsu ("DTT"), and KPMG.

4. Ernst & Young Germany and Andersen Germany are both active in the fields of the following professional services: audit and accounting services; tax advisory services and corporate finance advisory services. Andersen Germany provides legal advisory services through its associated law firm Andersen Luther, whereas Ernst & Young Germany provides a limited amount of legal advice through its legal department and co-operates with the law firm Menold & Aulinger. In addition, Andersen Germany is active in the provision of seminar and conference and business consultancy services. Ernst & Young is no longer active in the field of business consultancy.

5. Menold & Aulinger is a German partnership of 58 natural persons offering legal services, in particular, in the area of business law. Menold & Aulinger is member of the Ernst & Young law alliance without being integrated into the Ernst & Young international network.

II. THE OPERATION

6. On 23 April 2002, Ernst & Young Germany and Andersen Germany entered into a Co-operation Agreement, which forms the framework for the entire transaction and comprises the tax and audit, the legal, as well as parts of Andersen Germany's corporate finance business.

7. The combination of Ernst & Young Germany's and Andersen Germany's tax and audit businesses is structured in the following way. In the framework of the Co-operation Agreement, the tax and audit entities of Ernst & Young Germany and Andersen Germany entered into a business lease agreement according to which the Andersen Germany tax and audit entity leases its entire business to Ernst & Young Germany. As a consequence, Ernst & Young will operate Andersen Germany's tax and audit business in the name and for the account of Ernst & Young, the employees of the Andersen tax and audit business will be transferred to Ernst & Young, and Andersen Germany's partners shall become partners of the Ernst & Young civil law partnership in a similar way as the current Ernst & Young partners.

8. The combination of the legal branch of Andersen Germany and the law firm Menold & Aulinger and their integration into Ernst & Young are also dealt within the Co-operation Agreement. Ernst & Young and Andersen Germany agreed that the partners of Andersen Germany's legal branch, Andersen Luther Rechtsanwaltsgesellschaft mbH ("Andersen Luther"), will set up a new entity to which the entire legal business of Andersen Germany is leased. As explicitly foreseen in the Co-operation Agreement, Menold & Aulinger acceded to the Agreement by letter of 17 May 2002 and thereby

became party to the merger. The Co-operation Agreement provides further that the new entity will be […] member of the Ernst & Young law alliance in Germany and that it will be integrated into the Ernst & Young German and international network, to the extent legally possible and economically feasible.

9. A further agreement between Andersen Luther and Menold & Aulinger of 19 June 2002 ("Partnership Agreement") sets out the details of the integration [for merger control purposes] of Menold & Aulinger into Andersen Luther and ultimately into Ernst & Young. […] In consequence, the legal businesses of Andersen Germany and Menold & Aulinger will be combined and integrated into the Ernst & Young German and international network.

10. The parts of Andersen Germany's corporate advisory services not requiring a banking licence, which are carried out by Andersen Corporate Finance Beratung GmbH, will be merged with Ernst & Young's corporate finance business. Andersen Germany's business consulting activity as well as those of Andersen Germany's corporate advisory services, which require a banking licence, will be separated in the course of the transaction and will not form part of the transaction.

11. In order to combine all partners of Ernst & Young, Andersen Germany and Menold & Aulinger, the Co-operation Agreement finally foresees that […]

III. CONCENTRATION

12. The operation leads to a merger between Ernst & Young, which forms world-wide one single economic entity, Andersen Germany, which after the implosion of Andersen Worldwide's network forms an economic entity independent from all other Andersen Worldwide entities, and Menold & Aulinger.

Ernst & Young constitutes one single economic entity for the purpose of the application of the Merger Regulation

13. First, it has to be decided whether Ernst & Young's international network constitutes a single economic entity for the purposes of the Merger Regulation and is, therefore, to be considered as an undertaking for the purposes of Article 3(1)(a) of the Merger Regulation. For this purpose, it is necessary to examine whether the firms belonging to the Ernst & Young network share the same, permanent economic management and financial interests conferring to the network the character of a single economic entity for the purposes of the Merger Regulation.

