Reports

Austria / Germany

Joint Guidance on Transaction-Value Thresholds

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Part of the ongoing debate on the role of innovation in merger analysis revolves around the question whether existing notification thresholds fail to catch acquisitions of small but innovative businesses by their established rivals. The clear majority of notification thresholds are turnover-based: of a sample of 53 jurisdictions analysed by the OECD in 2016,[1] virtually all relied on the turnover of the firms involved in the merger. By contrast, only two jurisdictions (the United States and Mexico) took into account the value of the transaction, which in certain circumstances may more accurately reflect the competitive potential of an innovative business than its turnover.

While a consultation by the European Commission regarding the potential introduction of transaction value-based thresholds met with some scepticism by public and private stakeholders,[2] two EU Member States have since introduced new, value-based thresholds. The new German thresholds entered into force on 9 June 2017. Austria's similar new merger filing thresholds became applicable in November 2017. About a year after the new filing thresholds became applicable, on 9 July 2018, the German and Austrian competition authorities issued a joint guidance paper setting out their current practice and views on the interpretation of these thresholds.[3] An English convenience translation has also been made available on the websites of both agencies.[4]

I. The New Thresholds

Since the Austrian thresholds are based on the German model, the new filing requirements introduced in both countries are largely similar. The new thresholds will be met if the following, cumulative requirements are met:[5]

- A minimum combined worldwide turnover threshold (D: €500 million; A: €300 million);
- A minimum domestic turnover threshold (D: individual domestic turnover of one party of more than €25 million; A: combined domestic turnover exceeding €15 million);
- A minimum value of the consideration (D: €400 million; A: €200 million); and
- The target has significant operations on the domestic territory.

While the first two requirements are traditional turnover thresholds, both the transaction value threshold and the requirement of substantial domestic activities give rise to numerous questions of interpretation. The Joint Guidance aims to assist undertakings in dealing with these difficulties. With a view to the limited experience with the thresholds so far, the authorities however note that the views

DOI: 10.21552/core/2018/3/8

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1 OECD, 'Legal Nexus and Jurisdictional Thresholds in Merger Control – Annex to the Background Paper by the Secretariat' (2016) DAF/COMP/WP3(2016)4/ANN.

2 Summary of replies to the Public Consultation on Evaluation of procedural and jurisdictional aspects of EU merger control, July 2017 <http://ec.europa.eu/competition/consultations/2016_merger_control/summary_of_replies_en.pdf> accessed 28 August 2018.

3 Gemeinsamer Leitfaden Transaktionswert-Schwellen für die Anmeldepflicht von Zusammenschlussvorhaben (§ 35 Abs. 1a GWB und § 9 Abs. 4 KartG) der österreichischen Bundeswettbewerbsbehörde (BWB) und des Bundeskartellamtes (in the following: 'Joint Guidance')

4 <https://www.bundeskartellamt.de/SharedDocs/Publikation/EN/Leitfaden/Leitfaden_Transaktionsschwelle.pdf> and <https://www.bwb.gv.at/fileadmin/user_upload/Downloads/standpunkte/2018-07_Guidance_Transaction_Value_Thresholds.pdf> accessed 28 August 2018.

5 See s 35 para 1a Act Against Restraints of Competition (Germany) and s 9 para 4 Cartel Act (Austria), as amended.

set out in the guidance are preliminary and may evolve.[6]

II. Determination of the Value of the Consideration

While the determination of the value of the consideration may be rather straightforward in transactions where a fixed purchase price is paid in cash, even simple transactions give rise to the question how liabilities should be factored into the assessment. Moreover, many M&A transactions are much more complex than simple locked-box cash deals. Valuation issues arise, in particular, in relation to consideration which does not have a fixed value in Euros.

1. Treatment of Liabilities

Pursuant to German law, the value of the consideration includes not only 'all assets and monetary benefits received by the seller', but also 'the value of all liabilities assumed by the purchaser'.[7] While the Austrian legislator refrained from including a similar provision, an identical interpretation of the concept of value of consideration is included in the Austrian government's explanatory memorandum.[8]

It is evident that liabilities of the seller which are assumed by the purchaser in addition to paying the purchase price increase the consideration, and thus have to be included in the value of the consideration.[9] The treatment of liabilities held by the target in share deals however is more complex. Consider the following example: Target T has an unencumbered fair market value of €450 million, and debt owed to third party lenders of €400 million. Purchaser A offers to buy all of T's stock for €50 million, corresponding to the value of T's equity interest. Purchaser B takes on €400 million in new debt and offers to buy all of T's assets for €450 million, without assuming any of the existing debt. The transactions are equivalent and would result in A and B gaining control of the same assets. However, if only the purchase price is taken into account for purposes of determining the value of the transaction, Purchaser A's proposed transaction would not meet the value-of-consideration threshold in Germany and Austria, while Purchaser B's proposed transaction would.[10]

The Joint Guidance addresses this inconsistency by stipulating that the liabilities of the target corporation should be added to the cash purchase price.[11] An exception is made for non-interest bearing liabilities, such as, in particular, payables for goods and services.[12] The Joint Guidance explicitly refers to methods of enterprise valuation, such as the free cash flow to the firm (FCFF) method, in support of this approach.

