Client Update
Germany Updates Its Merger Control Regime

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Today, on June 9, 2017, the Ninth Amendment to the German Act against Restraints of Competition ("ARC") entered into force. The Amendment introduces a transaction value and a significant activity test relating to the target that complements the existing merger control thresholds. The Amendment is a reaction to an economic development in which significant dispositions of companies active in the fields of research, digitalization and big data but with yet small revenue become more and more important.

The Amendment also introduces other legislative changes that concern the implementation of the EU private damages directive, new consumer protection powers for the German Federal Cartel Office ("FCO") and the European concept of an "undertaking", thus expanding the liability of a controlling parent company for antitrust violations of its subsidiary.[1] These changes, however, are not discussed in this client update which concentrates on the relevant changes to German merger control review.

BACKGROUND

A transaction is subject to German merger control if it meets three different revenue thresholds, has palpable effects in Germany and does not fall under the exclusive jurisdiction of the European Commission ("Commission"). The Amendment does not change these basic principles. Instead, it introduces an additional criterion–transaction value–under which the German authorities can assess a merger. The addition aims to catch acquisitions of highly valued companies that previously fell outside of German merger control review because of low German revenue.

[1] Requirements for such liability include: (i) the companies formed an economic unit at the time of the infringement, and (ii) the parent company exercised decisive indirect or direct influence over its subsidiary.

The previous threshold excluded, for example, start-up companies that had high future potential but that did not generate sufficient revenue, as was the case in the acquisition of WhatsApp by Facebook in 2014.

Despite WhatsApp's considerable customer base in Germany, it did not generate enough revenue to meet German merger control thresholds. Furthermore, because the transaction did not meet the relevant EU merger regulation thresholds, the Commission did not have original jurisdiction to review it. The Commission was able to review the transaction after referral by the notifying party; referral was possible because the transaction was subject to merger control in three EU Member States.

The acquisition of WhatsApp by Facebook–while significant on its own–must, however, be considered in its larger context. It is the first merger control case in which the purely revenue-based test to assess mergers and acquisitions clashed with the realities of a data-driven economy. Other examples include acquisitions involving pharma R&D companies, innovation-driven industries or companies that have collected large amounts of data. Data, sometimes described as the "new oil", have become ever more abundant, valuable and powerful. Competition law is only now starting to address this new challenge. The Amendment is part of this process.

REQUIREMENTS FOR GERMAN MERGER CONTROL

Under the amended ARC, a transaction is subject to German merger control if, in the last business year,

- the combined worldwide revenue of all companies involved was more than EUR 500 million ("global threshold"); *and*
- the German revenue of at least one company was more than EUR 25 million ("first domestic threshold"); *and*
- either
  - in the last business year, the German revenue of the other company was more than EUR 5 million ("second domestic threshold"); *or*

- and this is new -

  - the value of the transaction is more than EUR 400 million and the target company has "significant activity" in Germany.

In the vast majority of transactions, the global threshold and the first and second domestic thresholds determine whether a German merger control filing must be

made. However, where the second domestic threshold of EUR 5 million is not met, one then must determine (i) the transaction value and (ii) whether the target company carries out "significant activity" in Germany. For these criteria, the *present* activity of the target company (i.e., not the last business year's activity) is determinative.

The criteria "transaction value" and "significant activity" are completely new and it is expected that the FCO will provide some guidance shortly. Until then, the explanatory memorandum to the Amendment provides background information.

TRANSACTION VALUE

The transaction value consists of the value of liabilities assumed by the purchaser and the purchase price–including all monetary payments, tangible and intangible assets, securities, voting rights, compensation for non-compete agreements and payments that depend on the occurrence of a certain condition typically contained in "earn out" clauses.

Transaction valuations may be more difficult in complex M&A transactions because the price may fluctuate based on performance and other factors and the price may not be set until closing. The FCO will accept any method to calculate the purchase price as long as that method is a recognized valuation practice.

SIGNIFICANT ACTIVITY

The Amendment's explanatory memorandum offers little guidance in defining "significant activity". The criterion must be assessed on a case-by-case basis. Factors to be considered include: whether customers are located in Germany; whether customers use the relevant products or services in the country; the maturity of the product or service; whether the market is fully monetized (e.g., free apps are not fully monetized); and whether there is a customer base (which can include a certain number of "monthly active users" in case of an app). Merely marginal operations in Germany do not constitute a "significant activity".

For a "significant activity" to arise, no actual revenue needs to be generated. In other words, the target company can offer its users or customers free products and services. Furthermore, the explanatory memorandum states that R&D activities also count as "being active". This could apply, for example, to pharmaceutical or technology start-up companies.

RELEVANCE FOR BUSINESSES

It is mandatory to notify the FCO of proposed transactions that meet the revised German merger control thresholds. Without FCO merger control approval the transaction may not be consummated. If the transaction is implemented without approval it is legally void and can be dissolved by order of the FCO.

The revised merger control thresholds should not result in dramatic changes because they merely expand the pre-existing thresholds. However, the Amendment is an important step towards adapting the German competition law to the challenges of the digital economy. Similar developments are taking place in other EU countries as well.

For example, Austria recently added a transaction value based test in its competition law that became effective on May 1, 2017. Many transactions that are reported in Germany must also be reported in Austria. Businesses should carefully consider whether the relevant competition authorities must be notified of the intended transaction. The Commission is considering adding a similar transaction value based test into the EU Merger Regulation. The Commission's sector inquiry into e-commerce, the Commission's various investigations into Google's practices and the FCO's Facebook user data investigations show that the competition authorities need the tools necessary to respond to the new challenges of digitalized markets.

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Please do not hesitate to contact us with any questions.