MERGERS (ACCOUNTING): THE ANDERSEN CASES

Subject: Mergers

Industry: Accounting

Parties: Ernst & Young Germany
Andersen Germany
Menold & Aulinger
Ernst & Young France
Andersen France

Source: Commission Statements IP/02/1241, dated 27 August 2002, and IP/02/1271, dated 5 September 2002

(Note. This is the last stage in the Commission's involvement in the break-up of the Arthur Andersen auditing firm. Having dealt with the UK merger by Deloitte & Touche, the following two cases relate to the mergers by Ernst & Young Germany and Ernst & Young France. Essentially, the Commission is satisfied that, while the reduction from five to four major firms is from a general competitive point of view regrettable, the mergers proposed in Germany and France will not in practice create or strengthen a dominant position on the European market; and this is the criterion it has to apply. Mergers in other Member States of the European Union involving the remains of Andersen Worldwide are being dealt with on a national basis.)

(I) Germany

The Commission has granted regulatory clearance to the proposed merger between Ernst & Young's German entities, most of Andersen Germany's business and the German based law firm Menold & Aulinger. The Commission examined the merger's impact particularly for audit and accounting services to large and quoted companies headquartered in Germany, which tend to choose one of the Big Five accountancy firm to audit their accounts. It concluded that the merger would not lead to competition problems in this market, given the strong position of the market leaders KPMG and PWC.

On July 23, 2002 Ernst & Young, Andersen Germany and Menold & Aulinger requested regulatory clearance from the Commission for their merger. In the course of the transaction, Andersen Germany's partners will join Ernst & Young and Andersen's business in Germany will be leased to Ernst & Young. The combined entity will closely integrate Andersen Germany's legal branch, which will be simultaneously combined with the currently independent German law firm Menold & Aulinger. The transaction does not involve the business consulting arm of Andersen Germany.

In the present operation, the Commission examined the merger's impact in Germany, in particularly regarding the market for audit and accounting of large quoted companies, which usually retain the services of the Big Five audit and accounting firms. Beside Ernst & Young and Andersen, the Big Five comprise PriceWaterhouseCoopers (PwC), KPMG, and Deloitte Touche Tohmatsu. The Commission considered that there was no danger of a creation of a single dominant position given that Ernst & Young and Andersen combined would only be the third player in the German market for large and quoted companies, clearly behind the market leaders KPMG and PWC, whereas Deloitte & Touche will be the smallest player.

The Commission also examined the extent to which there could be concerns about the reduction of the big auditing firms to four, as it did in the previous decision of July 2002 on the take-over of Andersen UK by Deloitte & Touche, with particular reference to the possible creation or strengthening of a collective dominance position. Similar concerns had already been analysed in 1998 in connection with the merger between Price Waterhouse and Coopers & Lybrand, before which there were six big audit firms.

A careful analysis has shown that, despite the reduction from five to four principal firms, the structure of the German market arising from the transaction is not conducive to collusion involving the merged entity. The reasons for this are the asymmetries between the market participants, with KPMG and PWC remaining the two clear leading firms after the merger in the German market and the merged entity following at a certain distance. Therefore, the Commission does not foresee a risk of a collective dominant position as a result of the transaction. On the basis of this analysis, the Commission concluded that there were no grounds to launch an in-depth investigation and cleared the operation.

The German business of Ernst & Young is a member of the global Ernst & Young network of accounting and professional services firms, which employ over 83,000 people in 125 countries. Andersen Germany was active as member firm of the Andersen Worldwide international network. Until recently, the Andersen Worldwide member firms collectively employed approximately 85,000 people around the world in 84 countries. Menold & Aulinger is a German law firm specialising in business law.

This merger must be seen in the context of the disintegration of Andersen Worldwide following the Enron bankruptcy and the ensuing damage for Andersen US, which audited the company's accounts. Subsequently, Andersen US was convicted of obstruction of justice in the US government's probe of the Enron collapse and will terminate the auditing of the accounts of US quoted companies in the near future. As a result, Andersen's national practices worldwide have either already joined or have announced their intention to join one of the remaining Big Four firms, on a national basis. Regarding the European Union, whereas the acquisition of control by Deloitte & Touche of the Andersen UK business had already been cleared by the Commission in July 2002, the merger between Andersen France and Ernst & Young is the subject of a separate decision by the Commission (see below). Other transactions in the European

Union involving national Andersen member firms are being looked at by national competition authorities.