14. The assessment of whether or not Ernst & Young is to be regarded as a single economic entity has to be made in the special and specific context of the audit and accounting market where there is an inherent economic incentive for member firms of the networks to act as a single economic entity. The key element for the economic success of a Big Five firm is the holding up of an international network, operating under a common brand name, and observing common professional rules and service standards which are centrally imposed on the member firms and centrally controlled. Furthermore, as discussed in a previous decision,[2] each of the networks is de facto considered as one

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2 Case IV/M.1016 – Price Waterhouse/Coopers & Lybrand, paragraph 118, OJ - L 050, 26/02/1999 p.27

single economic entity showing a single behaviour on the market. Compared to franchise networks in which member firms active in different geographic markets hardly depend on each other, the Big Five member firms vitally depend on the centrally organised network the possibility of working together with their international partner firms and, also, on the reputation of each individual member firm of the network

15. In addition, even where no central distribution of revenues takes place between the individual member firms, strong common financial interest is established by the systematic referral of clients across the network. As the disintegration of the Andersen Worldwide network shows, the failure of one member firm of the network to comply with professional standards puts all other member firms at risk. This leads to the result that risks created by one member firm are shared among the network. This risk sharing is underlined by the existence of one single captive insurer for the business risks for all entities of the entire network.

16. These features are all present for the Ernst & Young network, whose member firms are linked to Ernst & Young Global –the central Ernst & Young entity - through a series of contractual relationships. […]

17. Members of the Ernst & Young network are moreover obliged […]

18. The described relationship with Ernst & Young Global applies to Ernst & Young Germany […] The remaining Ernst & Young member firms are integrated into the network via Ernst & Young International, the older and less integrated central governance entity of the Ernst & Young network. […]

19. However, Ernst & Young, irrespective whether assessed according to the Ernst & Young International or the Ernst & Young Global structure, can be considered to be a single economic entity. In the Ernst & Young Global structure, a clear permanent economic centralised management is established, supplemented by centrally formulated policies and centrally provided services. In the case of the Ernst & Young International structure, the member firms rely on the common brand name and its reputation, the world-wide network and the centrally developed and monitored professional standards and common client relationships. The strong economic links by sharing of risks [regarding insurance and reputation] and [sharing of] revenues on the basis of referrals also apply to the Ernst & Young International structure. These links are reinforced by the central co-ordination and facilitation of standards, strategies and initiatives and the provision of common services. As set out in a previous case for DTT[3], these elements indicate a decisive degree of common economic management and common financial interest. They lead to the conclusion that Ernst & Young is to be considered as a single economic entity for the purposes of the Merger Regulation, irrespective in which structure this is assessed, and that Ernst & Young as a whole is one of the parties to the present transaction.

Andersen Germany does not form part of the Andersen Worldwide network for the purpose of the application of the Merger Regulation

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3 Case COMP/M.2810 – Deloitte Touche Tohmatsu/Andersen UK

20. Second, it has to be decided whether Andersen Germany forms the relevant economic undertaking for the purposes of the Merger Regulation or whether Andersen Worldwide still exists as a single economic entity. The latter conclusion would lead to the result that, in accordance with Article 5(2) of the Merger Regulation, all transactions between Andersen Worldwide and Ernst and Young would have to be considered as one and the same concentration.

21. The Commission's investigation has shown that Andersen Worldwide is no longer able to discharge its core contractual obligations of co-ordinating the global development of the member firms' practices world-wide, their commercial strategies and their management, as laid down in the contractual relationship between Andersen Worldwide and the national Andersen firms. This is notably demonstrated by the fact that the former member firms of the global Andersen network, each individually and without awaiting Andersen Worldwide's consent, have already joined or seek to join different networks of the remaining Big Four firms on a country-by-country basis. As a result of this disintegration, no central decision making process is any longer in place and the member firms do no longer operate under a common brand name and comply with common professional and service standards. For these reasons, Andersen Worldwide is no longer considered to constitute a single economic entity and a single undertaking for the purposes of the Merger Regulation.

22. Furthermore, following the crisis, Andersen Germany itself has terminated its membership in the Andersen network […] In any case, Andersen Germany considers that it is no longer bound by the terms of the contractual relationship with Andersen Worldwide […].

23. Given the above, Andersen Germany is to be regarded as the relevant economic undertaking for the purposes of the Merger Regulation.

Menold Aulinger is an economic entity independent from Ernst & Young

24. The law firm Menold Aulinger, member of the legal network Ernst & Young Law Alliance, has to be considered as an economic entity independent from Ernst & Young. Ernst & Young Germany […]

The merger between Ernst & Young, Andersen Germany and Menold Aulinger forms a single concentration

25. The operation includes the merger between Ernst & Young and Andersen Germany, on the one hand, and the merger between Andersen Germany and Menold & Aulinger, on the other hand. These two transactions constitute one concentration within the meaning of Article 3(1)(a) Merger Regulation. The merger of Ernst & Young, Andersen Germany and Menold & Aulinger has to be considered as a tri-lateral merger. The two transactions lead
    (1) to a single economic entity comprising Ernst & Young, Andersen Germany and Menold & Aulinger, and
    (2) are economically linked in a way that they are to be considered as a single transaction within the meaning of Article 3(1)(a) Merger Regulation.