While it is appreciated that the German and Austrian authorities provide a clear guideline on this issue, it is doubtful whether their solution is right in terms of policy. Merger control is concerned with the value of the target to the person acquiring control, ie, an equity investor. The FCFF method however estimates the value of future cash flows available not only to equity investors, but also to debt holders who have no say in the operative business of the company.

2. Consideration of the Value Which Is Not Fixed

Further valuation issues arise in relation to consideration or components thereof which are subject to fluctuations of value (eg stock or asset swaps, or payments in foreign currency), or which are contingent upon future events (eg earn-outs).[13] In order to assess whether the filing thresholds are met in such cases, it is necessary to establish both (i) the relevant

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6 Joint Guidance (n 3) para 6.

7 s 38 para 4a Act against Restraints of Competition.

8 Supplement 1522 to the minutes of the National Council, XXV Legislative Period.

9 Joint Guidance (n 3) para 52. See also Raoul Hoffer and Christoph Raab, 'Die Novellierung des österreichischen Kartellrechts als RL-Umsetzung PLUS' (2017) 5 NZKart 206, 209.

10 For further examples regarding the size-of-transaction test under the Hart-Scott-Rodino Act, see Malcolm R Pfunder, 'Valuing Asset Acquisitions Under the Hart-Scott-Rodino Act Where Liabilities Are Assumed: Some Anomalies Explored' (*theantitrustsource*, May 2006) 1.

11 In line with the explanatory memorandum of the German government, German Parliament Document No 18/10207, 77 et seq,

12 Joint Guidance (n 3) para 53.

13 Acquisitions of start-ups frequently are not structured as simple cash deals, but involve more complex methods of determining the consideration; see Michael Esser and Jan Christoph Höft, 'Fusions- und Missbrauchskontrolle 4.0 – Die 9. GWB-Novelle als Antwort auf die Herausforderung der Digitalisierung?' (2017) 6 NZKart 259, 260.

date and (ii) the relevant methods for value determination.

As regards the point in time relevant for determining jurisdiction, the Joint Guidance stipulates that the value of the transaction has to be determined on the date of completion of the merger.[14] Accordingly, even if the value of the consideration is below the filing threshold at signing, changes before closing (eg an appreciation of the currency in which the purchase price is denominated versus the Euro, or increases in the price of shares offered in a stock swap) can lead to the transaction becoming notifiable. This can lead to substantial uncertainty whether a notification is required. In order to avoid delays, the Joint Guidance recommends that the parties notify transactions if they consider it possible that the value of consideration may exceed the relevant threshold (€400 or 200 million, respectively) before closing.

Future cash payments have to be discounted to their present value on the day of completion of the merger.[15] As regards payments which are conditional on certain targets being reached (eg, milestone payments), the Joint Guidance recognizes that such payments may be uncertain. In determining the present value of uncertain payments, they may be discounted in accordance with the probability that they will become due – eg, in case of a payment with a probability of 85%, by multiplying its value by a factor of 0.85.[16]

If the consideration consists of securities traded on a liquid market, their value for merger control purposes corresponds to their weighted average market price during the last three months preceding the notification.[17] The value of securities not traded on a liquid market may be assessed based on valuation reports. This includes reports which have already been prepared for purposes of the transaction.[18] In asset swaps, the value of assets provided as consideration has to be determined based on an appropriate method, and reflect the intended use of the asset.[19] If a valuation report predates the notification by more than six months, the parties must disclose whether, and if yes, how, this time difference affects the value stated in the report.[20]

In addition to the purchase price for the shares or assets acquired, the value of the consideration must also reflect any payments made in exchange for the seller agreeing not to compete. The Joint Guidance however acknowledges that the value of such covenants is usually reflected in the purchase price.[21]

Further to these principles of valuation, the Joint Guidance also provides guidance on how the valuation should be demonstrated to the competition authorities. Each of the elements of the valuation, such as assumptions, discount rates, and cash values, should be made transparent and supported by appropriate reasoning. In case of doubt, a confirmation of the value by management of the purchaser (and in case of earn-outs or other uncertain payments, also of the seller) will be taken into account by the competition authorities.

