New deal value thresholds

Germany and Austria jointly publish merger control guidance

by **Paul Lugard, Catriona Hatton** and **Daniel Vasbeck**

The competition authorities of Germany (*Bundeskartellamt*) and Austria (*Bundeswettbewerbsbehörde*) have jointly published a much-awaited guidance paper (the "Guidance") on the new merger control thresholds that both countries introduced in 2017.[1] There are several reasons why businesses should be aware of this new development. In particular, while the pre-existing revenue-based merger-control thresholds in Germany and Austria were already relatively low and captured international transactions with relatively little domestic impact, the new thresholds have further expanded the reach of the merger control regimes in the two countries. This expanded reach is having a particular impact on industries, such as high-tech and pharma, where acquired assets or companies can be valuable despite low current revenues. The application of the new thresholds which are based on the combination of a certain transaction value and a significant domestic activity has proved difficult in practice. The Guidance seeks to address at least some of the uncertainties although it by no means eliminates them. Additionally, the new thresholds are part of a more general reflection among competition authorities in the EU and might herald a new trend towards alternative, value of transaction-based merger control thresholds in the EU and other jurisdictions, especially given that the US also applies a value-of-transaction based approach.

In 2017, Germany and Austria supplemented their traditional thresholds – based solely on revenues – (the "traditional thresholds") with additional, transaction value-based thresholds (the "new thresholds").

The purpose of the new thresholds is to close a perceived enforcement gap, by catching transactions – particularly in the digital economy and the pharmaceutical sector – involving target assets which do not (yet) generate sufficient revenues to reach the traditional thresholds but have meaningful market potential reflected in a high transaction value. The new thresholds focus therefore less on revenues (particularly domestic revenues) and rely instead on the following two key criteria, both of which must be met:[2]

(i) The transaction *consideration value*, which must exceed (a) €400m (Germany) or (b) €200m (Austria); and
(ii) A local nexus test, which is met if the target has substantial significant domestic activities.

Compared to criteria based on revenues or asset values which are generally straightforward to apply, the new "consideration value" and "significant domestic activities" tests give rise to numerous questions and considerable uncertainty. However, until last month, no useful guidance was available. The Guidance is designed to address this lack of clarity.

The Guidance is a fairly detailed 34-page document which was issued following public consultation. The key elements are summarised below.

Consideration value

According to the Guidance, the consideration value encompasses "all assets and other monetary benefits that the seller receives from the acquirer in connection with the transaction". It has to be interpreted broadly and can include, for example, cash, securities, company shares not traded as securities, tangible and intangible assets, future and variable considerations that are contingent on certain conditions, considerations for non-competition, and liabilities assumed by the acquirer. The Guidance describes in detail the methods that should be used when calculating the value of these different types of consideration. Notably, the Guidance states that the consideration value cannot be geographically limited to its German or Austrian components, if any.

Completion date as point of reference

In some cases, the consideration value may fluctuate over time, for example, if it includes securities or cash held in foreign currencies whose value typically varies depending on market developments. The Guidance makes clear that the relevant time for assessing whether the consideration value exceeds the threshold is the completion date of the merger. If various components of the consideration value are to be paid at different times, the value of all subsequent payments (such as earn-out payments) must be determined with reference to the completion date. This may not always be straightforward in practice, for example, because – for business or antitrust reasons – the completion date itself may still be uncertain when the parties assess whether merger filings are required. The Guidance acknowledges and partly addresses this difficulty, but unfortunately does not fully appreciate the practical issues associated with the required determination of the consideration value at the expected closing date.

The Guidance includes relatively detailed developments and examples on how the current value of future and uncertain payments should be determined. At the same time, it acknowledges that, in specific cases, it may not be possible to evaluate precisely, at the time of notification or assessment of the notification requirement, which value a given consideration will have at the completion date. Therefore, it suggests that parties may need to rely on the value as it stands at the time of assessment of the notification requirement, as a proxy. Where the consideration value exceeds the threshold at the time of notification but subsequently falls below the threshold, the parties may withdraw the notification, and the transaction will not be subject to merger control. Conversely, a transaction that was not notifiable a few months prior to completion may

become subject to notification if the value of, for example, foreign currencies or shares rises to such an extent that it now exceeds the thresholds. Where such a scenario is conceivable, the Guidance recommends a precautionary filing. It remains to be seen however whether this suggested course of action will prove attractive in practice.

Importance of contemporaneous documentation of valuation

Given the complexity associated with the assessment of the consideration value, it is advisable that parties document in a sufficiently detailed manner the value assessments made, also in the scenario where parties reach the conclusion that the consideration value is too low to meet the new thresholds. The Guidance specifically recommends that parties maintain such documentation with a view to potential verifications that the German or Austrian competition authorities may carry out.

Local nexus

While numerous international transactions will involve a consideration value in excess of €200m (Austria)/€400m (Germany), a filing requirement under the new thresholds will only arise if the target has significant domestic activities in Germany or Austria. This criterion may be broken down into two elements: first, the target must have current and market-oriented domestic activities; second, such domestic activities must be significant.