26. The new merged entity will combine Ernst & Young, Andersen Germany and Menold & Aulinger. Although the newly formed legal branch, called Luther Menold, will form a separate legal entity after the merger, it will be economically integrated into Ernst &

Young and will share the same permanent economic management and financial interests, which is shown by the following facts.

27. First, it is intended to link the management of Ernst & Young and Luther Menold […] In general, already the Co-operation Agreement provides for a close integration of the legal branch into the Ernst & Young German and international network. Ernst & Young and Luther Menold are therefore considered to be a single economic entity for the purposes of the Merger Regulation.

28. The transactions are linked in a way that they constitute one concentration within the meaning of Article 3(1)(a) Merger Regulation. First, they are based on the same contractual document as Menold & Aulinger acceded to the Co-operation Agreement between Ernst & Young and Andersen Germany and exercised its right to take part in the merger. The formation of the partnership involving Andersen Germany's legal branch and Menold & Aulinger is already a step in the implementation process of the merger. Second, the transactions are economically interdependent insofar as, on the one hand, the merger of Andersen Germany's legal branch and Menold & Aulinger would not have taken place without the merger between Ernst & Young and Andersen Germany. […] Finally, it is envisaged that both transactions, provided that merger control clearance has been received, will be carried out simultaneously. It would, on the other hand, not reflect the economic reality to assess the transaction between Andersen Germany and Menold Aulinger as a separate concentration, as proposed by the Parties. Such an assessment would not take into account the close involvement of Ernst & Young into the process [for merger control purposes] and the final merger structure, […] and the fact that Ernst & Young simultaneously forms a single economic entity with Andersen Germany and Menold & Aulinger.

29. Given these economic links, the two transactions involving Ernst & Young and Andersen Germany, on the one hand, and Andersen Germany and Menold & Aulinger, on the other hand, have to be considered as one single concentration within Article 3(1)(a) Merger Regulation.

IV. COMMUNITY DIMENSION

30. The undertakings concerned have a combined aggregate world-wide turnover of more than EUR 5 billion[4] (Ernst & Young €[…], Andersen Germany € […], excluding the management consultancy arm and those parts of the corporate finance branch not being part of the transaction, and Menold & Aulinger € […]) in 2001. Each of Ernst & Young and Andersen Germany have a Community-wide turnover in excess of EUR 250 million (Ernst & Young € […], Andersen Germany € […]), but they do not achieve more than two-thirds of their aggregate Community-wide turnover within one and the same Member State. The notified operation therefore has a Community dimension.

V. COMPETITIVE ASSESSMENT

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[4] Turnover calculated in accordance with Article 5(1) of the Merger Regulation and the Commission Notice on the calculation of turnover (OJ C66, 2.3.1998, p25). To the extent that figures include turnover for the period before 1.1.1999, they are calculated on the basis of average ECU exchange rates and translated into EUR on a one-for-one basis.

A. RELEVANT PRODUCT MARKETS

31. Both Ernst & Young and Andersen, before the disintegration of its network, were considered as two of the "Big Five" global audit and accounting networks. Both parties are active in the provision of a broad range of professional services to clients, which consist mainly of large companies, of both a national and multinational dimension, spanning a broad spectrum of business sectors, as well as to clients in the public sector. According to a previous Commission decision[5] the activities of the Big Five firms could be divided into the following relevant product markets:

    i) Audit and accounting services to quoted and large companies;
    ii) Audit and accounting services to small and medium-sized companies;
    iii) Tax advisory and compliance services;
    iv) Corporate finance advisory services.

32. Management consultancy services, which were also discussed in Price Waterhouse/Coopers & Lybrand are not considered in the present decision, as Ernst & Young is not active in management consultancy services and as Andersen Germany's activity in this field is excluded from the transaction. In addition, the present transaction includes the provisions of v) legal advisory services.

i) Audit and accounting services to quoted and large companies

33. "Audit and accounting" services consist of the performance of statutory and other audits of companies' accounts and other "audit-related" accounting services. In this context, "audit related" accounting services include such services as general accounting services, systems assurance, business risks assessment, internal audit, transaction services, in particular due diligence services and preparation of reports for stock exchange listings, and advice in international accounting standards[6]. The Parties have agreed to such an approach and the market investigation confirmed the categorisation of such audit-related services in the German market.