(II) France

The Commission has granted regulatory clearance to the proposed merger between Ernst & Young France and most of Andersen France's business. The Commission examined the merger's impact particularly for audit and accounting services to large and quoted companies headquartered in France, which need one of the Big Five accountancy firms to audit their accounts. It concluded that the merger would not lead to competition problems in this market.

On 7 July 2002 Ernst & Young and Andersen France requested regulatory clearance from the European Commission for their merger. The transaction consists of the amalgamation of most of Andersen France's business including activities in the area of audit and accounting, tax and legal advice, and corporate finance with Ernst & Young, but does not involve Andersen France's business consulting arm.

Although the merger will create France's biggest firm on the audit and accounting market for large and quoted companies, the Commission found that there was no danger of a creation of a single dominant position. Already before the merger the merging parties had lost a number of large customers due to the loss of Andersen Worldwide's reputation; and they will inevitably lose other significant business as French rules require that a company's accounts be subject to two independent audits (so-called co-auditorship). This will reduce the gap between the merged entity and the other Big Four firms. In any event, the market investigation has shown that large French companies usually appoint their statutory auditor after launching tender procedures and that the Big Four firms are all recognised as credible bidders.

In line with its previous decisions on the UK and German market, the Commission further focussed its investigation on the possible risk of a creation or strengthening of a collective dominant position in the market, as the transaction leads to the reduction of the big auditing firms from five to four. A careful analysis showed that, although Andersen France might be able to continue as an independent audit and accounting firm for smaller clients, it could no longer service its large clients. Large clients demand a global network, a high degree of international expertise and a reputation that only the remaining Big Four firms can offer. Andersen Worldwide was able to offer this, but Andersen France on its own cannot. Furthermore, the hypothetical acquisition of Andersen France by second-tier, French auditing firms, such as Mazars & Guérard or Salustro-Reydel, would not be able to replicate the global network and the reputation required to enter the market for quoted and large companies. Therefore, and as far as large, quoted clients are concerned, a reduction to four was inevitable and would have occurred whether Andersen France was taken over or simply disintegrated. On the basis of this analysis, the Commission concluded that there were no grounds to launch an in-depth investigation and cleared the operation.

The French business of Ernst & Young is a member of the global Ernst & Young network of accounting and professional services firms. Andersen France acts also under the names Barbier Frinault & Associés and Archibald. It was active as member firm of the Andersen Worldwide international network. After the UK case, cleared in July 2002, and the German case, cleared in August 2002, this third decision concludes the Commision's merger investigations on the take-over of the national Andersen entities within the European Union. Other transactions in the European Union involving national Andersen member firms have either already been cleared or are currently being looked at by national competition authorities. ■

The GVS / ENI / EnBW Case

The Commission has decided to undertake an in-depth investigation into the proposed joint acquisition of German regional gas distributor Gasversorgung Süddeutschland (GVS) by Italian energy company ENI SpA and Energie Baden-Württemberg (EnBW), a company partly controlled by France's EdF. The Commission at the current stage has concerns that the deal may reinforce the strong position of GVS in the transmission and distribution of gas in the region of Baden-Württemberg along the French eastern border. Gasversorgung Süddeutschland (GVS) distributes gas and operates a pipeline transport system in the German southern region of Baden-Württemberg.

Energie Baden-Württemberg (ENBW) is a subsidiary of Eléctricité de France (EdF) and OeW, an association of nine public districts in southwest Germany. It is active in the generation, transmission, distribution, supply and trading of electricity as well as gas and district heat.

ENI is active in the exploration and production of oil and natural gas worldwide. Through its shares in various projects, ENI disposes of pipeline transmission capacities in some Member States and outside the European Union.

On the basis of the information available to date, GVS holds a strong position in the distribution and transmission of gas in the region of Baden-Württemberg. EnBW's position in the gas market is less significant than in the electricity market (it is Germany's fourth electricity company), but its activities in the local distribution of gas could reinforce the position of GVS. Therefore, the Commission currently has serious doubts about whether to approve the transaction in its present form. The opening of a second-stage merger investigation is without prejudice of the Commission's final decision. The Commission now has a total of four months within which it will first carry out a detailed investigation of the deal's impact on competition in the market concerned.

Source: Commission Statement IP/02/1312, dated 17 September 2002