III. Significant Domestic Operations

The new German and Austrian thresholds only apply if the target has significant domestic operations in the respective country. This requirement is meant to ensure that only transactions which exhibit a sufficient local nexus fall to be notified under the new thresholds. Pursuant to the Joint Guidance, the establishment of substantial domestic operations consists of a three prong test: (i) the target must have activities on the domestic territory, (ii) these activities must be market-oriented, and (iii) they must be significant.

As regards the first criterion, the Joint Guidance specifies that only current domestic activities will give to a sufficient local nexus. Future or anticipated

14 Joint Guidance (n 3) para 28. This is in line the majority opinion in Austrian legal writing: Franz Urlesberger in Petsche, Urlesberger and Vartian (eds), *Kartellgesetz* (2nd edn, Manz 2016) s 9 Cartel Act, para 28; Raoul Hoffer, *Kartellgesetz* (LexisNexis ARD ORAC 2007) 151. In Germany, some authors share this view (Stefan Thomas in Immenga and Mestmäcker (eds), *Wettbewerbsrecht* (5th edn, CH Beck 2014) s 38 GWB, para 24 et seqq; Burkhard Richter and Till Steinvorth in Wiedemann (ed), *Handbuch des Kartellrechts* (3rd edn, CH Beck 2016) § 19, para 137 et seq), while others consider the date of notification or the date of the decision to be relevant (Thorsten Mäger in Bornkamp, Montag and Säcker (eds), *Münchener Kommentar Europäisches und Deutsches Wettbewerbsrecht* (2nd edn, CH Beck 2015) s 38 GWB, para 22; Gunnar Kallfaß in Langen and Bunte (eds), *Kartellrecht* (12th edn, Luchterhand 2014) s 35 GWB, para 26).

15 Joint Guidance (n 3) para 29 et seqq.

16 Joint Guidance (n 3) para 34.

17 Joint Guidance (n 3) para 43 et seqq.

18 Joint Guidance (n 3) para 45.

19 Joint Guidance (n 3) para 50.

20 Joint Guidance (n 3) para 22. The English translation inaccurately suggests that the disclosure obligation is limited to effects 'caused by this time difference'.

21 Joint Guidance (n 3) para 59.

activities are not sufficient.[22] This criterion clearly is met if the target already markets its products or services in the domestic territory. However, pre-marketing activities may also be sufficient. By way of example, the Joint Guidance lists activities to establish a sales structure, such as the recruitment of personnel or the conclusion of distribution agreements, or activities aimed at obtaining marketing authorisation e.g. for pharmaceutical products. Further to such activities directly related to market entry, the Joint Guidance also considers that research and development activities on the domestic territory may give rise to a sufficient local nexus, provided that the results of such R&D are marketable and are likely to be sold domestically.[23]

The second criterion is that the activities must be market-oriented. This will clearly be the case if products or services are offered for money. However, the new threshold specifically is meant to capture scenarios where this is not (yet) the case. The Joint Guidance identifies the following scenarios in which activities will be considered to be market-oriented even though they are not currently offered against payment:[24]

- A service is remunerated by means other than monetary payment, eg, by the user providing data or consuming advertising;
- A service is monetised in a different way, eg through advertising revenue, or can be expected to be monetised in the future, eg, by offering a premium version or through advertising revenues once it has reached a sufficiently large user base and popularity;
- The activity consists of R&D of future goods or services, provided that its results will be marketable. By way of example, the Joint Guidance considers that pharmaceutical products will generally be sufficiently close to commercialisation once they have entered Phase III clinical trials. The examples relating to other sectors are less concrete. For example, in the area of plant protection, the Joint Guidance considers that the acquisition of rights to recently discovered molecules that are now in the product development stage may be sufficient.

Thirdly, in addition to being current and market-facing, the activities must also be significant. If the turnover of the target adequately reflects its market position and competitive potential, both competition authorities indicate that they will not consider the target's activities to be significant unless a certain minimum turnover is reached. In Germany, this thresholds amounts to €5 million, corresponding to the second domestic turnover requirement under the 'normal' turnover thresholds of Section 35 paragraph 1 subparagraph 2 GWB.[25] While Austria does not have a dual domestic turnover requirements, the Federal Competition Authority considers that domestic activities will typically not be significant if the local turnover does not exceed €0.5 million.[26]

These thresholds however do not apply if the target's turnover does not reflect its market position or competitive potential. This may be the case eg because the market is not characterised by turnover or because the product has only recently been introduced. In such cases, the assessment of the significance of domestic activities must be made in line with the standards of the relevant industry. By way of example, the Joint Guidance states that key performance indicators such as monthly active users and unique visitors will be used in digital economy cases.[27] If the target's activity consists of R&D, the significance of such activities may be assessed based on a number of criteria, including the number of employees engaged in R&D, the size of the R&D budget, and the number of patents and patent citations.[28]