34. As regards the definition of a separate market for audit and accounting services to quoted and large companies the Commission's market investigation focussed
    - on the question whether statutory audit and audit related services still belong to a single market,
    - on the question whether audit and accounting services to quoted and large companies, which are predominately provided by the Big Five global audit and account networks, form a distinct product market for the purpose of this decision, including the discussion of some German particularities.

Statutory audit and audit related services belong to a single market

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5 Cases COMP/M.2810 - Deloitte & Touche/Andersen UK, Price Waterhouse/Coopers & Lybrand quoted above, paragraphs 20,22

6 Price Waterhouse/Coopers & Lybrand; Case COMP/M.2810 Deloitte & Touche/Andersen UK, 01/07/2002

35. Due to existing or new legal restrictions resulting from the Enron crisis and applied to German companies the Commission had to verify whether the range of services comprising statutory audit and audit related services constitute a single market or whether statutory audit should form a separate market. The investigation confirmed that some of these "audit-related" services cannot be provided by the incumbent statutory auditor to its client so that there is no perfect demand side substitutability among the entire range of services. In particular, as specified under German law, the statutory auditor may not be involved in internal audit services. The situation may be aggravated by the US Sarbanes-Oxley Act of 2002 which prohibits registered public accounting firms from providing nine types of services to clients, comprising audit related services[7]. These provisions will in general also apply to German companies listed at a US stock exchange and therefore underlie SEC regulation. It can moreover be expected that this Act will trigger similar regulation in other countries.

36. However, the investigation confirmed that the prohibition to provide some audit related services to their statutory audit clients does not prevent the same firm from offering these services to other clients as similar expertise is needed for the provision of statutory audit and audit related services. Both kinds of services are therefore characterised by a clear supply-side substitutability. In addition, most of these services can still be provided together, also by the incumbent statutory auditor. Given these elements, statutory audit and audit related services are currently still to be considered as belonging to the same market.

Audit and audit related services to quoted and large companies form a distinct product market

37. In previous decisions[8], the Commission identified the following main reasons for which it considered that audit and accounting services to quoted and large companies form part of a separate product market: the necessity for such companies to have audit and accounting services provided by a firm with the necessary reputation in the financial markets (in the case of quoted companies), the geographic breath to cover the companies' needs worldwide (in the case of multinationals), the depth of expertise in the particular sector (large companies in general and, in particular, regulated sectors such as banking and insurance) and significant resources (all large companies). The Commission concluded that only the worldwide active audit and accounting firms known at that time as the Big Six had both the geographic coverage and the degree of reliability with respect to financial statements required by the international capital markets, so that only they operated in the audit and accounting market for quoted and large international companies. The parties do not dispute this product market definition.

38. The market investigation in the present case confirmed the existence of a separate market for audit and accounting services to large and quoted companies which can only

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7 (i) bookkeeping services relating to accounting records or financial statements of the client; (ii) financial information systems design and implementation; (iii) appraisal or valuation of services and fairness opinions; (iv) actuarial services; (v) internal audit outsourcing services; (vi) management functions or human resources; (vii) broker-dealer, investment adviser or investment banking services; (viii) legal or expert services unrelated to the audit; and (ix) any other service that the Board of the SEC determines to be impermissible.

8 Cases COMP/M.2810 – Deloitte & Touche/Andersen UK; IV/M.1016 - Price Waterhouse/Coopers & Lybrand,

be provided by the Big Five audit firms. The vast majority of responding customers among large and quoted companies indicated that they would not consider second tier firms, including BDO -a second tier firm with a considerable, but far smaller international network than the Big Five firms- as substitutes for Big Five firms. The vast majority of large firms who had Andersen as their auditor replied that they would switch away from Andersen to another Big Five firm, if Andersen was not taken over by a Big Five firm. The customers in Germany saw as the most important differences between Big Five and second tier firms representing simultaneously the main reasons why they would only choose a Big Five auditor: the international network of the Big Five firms, their reputation in the financial markets, their professional know-how and their specific knowledge in international auditing and accounting standards (expertise in US-GAAP and IAS).

German particularities of the relevant market

39. Several distinct features of the German market, however, have to be acknowledged. Unlike the situation in the UK[9], where most large companies are also listed at the stock exchange, a considerable number of large German companies are privately owned and less dependent on capital markets. Even for German quoted companies an important number of large quoted companies are privately controlled. In consequence, these companies rely less on the recognition which their statutory auditor receives from shareholders, banks and capital markets, in particular from outside Germany, but it is more important for them that the auditing firm is being trusted by the private owner or controlling shareholder. For this reason, the number of quoted companies requiring a Big Five auditor only for the reputation in the capital markets appears to be considerably smaller in Germany than in the UK. A bigger number of large privately owned companies has to be included in the market than in the UK as they need to retain a Big Five auditor due to their widespread international activity. This also applies to listed but privately controlled companies which may require the resources of a Big Five auditor in order to cover their international activity although they do not need a Big Five auditor for their recognition in the capital markets.

