

CPI's Europe Column Presents:

The Transaction Value Threshold in Germany

Experiences with the New Size of Transaction Test in Merger Control

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Introduction

The takeover of WhatsApp by Facebook in 2014 was widely perceived as an eye-opener in the global competition policy community. The case showed that there might be a gap in the system of international merger control regimes in the face of new business models of the digital world. Despite both firms' undisputed market positions, the case proved challenging for typical turnover based merger control thresholds. In fact, the case was not notifiable in most European jurisdictions due to the companies' turnover figures. Therefore, in 2017 German and Austrian lawmakers introduced new additional size of transaction tests in their competition laws. These amendments now require notifications of mergers and acquisitions above a certain value, even without requiring the merging parties to fulfill the former pure turnover thresholds. Thus, the amendments enable the German and Austrian competition authorities to control the takeover of low turnover unicorn firms in their infancy. As the European competition community had little experience with transaction value thresholds, the German and Austrian competition authorities published a joint guidance for their application in 2018. Now in 2019, for the first time the authorities have also published some statistics and experiences concerning the application of their law amendments.

This article provides an overview of the German size of transaction test, the German-Austrian explanatory guidelines and the German authority's first experiences with the new thresholds. It thus provides insights into the authority's handling of cases and questions of interpretation. In addition to the German experiences, this article gives an overview of the current state of the international discussion about transaction value-based jurisdictional thresholds triggering ex ante merger review.

The Transaction Value Provisions of the German Competition Act (GWB)

Traditionally, notification of mergers and acquisitions in Germany has been required if the merging parties met a set of turnover thresholds. According to §35 GWB (Gesetz gegen Wettbewerbsbeschränkungen) notification was basically required if:

1. The combined aggregate worldwide turnover of all the undertakings concerned was more than €500 m, and
2. The domestic turnover of at least one undertaking concerned was more than €25 m and that of another undertaking concerned was more than €5 m.

The 2017 amendments to the Competition Act introduced an additional size of transaction test.²

According to the new size of transaction test in §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 new provisions obviously go beyond a single stand-alone transaction value. In fact, as in the traditional turnover test under §35 GWB, a precondition for the notification requirement is still that the parties concerned generated significant worldwide turnover. In a typical case, one might expect that the acquirer would account for a large part of the €500 m. The second criterion touches the question of ensuring a local nexus. One of the parties concerned has to generate a turnover of at least €25 m in Germany. Again, this will typically be the acquirer. Additionally, it is required that no other party, in particular not the target company, achieved a turnover in Germany of over €5 m. This should be read in conjunction with the traditional turnover test of §35 GWB that will otherwise apply. The third element of the size of transaction test is the transaction value of €400 m. The last criterion is the requirement of the target's substantial operations in Germany. This is an additional element to ensure the local nexus of a transaction.

Taken together, these four criteria address the fundamental challenge that lawmakers face, particularly with unicorn firms in the digital economy: how to control the acquisition of a party with minimal turnover while ensuring a local nexus without being able to refer to turnover data as a guiding principle for the geographic distribution of the party's activities. For a practitioner, these criteria lead to questions of how to calculate a transaction value and how to establish substantial operations in Germany.

Guidelines

In 2018 the German and Austrian Competition authorities, the Bundeskartellamt and the Bundeswettbewerbsbehörde, jointly published a guidance to explain the authorities' approach in particular to the calculation of the transaction value and the establishment of local operations.³ Generally, the transaction value, or the consideration for the target, shall include all assets and other consideration of monetary value that the seller receives from the acquirer in relation to the particular transaction, as well as the value of any liabilities assumed by the acquirer, according to §38 GWB.

These general provisions are further explained in the guidelines with particular consideration given to establishing the value of pure cash transactions, equity swap transactions and asset swaps.

Regarding the establishment of a local nexus, the guidelines further explain how to systematically analyze a company's domestic operations. In particular, the guidelines describe how criteria can be identified to measure a company's operations without referring to its turnover (e.g. the number of monthly active users) in the digital world. Furthermore, it is explained how such criteria can be geographically located. Here, particular emphasis is given to research and development activities. Additionally, operations need to be marketable to be considered for the purpose of the transaction value threshold. And finally, the guidelines elaborate how to establish whether a company's domestic operations are substantial in scale and scope.

