CPI's Europe Column Presents:

New merger control guidelines for transaction value thresholds in Austria and Germany

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Introduction

How to best cope with the digital economy is an ongoing debate in the competition community. For all its blessings that the digital revolution has brought about for consumers, from a competition authority's perspective it can be difficult to deal with digital businesses.

Hence, the German lawmaker introduced new, additional merger thresholds in the German Competition Act (GWB) in 2017 based on transaction values, while similar thresholds have been added to the Austrian Competition Act. These new thresholds are not limited to the digital economy, although they are well suited to address a gap in the system of merger control that digital business models in particular have revealed. Now, in July 2018, the German Bundeskartellamt and the Austrian Bundeswettbewerbsbehörde have jointly published new guidelines, providing some further explanations concerning these amendments.

The new provisions of the German Competition Act[2]

The guidelines in particular focus on the new § 35 para. 1 a GWB, which was introduced in the German Competition Act in 2017. The new provisions complement the original § 35 para. 1 GWB providing solely for turnover thresholds. According to § 35 para. 1 a GWB, the relevant thresholds are:

1. In the last business year, the combined aggregate worldwide turnover of all undertakings concerned was more than € 500 m.

2. In the last business year, the domestic turnover of one undertaking concerned was more than € 25 m. Neither the target undertaking nor any other undertaking concerned achieved a domestic turnover of more than € 5 m.

3. The value of the consideration for the acquisition exceeds € 400 m.

4. The target undertaking has substantial operations in Germany.

The guidelines

The new guidelines in particular explain how to calculate the *transaction value* and how to establish *substantial operations* for the purposes of the new provisions. The guidance is based on the authorities' first experiences with the application of the new provisions, in-depth discussions with legal experts and a public consultation. The authorities received valuable comments in various substantial submissions, in particular from national and international practitioners. The submissions will be published on the Bundeskartellamt's website.

The transaction value

The German Competition Act's new provisions already explain in general terms how a company's purchase price – the consideration for the acquired party – shall be determined in § 38 GWB. According to the new provisions, the consideration shall include all assets and other consideration of monetary value that the seller receives from the acquirer in relation with the particular transaction, as well as the value of any liabilities assumed by the acquirer.

Therefore, the consideration is solely based on the transaction in question, which might differ from the overall target's value, particularly in cases where the acquirer already holds parts of the target's shares from previous transactions that are unconnected with the acquisition at hand.

It is also worth highlighting that the lawmaker chose the consideration and not the target's value to determine the transaction value. Since the saying goes that company valuation is more art than science (and sometimes more magic than craft), this will make it easier for most cases to clearly identify the transaction value of a case. This will hold true in particular for cases of pure cash transactions. For stock transactions or asset swaps, the valuation of the consideration could be more difficult to establish. Therefore, the guidance explains how to determine a transaction's consideration value in such cases. In a stock transaction, a decisive question is whether shares are traded on a liquid market. Such a market will generally provide reliable, up-to-date market values that reflect the consideration's value. Without a liquid market – and hence current market values – valuation reports may be used. It is worth highlighting that in such a case the parties to a merger are free to choose a reasonable valuation method, as long as it reflects a going concern value. However, the guidance as well as the Competition Act require providing the valuation's basis and input data as well as an explanation for why a particular method has been chosen. Similarly, in asset swap transactions, the particular assets that represent the consideration will have to be valued, whether they are tangible or intangible. Again, an appropriate valuation method should be used that takes the assets' intended use into account.

Since future payments are typically of particular interest in M&A valuations, the guidance also provides explanations on how to deal with such uncertain payments. For the purpose of determining a transaction's consideration, the guidelines point out that the payments' present value should be calculated, thus taking the time value of money into account. This approach poses some particular challenges regarding the documentation of the consideration's calculation in the notification. Therefore, the guidance explains how to discount payments and what kind of data shall be provided to the authorities.