40. A further feature of the German market is that in Germany the traditional relationship with an auditor seems to be even more important than in the UK and that changes of the statutory auditor rarely occur. The market investigation revealed that a large number of large German companies have not changed their statutory auditor for decades.

41. The market investigation has shown that, due notably to the peculiarities explained above, second-tiers and even smaller audit firms have clients among large German companies. This is in particular the case for BDO, which has a noticeable number of mandates among Germany's large firms. A number of factors can explain this observation. In a large number of cases, this position seems to be based on a historical relationship of BDO with their German clients. Furthermore, as outlined above, a number of large German firms do not directly depend on the capital markets and do not need to retain an auditing firm for its reputation in the capital markets or for its knowledge in international accounting standards. This is even valid for listed but privately controlled companies, in particular if they do not intend to attract international investors. For such companies, it seems to be sufficient to retain BDO as statutory auditor provided they do not require one of the global auditing networks due to the

9 cf. Case COMP/M.2810 – Deloitte & Touche/Andersen UK.

company's worldwide activity. However, this does not mean that BDO in particular should be considered as being part of the audit and accounting services market for large and quoted companies, as it is defined for the purpose of this decision: the market investigation demonstrated that the vast majority of Big Five customers would not switch to second tier firms, including BDO, as for them BDO did not represent a suitable alternative.

Conclusion

42. In conclusion, for the purposes of this decision it is considered that a distinct product market for audit and accounting services for large and quoted companies, exclusively served by Big Five firms, can be defined. This market comprises audit and accounting services to large quoted companies, whether national or international in dimension, as well as to large non-quoted companies. However, the Commission found some evidence that the gap between Big Five firms and in particular BDO, as second tier firm, is less significant in Germany than in other European countries. It can therefore be considered that BDO, in particular after the disintegration of the Andersen network, may exert some competitive pressure on the margin, even though it does not belong to the same market.

ii) Audit and accounting services to small and medium-sized companies

43. The market for audit and accounting services to small and medium-sized companies covers the audit and accounting services to all those companies, who do not require one of the features mentioned above, which can only be provided by one of the global audit and accounting networks.

iii) Tax advisory and compliance services

44. The market investigation showed some features, as in a previous case[10], which could justify a definition of separate markets for services provided predominantly with regard to national tax legislation, and services with international dimension. Whereas national tax advice can be provided by a firm, which is only active in one country, the provision of international tax advice services can, in principle, be provided either by an international network or by co-operation of different national firms. The market investigation, however, indicated that for a significant number of customers the network solution is the preferred choice. However, it is not necessary for the purpose of this decision to define the market precisely, as the proposed operation does not lead to the creation or strengthening of a dominant position irrespective of the precise definition retained.

iv) Corporate Finance Advisory Services

45. As regards the market for the provision of corporate finance advisory services, the market investigation has confirmed the results of the case IV/M.1016 – Price Waterhouse/Coopers & Lybrand that this can be considered as distinct product market.

v) Legal Services

46. The market investigation has shown that there is a separate market for legal advice and gave some indications that there might be a separate market for business law. It showed

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10 Case COMP/M.2810 Deloitte & Touche/Andersen UK, 01/07/2002

some features, which could justify a definition of separate markets for services provided predominantly with regard to national legislation, and services with international dimension. In the same way as regarding tax advice, the provision of international legal advice can, in principle, be provided either by an international network or by co-operation of different national firms. The market investigation indicated that for a significant number of customers the network solution is the preferred choice. However, it is not necessary for the purpose of this decision to define the market precisely, as the proposed operation does not lead to the creation or strengthening of a dominant position irrespective of the precise definition retained.

B. RELEVANT GEOGRAPHIC MARKETS

47. As regards the geographic dimension of the relevant product markets for i) audit and accounting services to quoted and large companies, ii) audit and accounting services to small and medium-sized companies, and iii) tax advisory and compliance services the Commission has stated in case IV/M.1016 – Price Waterhouse/Coopers & Lybrand that these markets are national in scope. The reasons given were in particular significant national differences for the services' main features such as the specific professional expertise required, applicable regulations, and the relevant laws for which the above mentioned advisory services are provided. The market investigation has confirmed the national scope of these product markets, as these features of the market have not changed to date.