In Austria, a detailed examination of the three criteria however will not be necessary if the target has domestic facilities. If the target owns a site in Austria and if the activities carried out at that site are market-oriented (which may not be the case, eg, if the Austrian site is that of a mere financial holding), the target will be presumed to have significant domestic activities.[29] In Germany, the existence of domestic facilities will also be taken into account in R&D cases: if the transaction primarily involves the acquisition of a domestic research site with sufficient

22 Joint Guidance (n 3) para 70.

23 Joint Guidance (n 3) para 74.

24 Joint Guidance (n 3) para 76 et seqq.

25 Joint Guidance (n 3) para 82.

26 Joint Guidance (n 3) para 83.

27 Joint Guidance (n 3) para 66 et seq.

28 Joint Guidance (n 3) para 84.

29 Joint Guidance (n 3) paras 68, 101; Explanatory memorandum of the Austrian government, Supplement 1522 to the minutes of the National Council, XXV Legislative Period, 3.

domestic market orientation, significant domestic activities will be presumed.[30]

IV. Comment

The new German and Austrian thresholds give rise to numerous questions, both with regard to the determination of the value of the consideration and to the establishment of a sufficient local nexus. The Joint Guidance provides undertakings with valuable assistance in dealing with these novel questions. From a practitioner's point of view, it is also appreciated that the German and Austrian competition authorities laid down a single approach in a joint document.

But in spite of the detailed guidance, questions remain. As regards the determination of the value of the consideration, the Guidance's approach that liabilities held by the target should be added to the purchase price appears difficult to reconcile with the concept of 'value of consideration' – considering, in particular, that the criterion of the value of consideration was chosen over the value of the target on the grounds that it is easier to establish.[31] Moreover, the Joint Guidance provides only limited assistance in assessing whether a target has 'significant' domestic activities in Germany or Austria. Those clarifications which are provided point to a rather wide interpretation of what will be considered 'significant' (eg any site with market-oriented activities in Austria, or any R&D site in Germany).[32]

It is perhaps not surprising that, after only one year of experience with the new thresholds, the authorities do not want to limit their discretion too much, and prefer parties to contact them and to notify in case of doubt.[33] The future will show whether the new thresholds have sufficient benefits – in allowing the authorities to intervene in problematic cases which otherwise would have escaped competition law scrutiny – in order to justify the public and private costs which they give rise to. This ties into the wider debate regarding the role of innovation in merger analysis and the adequacy of the toolbox available to competition authorities in assessing such concerns.[34] The evaluation of the new thresholds, which German law requires to be undertaken three years after their entry into force,[35] may provide an opportunity to assess this question.

30 Joint Guidance (n 3) paras 84, 105.

31 Explanatory memorandum of the German government, German Parliament Document No 18/10207, 73. For a more detailed, critical appraisal see Dieter Hauck, 'BKA/BWB: Leitfaden zur Transaktionswert-Schwelle für Zusammenschlüsse - im Konsultationsverfahren' (2018) ÖBl 217, 219 et seq.

32 For a critical appraisal see Judith Feldner, '§ 9 Abs 4 KartG – Die praktische Bedeutung des neuen Schwellenwerts' (2017) ÖZK 149, 153.

33 This is encouraged eg in Joint Guidance (n 3) paras 23 and 114, as well as by senior officials writing in a private capacity, see Peter Matousek, Volker Weiss and Martin Gassler, *Zusammenschlusskontrolle – Neuer Transaktionswerttest* (ecolex 2017) 388, 391.

34 Esser and Höft (n 12) 261. See also the remarks of Carles Esteva Mosso, 'Innovation in EU merger control' (ABA Antitrust Law Spring Meeting, 12 April 2018) <http://ec.europa.eu/competition/speeches/text/sp2018_05_en.pdf> accessed 28 August 2018; Justus Haucap, *Merger Effects on Innovation: A Rationale for Stricter Merger Control?* (DICE Discussion Paper No 268, September 2017) <http://www.dice.hhu.de/fileadmin/redaktion/Fakultaeten/Wirtschaftswissenschaftliche_Fakultaet/DICE/Discussion_Paper/268_Haucap.pdf> accessed 28 August 2018; Raphaël De Conick, 'Innovation in EU Merger control: in need of a consistent framework' (September 2016) 2 Competition Law & Policy Debate 41; Carl Shapiro, 'Competition and Innovation: Did Arrow Hit the Bull's Eye' in Lerner and Stern (eds), *The Rate and Direction of Inventive Activity Revisited* (University of Chicago Press 2012), 361

35 s 43a GWB.