Case Experiences

Now, about two years after the new thresholds have gone into effect, the Bundeskartellamt and the Bundeswettbewerbsbehörde have published annual and biannual reports that provide insight into the authorities' experiences with the size of transaction tests.⁴

Above all, for the first time, the authorities published the number of cases that were notified because of the new requirements. During the legislative process it was criticized that a transaction value threshold would, by its very nature, not correctly differentiate between cases with a local nexus and cases without. Thus, it was argued that such thresholds would generate a vast amount of additional international notifications and thereby create a heavy burden on the international business community.

As it turned out, this was not the case. The Bundeskartellamt received eight notifications in 2017 and 10 notifications in 2018 as a result of the new threshold. As the authority points out in its report, some of these notifications were intended to be precautionary. This is a small percentage of the Bundeskartellamt's overall number of notifications which totaled 2,686 in 2017/2018, the vast majority of which are due to the traditional turnover based thresholds. These numbers highlight that the new threshold only applies to certain additional cases that lead not to a traditional notification, as intended by the lawmakers and as made clear by the design of the new §35 para. 1 a) GWB. In seven of these cases the authority's analysis came to the conclusion that the notification requirements were not fulfilled, and in these cases the notification was withdrawn. In the remaining eleven cases the authority reached a clearance decision within its first phase investigation. The Bundeskartellamt points out that in some of these decisions there was no final conclusion regarding the notification requirement. One case proved to be especially interesting: the acquisition of GitHub by Microsoft. In this case, the merging parties requested a referral to the European Commission according to Article 4 para. 5 EU Merger Regulation. Such a request requires a notification in at least three member states. In Germany's case, the merging parties argued that the transaction would require a notification according to the transaction value threshold. In addition to the notified concentrations, the Bundeskartellamt was also contacted by approximately the same number of preliminary enquiries with respect to the applicability of the transaction value threshold.⁵

The experience in Austria proved to be similar. Here the Bundeswettbewerbsbehörde counted 17 cases that were filed due to the new size of transaction test in 2018. To put this into perspective, it is worth pointing out that the Austrian authority reports 481 merger notifications due to its traditional turnover based test and its new thresholds for the same period of time. Again, only a small percentage of total notifications was due to the new transaction value test.⁶

Regarding the sectoral distribution of cases in Germany, the Bundeskartellamt's report further revealed that the transaction value cases particularly concerned the pharmaceutical, chemical and IT industries. Thus, the new notification requirements

fulfilled their aim. Although the transaction value thresholds were never designed as a sector specific law, at the very beginning of the public debate the German Monopolies Commission, an independent expert committee and advisor to the German government, highlighted that such thresholds should particularly ensure notifications from the pharmaceutical sector and data driven businesses.⁷

With respect to notifications and enquiries in which the transaction value threshold proved to be not applicable, one can see why no notification was required. Because the size of transaction test consists of four different requirements that have to be satisfied cumulatively, a notification can depend on any of these requirements: the transaction value, the target's substantial business activities in Germany or the acquirer's turnover. In the past two years, the lack of the target's significant business activities has proven to be the main reason why a notification requirement was rejected. The Bundeskartellamt and the Bundeswettbewerbsbehörde were therefore right to dedicate large parts of their guidance paper of 2018 to the question of how to identify significant domestic business activities for companies without turnover data.

Concerning the pharmaceutical industry, the report in particular provides insights into the Bundeskartellamt's handling of concentrations with pipeline products and presents two particular cases. The authority's analysis in the two cases focused on the requirement of the targets' substantial domestic business activities according to §35 para. 1 a) no. 4 GWB. As the German-Austrian guidance points out, business activity within the meaning of §35 para. 1 a) can consist of research and development activities concerning (future) products or services.⁸ However, in such cases basic research has to be distinguished from product and service related research and development. As the guidance further explains, the determining factor for such a distinction is whether the research result will be marketable.

Both reported cases provide insight about which criteria the Bundeskartellamt takes into account when measuring research activities and, in particular, when assessing the marketability of research and development activities. In one case the relevant business activity in the meaning of §35 para 1 a) GWB consisted essentially of two clinical trials that were partly carried out in Germany and two research partnerships. When assessing these criteria the Bundeskartellamt took into account that 25% of all future EU patients were expected to live in Germany. These criteria and circumstances together led the Bundeskartellamt to regard these activities as domestic and substantial and to accept the notification.