48. With regard to the geographic markets for iv) corporate finance advisory services, the Commission has already recognised the existence of both national and international aspects for the provision of these services. In the absence of competition concerns, the Commission did not have to conclude on the geographic scope of these markets. As the market investigation has not raised new elements in this respect, and as these two markets do not lead to the creation or the strengthening of a dominant position irrespective of the precise definition of the markets' geographic scope, the Commission does not need to deviate from its previous approach for the purpose of the present case.

49. If a separate market for tax advisory services with international dimension were to be considered, the market investigation has indicated that such a market would show some national characteristics. Tax advice on international matters is linked to the national tax law of the advice seeking company and therefore presupposes knowledge of the national tax regime under which the company is operating. The company will therefore normally liase on matters with an international character with its national tax adviser, who will then usually co-operate with experts - either from the network or from independent co-operating firms - in the jurisdiction where the other end of the operation in question is located. The precise definition of the geographic scope of such a possible market, however, can be left open, as the proposed operation does not create or strengthen a dominant position irrespective of the geographic delineation of the market chosen. The same line of reasoning applies to a possible market for legal advice with international dimension. Also for this possible market the precise delineation of the market can be left open as the proposed operation does not create or strengthen a dominant position irrespective of the geographic definition of the market chosen.

C. COMPETITIVE ASSESSMENT

50. The transaction will lead to horizontal overlaps in all the relevant markets mentioned above. The parties' combined market shares will, however, only exceed 15 % in the German audit and accounting services market for quoted and large companies and the German tax advisory services market with an international dimension, assuming that such a market exists. Therefore the competition assessment of the transaction will focus on the markets for 1) audit and accounting services to quoted and large companies, and the possible market for 2) tax advisory and compliance services with an international dimension.

51. On all other relevant markets deterioration of competition can be excluded, as the parties combined market shares will be well below 15% and the clients' choice of service providers in these areas is not limited to the Big Five audit and accounting firms. Audit and accounting services to small and medium-sized companies can be provided by a large number of smaller audit and accounting firms active in Germany. For corporate finance advisory services the parties are in competition with the large investment banks. Regarding the provision of legal services the parties compete with a large number of law firms providing legal advice in the field of business law, a significant number of which are integrated into international networks.

1. Market for audit and accounting services for quoted and large companies

a) Market shares in the relevant market

52. The calculation of market shares for the relevant market requires in a first step the definition of the sample, which gives the best approximation for the German market for audit and accounting services for quoted and large companies. In a second step the best estimates of market shares for this sample has to be established.

Relevant sample for the German audit and accounting services market for large and quoted companies

53. No categorisation defining the sample of companies for the market for audit and accounting services for quoted and large companies is available. The market investigation has shown that the companies belonging to the DAX and the MDAX (the largest 100 companies listed on the Frankfurt stock exchange, further referred to as "DAX 100") or to the German Top 300 companies according to their turnover (the smallest Top 300 company achieves a turnover of € 1,800 million) would represent a suitable approximation for the relevant market. However, companies belonging to the sample may only be taken into account if competition for the statutory audit of these companies takes place at the level of those companies. The market investigation showed that in the large majority of groups the decision upon selecting the auditing firm is taken centrally for the whole group even if this decision may be implemented separately for each group member according to the requirements of applicable company law. Thus, subsidiaries have been taken out of the sample. Exceptions from this rule have to be made for quoted subsidiaries. The market investigation revealed that some of the quoted subsidiaries have different auditors than their parent companies. This indicates that the shareholders' general meeting, including the minority shareholders, may also de facto determine the choice of the statutory auditor. For similar reasons, 50/50 joint ventures between different parent companies are included in the sample. The decision about the statutory auditor of such a joint venture cannot be determined centrally on the group

level, but the parent companies have to agree on the level of the joint venture where also competition takes place.

54. Finally subsidiaries of groups which are headquartered outside of Germany have been excluded from the sample. The market investigation showed that the vast majority of international groups decide centrally about the auditors of their subsidiaries, irrespective of the country in which the subsidiary is located. However, even if such referred-in work for auditing firms is not taken into account for the calculation shares in the German market, such work must be taken into account when it comes to the assessment of the their entire competitive potential on the German market. Referred-in work gives the auditing firms the possibility to build up the resources for auditing and accounting work in order to be a credible bidder for companies directly belonging to the German market.

55. In conclusion, the Commission found that the best approximation for the relevant sample for the German audit and accounting services market for large and quoted companies consists of DAX 100 and German Top 300 companies excluding non-listed subsidiaries, jointly controlled joint ventures and referred-in work. Thereby, only the number of actual Big Five mandates is taken into account. This seems to lead to a more accurate approximation of the market for audit and accounting work for large and quoted companies as those companies represent the customers who need to retain a Big Five auditor for at least one of the reasons given above and who therefore are not in a position to switch to a second tier audit firm. On this basis, the sample comprises 152 companies.