Additionally, contingent payments and assumed liabilities have to be considered, whereas the guidance points out that the latter can usually be limited to interest-bearing liabilities. In this context, the term assumed liabilities also comprises liabilities on the acquired company's balance sheet, as the guidance makes clear. With this approach, the determined consideration shall be less prone to changes in the target's capital structure.

However, with respect to the technical details of determining the consideration, the guidance also points out that its overall aim is to enable the authorities to scrutinize the consideration's value. Therefore, the guidance foresees a general simplification rule. In clear-cut cases, where it is beyond doubt that the consideration exceeds or falls below the threshold value, less details of the consideration's calculation have to be provided.

Local nexus

The second pillar of the new transaction value threshold comprises the provisions to ensure a case's local nexus. Since a transaction's value can hardly be linked to a certain jurisdiction, the Competition Act introduced a twofold approach. A local nexus will essentially be assured by the requirement that one party had a domestic turnover of € 25 m and the acquired party has current operations to a substantial extent in Germany. This second requirement of having substantial operations in Germany is further explained in the Act's explanatory notes and the guidance.

The guidance sheds light on the question of how to measure current business activity. Whereas in mature markets turnover data is the traditional choice of establishing business operations for merger notification purposes, the cases targeted by the Competition Act's new provisions obviously make different indicators necessary. As a general rule, the guidance acknowledges that different industries may use different indicators and that notifying parties should adhere to commonly accepted measures in their particular industry. This might be the monthly active users or the number of unique visitors in the digital world. In a next step, the guidance introduces a systematic approach to identify what kind of operations qualify for a notification, based on their local nexus, their marketability and their extent.

First, the chosen indicator's value within Germany has to be ascertained. Therefore, the business operation will be linked to the location of the intended use. Typically, this will be the customers' location. However, domestic R&D activity and supplementary activities related to market entry might also establish a local nexus, as long as the R&D results are generally marketable and the resulting products and services are expected to be brought to the market in Germany. For such cases, the location of R&D staff, infrastructure, laboratories and distribution agreements are indicators of domestic R&D activity.

Second, concerning an operation's marketability, the guidance clarifies that a product or service's marketability might also be established if non-monetary remuneration takes place. Providing data, consuming commercials or simply postponing payments to the future might be such examples of non-monetary remuneration. In this context, the guidance also explains how to establish the marketability of R&D activities. For the pharmaceutical industry, marketability will be assumed if a certain substance has reached an advanced clinical trial phase, typically at least the beginning of phase three. However, this presumption is rebuttable.

Third, the operation in question must be substantial to qualify for notification. Generally, a target company's operation will not be regarded as being substantial if the company generates sales of less than € 5 m and operates in markets where turnover correctly reflects the target's market position and its competitive potential. This might particularly be the case if the target generates substantial revenues in foreign markets but not in Germany. However, if turnover data is not a reliable indicator, alternative measures have to be used, as mentioned above. In R&D cases, such measures might include the R&D department's headcount, its budget, the number of patents or patent citations.

Furthermore, these criteria are explained in different examples, ranging from an app developer – whose activity is measured with the number of monthly active users as a performance indicator – to a traditional industry, in which the target's market position is reflected in its revenues. The guidance further elaborates on cases in the pharmaceutical industry and provides examples of how to deal with pharmaceuticals and substances in clinical trials that may generate no or hardly any turnover.

However, it has to be kept in mind that the question of domestic effects in German merger control is also addressed under the Act's domestic effects clause in § 185 para. 2 GWB. According to this, a concentration has to have sufficient effects within Germany to trigger the obligation of notification.

Conclusion

The new guidelines are a joint approach by the German and Austrian competition authorities to establish a level playing field for notifying parties in both jurisdictions. It is the first time that such joint guidelines have been developed. They are intended to assist practitioners in dealing with the new

law provisions concerning the recently introduced transaction value thresholds. Therefore, they represent the latest experiences of the authorities and numerous interested parties that have participated in in-depth discussions and the public consultation.

[1] All views expressed are solely those of the author and do not necessarily reflect the position of the Bundeskartellamt.
[2] This article focuses on the German Competition Act. However, the respective provisions are similar in the Austrian Competition Act.