In the other pharmaceutical case the merging parties submitted a notification because the target's leading product was in the third phase of its clinical trials. For this purpose the target had contracted eight clinical test centers. As the German-Austrian joint guidance points out, research for a pipeline product in the third phase of its clinical trials can generally be assumed to be marketable, since in such phases a pharmaceutical substance's efficacy among a large group of patients is examined. It will therefore not be regarded as mere basic research without any market orientation. On the other hand, the Bundeskartellamt reports that the target did not employ a research group leader in Germany at that time. Moreover, no test persons had been recruited and thus no medicine had been administered. Nevertheless, the Bundeskartellamt took

this as a given marketability of the target's research as defined in para. 79 of its guidelines. However, although these activities were accepted as being marketable, they proved not to be substantial and thus no notification was necessary.

International Developments

The debate about how to deal with new business models of the digital world and more specifically whether competition policy and international merger control regimes need to adapt is still ongoing. This is hardly surprising since the *Facebook/WhatsApp* case was only the tip of the iceberg. According to data compiled by Bloomberg, there have been approximately 431 acquisitions by Facebook, Amazon, Google (Alphabet), Apple and Microsoft alone in the last decade.⁹ Academic research also indicates that not every acquisition aims at exploring new business opportunities. Rather, the evolving killer acquisitions literature points out that a significant number of acquisitions follows the clear intention to preempt future competition and discontinue the development of a competitor's products.¹⁰

It is therefore interesting to see how other jurisdictions will cope with cases in the digital world and the WhatsApp-Gap in particular. There are signs that in some jurisdictions similar size of transaction tests are being discussed.

In October 2017, the French Autorité de la Concurrence launched a reflective process aimed at modernizing and simplifying French merger law, including a public consultation. This included an assessment of the adequacy of the legislative framework governing merger control. As part of this evaluation the Autorité also explored the introduction of a transaction value threshold and pointed out that in the light of cases such as *Facebook/WhatsApp*, possible merger control shortcomings had to be evaluated.¹¹ The assessment ended in June 2018 with an opinion on possible legislative changes by the Autorité that ruled out the introduction of a transaction value threshold. The authority acknowledged that there can be highly valued transactions without significant turnover figures that may raise competition issues. On the other hand, it expected that it would have only a limited number of problematic mergers, and that a transaction value threshold would not necessarily make it possible to tackle all potentially problematic gap cases.¹²

However, it was interesting to see that France joined Germany and Poland in a joint initiative to modernize EU competition policy in July 2019, because this initiative also suggested that the European Commission should evaluate the introduction of a transaction-based merger control threshold to deal with potentially anti-competitive mergers.¹³

Briefly after the French evaluation, the United Kingdom started its own review of competition in the digital markets. In September 2018, the Digital Competition Expert Panel was established, chaired by Professor Jason Furman and composed of experts in economics, competition policy, law and computer science. The panel launched a public consultation which asked for comments on key challenges concerning mergers and takeovers in digital markets. The panel's analysis resulted in the so-called Furman Report: Unlocking Digital Competition. The report came to the conclusion that it may

be appropriate to introduce a transaction value threshold if shortcomings of the UK's share of supply test arise.¹⁴ However, in its response to these recommendations, the UK's Competition and Markets Authority CMA pointed out that the existing legislative framework is still appropriate to deal with mergers in digital markets.¹⁵

In April 2019, the European Commission published a report prepared by three special advisers to explore how EU competition policy should evolve in the digital age.¹⁶ Among other topics, the report discussed the possibility of introducing a non-turnover-based threshold into the EU Merger Regulation. The report came to the conclusion that the EU should wait and assess how the new transaction value-based thresholds in Germany and Austria play out in practice and whether the Merger Regulation's referral mechanism will be sufficient to ultimately control high value low turnover transactions at the EU level. With *Facebook/WhatsApp* in 2014, *Apple/Shazam* in 2018 and *Microsoft/Github* in 2018, there have been at least three digital/data cases that took the way of a referral from national to EU level either according to Article 4.5 or Article 22 EU Merger Regulation in the last decade.