Calculation of market shares

56. The Commission was faced with considerable difficulties to calculate market shares on the basis of this sample, As there is no publicly available data on the German market. The parties proposed to calculate market shares on the basis of the published turnover figures of the Big Five firms in the audit and accounting market. However, these figures comprise the total turnover achieved by the Big Five firms in the audit and accounting market and do not match the relevant market defined above. The total turnover of the firms can therefore only be used in order to double-check the market shares established on a basis closer to the sample. It also proved difficult to rely on data provided by the Parties and their Big Five competitors regarding their turnover for the relevant sample as all Big Five firms had significant difficulties to re-calculate the required data on the basis of data collected for their internal purposes.

57. The Commission therefore decided to calculate market shares on the basis of the number of statutory audit mandates. This method can rely on publicly available data since the statutory auditor of large companies is published in the annual reports, which have to be submitted to the publicly accessible commercial register. Using these figures it has to be borne in mind that the number of statutory audit mandates does not necessarily correspond to the position in audit related work. It can, however, be considered as a suitable approximation since the number of statutory audit mandates appears to be a key factor for the competitive position on the relevant market in Germany.

58. The market share data for the sample on the basis of number of mandates can be summarised as follows.

Table 1 Market shares by number of mandates

Financial Year 2001	Andersen Germany	E&Y	Andersen + E& Y	PwC	KPMG	DTT
Number of Mandates	9	15	24	57	61	9
Market share	6%	9.9%	15.9%	37.7%	40.4%	6%

59. The market shares on the basis of number of mandates can be cross-checked by taking into account the turnover of Big Five for all audit and accounting work for the year 2001. Thereby, the audit related work carried out by Big five firms in the market for large and quoted companies and referred work is taken into account as well as the audit and accounting work in the market for small and medium-sized companies.

Table 2 Market shares by turnover for audit and accounting services

Financial Year 2001	Andersen Germany	E&Y	Andersen + E&Y	KPMG	PwC	DTT
Turnover in EUR million	[…]	[…]	[…]	[…]	[…]	[…]
Share of total Big Five turnover	[10-20]%	[10-20]%	[20-40]%	[30-40]%	[30-40]%	[5-15]%

Source according to Parties: Publicly available figures and internal data of the parties.

b) General characteristics of the market

60. Before assessing the impact of the transaction on competition in the market for audit and accounting services for quoted and large companies, it is useful to outline the conditions of competition in this market. Under German law, companies are required to have their accounts annually audited by a qualified auditor. In public companies, the Supervisory Board will propose an auditing firm which will be formally appointed by the shareholders at the annual general meeting. In selecting the auditor, large companies typically use a competitive tender process, which may be more or less formal. They invite several firms (generally not more than three or four) to submit a proposal. For quoted and large companies, the competition for audit and accounting services therefore operates at the moment of such competitive tenders. The investigation revealed that the length of time for which audit firms are retained tend to be even more long-term in Germany than in the UK[11]. Even if the shareholders in each annual general meeting have to approve the auditor again, the norm is that appointed auditors will be renewed and that the auditor-client relationship can last many years. Despite such a renewal in favour of the incumbent auditor, launching an invitation to tenders imposes a

11 cf. for the situation in the UK Case COMP/M.2810 – Deloitte & Touche/Andersen UK; in general Price Waterhouse/Coopers & Lybrand, quoted above, paragraphs 20,22

competitive constraint on the incumbent auditor and may lead to a re-negotiation of the fees.

61. The Commission's investigation showed that the respective market shares among the Big Five did not fully reflect the ability to win a tender. The market investigation has shown that customers view any of the Big Five as a credible bidder in a competitive tender.

c) Single dominance

62. The combination of the parties' market shares (15.9% by number of mandates) will only result in the creation of the third largest player in the market, which will be significantly smaller than the market leaders PWC and KPMG. The market leaders have each a market share of around 40%. Therefore the proposed operation will not result in the creation of a single dominant position.

d) Collective dominance

63. In case IV/M.1016 – Price Waterhouse/Coopers & Lybrand quoted above, the Commission considered that the market characteristics of the audit and accounting market for quoted and large companies could, in principle, lead to collective dominance. On the demand side, the Commission considered, in particular, that there was moderate growth in the market and a low price elasticity of demand. On the supply side, the Commission considered the existence of a high concentration, high market transparency for a rather homogeneous product, mature production technology and structural links between competitors. Finally the Commission considered that high barriers to entry characterise this market, in particular, due to the audit firm's required broad geographical network, extensive human resources required, and a well established reputation which has been built up over a significant period of time.