Current and marketable domestic activities

According to the Guidance, whether or not a target is active in Germany or Austria has to be assessed by reference to the location of the customer, more specifically the place of intended use of the products or services. The target will therefore have domestic activities if there are users in Germany or Austria that avail themselves of the target's offerings. In Austria, the local nexus may also result from the location of the target company. R&D activities may qualify as domestic activities where (i) either the R&D activity itself takes place domestically (which must be assessed based on the place where the staff conduct the R&D activity); or (ii) other activities take place domestically which are related to a domestic market entry (eg activities carried out with a view to obtaining drug approval on the domestic market in pharmaceutical transactions or with a view to establishing domestic distribution structures). In addition, the Guidance indicates that the local nexus test will only be met in relation to R&D activities if the products or services in question are expected to be marketed in Germany or Austria.

Further, to meet the "domestic activities" test, the activities must be current and marketable (in other words, market-oriented). The Guidance clarifies that activities may be considered as marketable even if they do not give rise to any revenues or monetary payments. Examples of marketable digital services include (i) services remunerated by the supply of data or the consumption of advertising; and (ii) services offered initially free of charge but that can be expected in future to require payment or be monetised in a different way. R&D of (future) products is only caught to the extent that the research results will be marketable. In pharmaceutical research, for example, this applies to the planned acquisition of rights to substances that are in an advanced phase of clinical trials (which the Guidance typically considers to be the case in phase III).

Significance of domestic activities

To fall within the scope of the new thresholds, the domestic activities of the target must be significant at the time of transaction closing. In other words, a purely future nexus alone is not sufficient. The Guidance distinguishes two situations, depending on whether or not the revenues generated by the target in Germany or Austria (if any) adequately reflect the target's domestic market position and competitive potential:

- If the revenues adequately reflect the target's domestic market position and competitive potential (which will typically apply, for example, to mature markets where monetary payments are customary), then these revenues may be used as a benchmark to assess the significance of the domestic activities. If the target's revenues in Germany are below €5m, no notification requirement will arise in Germany in such a situation. An example may be when the target generates substantial revenues abroad, but not in Germany – for instance, because the company has not (yet) established a sales structure in Germany. The Guidance cites €500,000 as an equivalent benchmark for Austria.
- If the revenues do not adequately reflect the target's domestic market position and competitive potential, the significance of the domestic activities needs to be determined based on other criteria. The Guidance does not provide a definitive list of such criteria but states that different criteria may be applied to different sectors, and that the assessment should be carried out in line with industry standards that cannot be easily manipulated. Examples of criteria cited for the digital sector include the number of monthly and daily active users or the number of unique visitors. As regards R&D activities, the Guidance states that different criteria are conceivable and refers by way of example to the number of staff, the R&D budget, the number of patents and patent citations. In Austria, significant domestic activities will generally be presumed if the target has a location (site) in Austria, to the extent that the activities carried out at this site have domestic market orientation.

Implications for businesses

Complexity of the new thresholds

With the new thresholds, the assessment of merger filing requirements in Germany and Austria has become more complex and uncertain. This is illustrated by the level of detail of the Guidance which reduces uncertainty without, however, eliminating it. In particular, calculating the consideration value in line with the Guidance for the purpose

of determining whether the transaction is notifiable may constitute a complex and burdensome exercise, unless this value has been structured in a very basic manner. Second, while the precise level and components of the consideration value will typically be driven by financial parameters, it may in some cases make sense that parties consider the application of the new thresholds at an earlier stage of the M&A process than they would otherwise do.

Significant domestic activities in mature markets

The Guidance includes a number of important clarifications. For example, it confirms that the €5m threshold remains relevant for Germany in cases where the target's German revenues adequately reflect its domestic market position and competitive potential (eg in mature markets). This rule should help avoid unnecessary precautionary filings which would not be in line with the purpose of the new thresholds.

Precautionary filings

Since both key criteria (ie the consideration value test and the significant domestic activities test) are cumulative, filing requirements may be excluded on the basis that either of them is not met. To the extent doubts remain, a precautionary filing may be the most suitable and effective solution, in particular for Germany where the transaction may be cleared without it being necessary to take a definitive view on the existence of a filing requirement.

Consistency

Given the frequent cooperation between the German Bundeskartellamt and the Austrian Bundeswettbewerbsbehörde, illustrated by the joint publication of the Guidance, it appears increasingly important to take a consistent approach in relation to Germany and Austria. To the extent that businesses reach the conclusion to file in one, but not in the other jurisdiction, they should be mindful of legal or factual differences which substantiate this approach.

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Endnotes

1. The Guidance is available in the German language on the following website: (https://www.bundeskartellamt.de/SharedDocs/Publikation/DE/Leitfaden/Leitfaden_Transaktionsschwelle.html?nn=3599398). An English-language version will be published subsequently.
2. Please refer to the annex for a more detailed presentation of the new thresholds and a comparison with the traditional thresholds, which remain in force in addition to the new thresholds.

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