Conclusion

About 18 months after the new size of transaction test was introduced in Germany, the German competition authority provided insights into its experiences with the new threshold. It turns out that the new test reached its aim: requiring the notification of acquisitions of highly valued start-ups and assets with low turnover and a local nexus. The Bundeskartellamt has reported a small number of additional notifications that are due to the new transaction value threshold and the Austrian experience with the new test seems to be similar. However, this should not come as a surprise since the transaction value threshold was always about closing a gap. Triple-digit case numbers were never to be expected. By their very nature, unicorns are rare. Even in the digital world, the case of *Facebook/WhatsApp* seems to have been outstanding. Critics of the new test who fear that a threshold without national turnover criteria might open the door to an influx of worldwide merger cases appear to be wrong. The German and Austrian experiences made it clear that a transaction value threshold can be designed for cases with a national nexus. Thus, it will be interesting to see whether and how the ongoing debate about killer acquisitions and the protection of competition in the digital world will profit from these experiences.

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- ¹ Rapporteur at the Bundeskartellamt and co-author of the transaction value guidelines; All views expressed are solely those of the author and do not necessarily reflect the position of the Bundeskartellamt.
- ² See also Meyer-Lindemann (2017): Die neue Aufgreifschwelle in der deutschen Fusionskontrolle, in: Kersting/Podszun (2017): Die 9. GWB-Novelle, München.
- ³ See for a more detailed review of the new threshold and guidelines: Sauerermann (2018): New merger control guidelines for transaction value thresholds in Austria and Germany, in: Competition Policy International July 26, 2018, <https://www.competitionpolicyinternational.com/new-merger-control-guidelines-for-transaction-value-thresholds-in-austria-and-germany/>
- ⁴ See Bundeskartellamt (2019): Tätigkeitsbericht des Bundeskartellamts 2017/2018; Bundeswettbewerbsbehörde (2019): Tätigkeitsbericht (2018).
- ⁵ See Bundeskartellamt (2019): Tätigkeitsbericht des Bundeskartellamts 2017/2018, p. 25, https://www.bundeskartellamt.de/SharedDocs/Publikation/DE/Taetigkeitsberichte/Bundeskartellamt%20-%20T%C3%A4tigkeitsbericht%202017_2018.html.
- ⁶ See Bundeswettbewerbsbehörde (2019): Tätigkeitsbericht (2018), p.40, https://www.bwb.gv.at/fileadmin/user_upload/Downloads/taetigkeitsbereich/Taetigkeitsbericht_der_BWB_2018_final.pdf.
- ⁷ Monopolies Commission (2015): Competition policy: The challenge of digital markets – Special Report No 68, https://www.monopolkommission.de/images/PDF/SG/s68_fulltext_eng.pdf.
- ⁸ Bundeskartellamt/Bundeswettbewerbsbehörde (2018): Guidance on Transaction Value Thresholds for Mandatory Pre-merger Notification, para. 76, https://www.bundeskartellamt.de/SharedDocs/Publikation/EN/Leitfaden/Leitfaden_Transaktionsschwelle.pdf;jsessionid=55E474D3922730E8113FF743E3890833.1_cid378?__blob=publicationFile&v=2
- ⁹ See <https://www.bloomberg.com/news/articles/2019-03-22/did-big-tech-get-too-big-more-of-the-world-is-asking-quicktake>
- ¹⁰ See Cunningham/Ederer/Ma (2019): Killer Acquisitions; Bourreau/de Streel (2019): Digital Conglomerates and EU Competition Policy.
- ¹¹ See Autorité de la concurrence (2017) : Consultation publique, le 20 octobre 2017, Contrôle des concentrations.
- ¹² See Autorité de la concurrence, press release 07 June 2018: Modernization and simplification of merger control.
- ¹³ See https://www.bmwi.de/Redaktion/DE/Downloads/M-O/modernising-eu-competition-policy.pdf?__blob=publicationFile&v=4
- ¹⁴ See Unlocking digital competition - Report of the Digital Competition Expert Panel, pp. 94, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/785547/unlocking_digital_competition_furman_review_web.pdf
- ¹⁵ See Digital Competition Expert Panel recommendations – CMA view, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/788480/CMA_letter_to_BEIS_-_DCEP_report_and_recommendations_Redacted.pdf
- ¹⁶ See Competition Policy for the Digital Era - A report by Jacques Crémer, Yves-Alexandre de Montjoye and Heike Schweitzer, 2019, <https://ec.europa.eu/competition/publications/reports/kd0419345enn.pdf>, p. 115.