64. However, the Commission found no conclusive proof that such dominance resulted from the relevant operation in the (then) Big Six market. The Commission concluded that 'in view of the continued post-merger existence of no fewer than five suppliers, of the likely continued participation of these five suppliers in the tender offers which constitute the competitive process in the relevant markets, and of the non-emergence of any two clear leading firms following the merger; the Commission has found no conclusive proof that the reduction from six to five players would create or strengthen a position of oligopolistic or duopolistic dominance within any of the national Big Six markets for audit and accounting services to large companies within the Community.'[12]

65. As the transaction leads to a reduction in the number of market participants from five to four in the audit and accounting market for quoted and large companies in Germany, it has to be considered that the transaction could lead to the creation or strengthening of a collective dominant position. However, on the basis of the market characteristics in Germany, as outlined above, there does not appear to be a risk that the present transaction creates or strengthens a position of collective dominance in such a market.

66. Unlike the UK market, as described in Case COMP/M.2810 – Deloitte & Touche/Andersen UK, the German market is characterised by a structure of two clear

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12 Price Waterhouse/Coopers & Lybrand, quoted above, paragraph 119

market leaders, KPMG and PWC. Both firms together account for nearly 80% of the Big Five mandates. The parties would have a combined share of 15.8%, DTT, as smallest player, has a share of 5.9% of the Big Five mandates. These figures may even overstate the market position of the parties in the immediate future. As a number of clients defected from Andersen Germany following the loss of reputation due to the Enron affair and as conflicts of interests will arise for several of the clients of the combined Ernst&Young and Andersen Germany entity, it is expected that the market share of the merged entity will be lower than the combined market shares of both undertakings which reflect the status of 2001.

67. The advantage of the market leaders in terms of total turnover in audit and accounting over the parties and DTT, as shown in Table 2, is less significant than the advantage in terms of market shares. KPMG and PWC are the clear leaders also in terms of turnover achieved in audit and accounting work. The parties would have a combined share of [20- 40%] of the total turnover of the Big Five, DTT around [5-15%]%. This may, beside the inclusion of the turnover resulting from audit and accounting activities carried out for small and medium-sized companies, be explained in particular by the comparatively stronger position of the parties and DTT in audit related work and in referrals. Nevertheless, even on the basis of turnover figures including the entire audit and accounting work done by these companies, KPMG and PWC are the clear leaders and have a similar position, the combined entity would be third with a considerable distance and DTT is the fourth player on the market, significantly smaller than the combined entity.

68. The Commission considers that, given the significant asymmetries between the players, the market structure in this case is not conducive to collusive behaviour between the two leading market players and the merged entity or between all four market participants. This market structure does not provide incentives for the merged entity to collude with the market leaders as it has more to gain by an increase of its market share. Even in the contrary, it could be considered that the merged parties might be in a position to close the gap between them and the two market leaders by making use of their enlarged resources.

69. Given the above position of the parties in the market, the Commission does not consider that the concentration leads to a substantial alteration to competition as it stands. Therefore, unlike in the UK market, the Commission does not see a risk that the concentration could lead to the creation or strengthening of a dominant position.

2. Market for Tax Advisory services

70. The market investigation has shown that it could be considered that the market for tax advisory services might be further divided between international tax advisory services, and national tax advisory services.

71. In this case, the market for international tax advisory services would be similar to the market for the provision of audit and accounting services to large and quoted companies, in that the service requires an international network and there are few providers on the market. The market investigation has shown, however, that the Big Five are not the only service providers on this possible market for international tax advisory services in Germany. To a considerable extent big law firms, which either have an international network comparable to the one of the Big Five or usually co-operate with law firms in other countries are or at least could be active on this market.

72. Given the fact that a considerable number of big international firms are active on the same market, no competition concerns can arise in the possible market for tax advisory services with an international dimension. Furthermore, if such a market exists, this market would largely coincide with the market for audit and accounting services to international firms. Thus, the same reasoning and assessment can be carried out as above. Therefore, the transaction will not lead to the creation or strengthening of a dominant position on such a market.

VI. CONCLUSION

73. For the above reasons, the Commission has decided not to oppose the notified operation and to declare it compatible with the common market and with the EEA Agreement. This decision is adopted in application of Article 6(1)(b) of Council Regulation (EEC) No 4064/89.

For the Commission

Signed by Michaele Schreyer
Member of the Commission