Draft guidelines on new transaction value merger thresholds in Germany and Austria

Kluwer Competition Law Blog
May 18, 2018

Silke Heinz (Heinz & Zagrosek Partner mbB, Germany)

Please refer to this post as: Silke Heinz, 'Draft guidelines on new transaction value merger thresholds in Germany and Austria', Kluwer Competition Law Blog, May 18 2018, http://competitionlawblog.kluwercompetitionlaw.com/2018/05/18/draft-guidelines-new-transaction-value-merger-thresholds-germany-austria/

On May 14, 2018, the German and Austrian competition authorities have published joint draft guidelines on the new transaction value merger thresholds, including an English translation (see here). Comments can be submitted by June 8, 2018. It would certainly be helpful if members of the legal and economic community from jurisdictions with similar transaction size thresholds (notably the U.S.) could comment on the draft guidelines.

I. New transactional value thresholds

The new transaction value thresholds were introduced in Germany and Austria in 2017 (Section 35(1a) GWB and 9(4) KartG, respectively). Even if the turnover-based thresholds are not met, a concentration may be notifiable if the value of the transaction consideration exceeds € 400 million in Germany or € 200 million in Austria, and the target has significant current domestic activities. The value thresholds shall catch cases in which the target has so far only little or no domestic turnover, but the purchase price is disproportionately higher. The high purchase price may reflect innovation activities with high market potential, the acquisition of which the agencies want to review.

The draft guidelines cover: (i) determining the consideration value, (ii) scope of substantial current domestic operations and (iii) impact of the new threshold on technical aspects of the notion of concentration in asset acquisitions. This post will deal with the first two areas.

II. Determining the consideration value

The draft clarifies that the company value may differ from the consideration value, which often includes a premium for the acquisition. The relevant consideration comprises all assets and other monetary benefits that the seller receives from the buyer in connection with the concentration, including all cash payments, transfer of voting rights, securities and tangible and intangible assets. It also covers any future payments, such as earn-out-clauses or payments conditional upon reaching certain turnover or profit targets (including outside Germany), payments for non-competition by the seller, as well as assumed liabilities of the target or the seller (limited to interest bearing parts thereof).

The draft confirms that it is up to the merging parties to determine the consideration value and whether a filing is mandatory. However, they need to disclose how they determined the consideration value and demonstrate its plausibility vis-à-vis the agency if necessary. In critical cases, the draft suggests that a written declaration by the management of the purchasing company (or its parent) on the consideration value and its determination might help to alleviate doubts regarding a filing obligation. The draft provides principles on determining the consideration value, as well as disclosure and communication requirements vis-à-vis the agency in critical cases.

1. Relevant date

The consideration value may change over time, in particular regarding securities and cash payment in non-EURO currencies. Under German law, it is relevant whether there is a filing obligation at the time of completion of the merger, and thus, completion is also the reference date for assessing the consideration value. If at the time of the planned closing the future value is unclear, the parties can resort to the date of assessing the filing obligation. However, if the value subsequently increased and then crossed the threshold prior to closing, the transaction would turn notifiable and require notification and clearance pre-closing. The draft therefore suggests to submit a precautionary filing in doubtful cases. If the value decreased after the earlier assessment and prior to closing, the parties could always withdraw the filing. (The draft clarifies that the consideration value increasing after completion of the merger would not create a notification obligation.)

2. Value of future or conditional payments

Any future or conditional payments, e.g., earn-out clauses based on the target's performance or payments after reaching specified milestones, need to be determined as cash value at the date of closing. The draft explains that this (theoretical) closing date value of future payments should be calculated based on discounting methods commonly used in the financial sector, e.g., in multi-period (or dynamic) capital budgeting. The merging parties need to disclose the underlying assumptions and interest (discount) rates used in the calculation and explain these so that the agency can verify the result. This applies to all various individual calculation components, including estimates as to when the specified targets or milestones may be reached and the probability thereof, which can be reflected in the discount rate.

3. Assessment methods

The draft provides details on possible assessment methods for considerations consisting of securities and/or assets. In essence, the value of securities should be based on market value, if traded in a liquid market, and on a valuation report if not. The parties can freely select the assessment method in the report (if recognized in company valuation practice for continuation of a company). The value is usually deemed correct if determined in accordance with the described principles and confirmed by the acquiror's management. Determining an asset swap consideration requires assessing the value of the assets appropriately, and the method should reflect the intended use of the asset. If the authority examines the notification obligation, they parties need to disclose and justify their value assessment, including the method used, components of any valuation report, and all underlying assumptions.

III. Significant current domestic activities

The criterion is aimed at excluding the acquisition of companies that primarily operate outside of Germany. The draft deals with measurement indicators, local nexus and marketability issues, and provides several examples. It also confirms that the new thresholds do not apply if the target's turnover is low and adequately reflects its market position and potential, e.g., in mature markets and if the target has not only recently launched its products. In Germany, if in such a case the target's domestic turnover is below € 5 million (second domestic turnover threshold), the domestic activities will not be considered as significant.

1. Indicators

Other than in mature markets, domestic turnover is typically not seen as suitable indicator to measure significant domestic activity. The draft says indicators may vary by industry sector and should be in line with industry standards. For example, in the digital sector user numbers (monthly active users or unique visitors) may be possible indicators. In Austria only, the location of the target may also be relevant. The criterion is "current domestic activities" so the reference date is not the last business or calendar year but the target's activities at the time of notification.

2. Local nexus

The local nexus or geographic allocation of the business activity is the place of intended use, which is typically the customer location. For R&D activities, the local nexus may be the operation's location, including staff and infrastructure. The draft also refers to inventor's address in a patent application or activities for market entry (application for marketing authorization for the domestic market).

3. Marketability

The activity in question needs to have a market nexus. This is clearly the case if the target offers paid products or services in an existing market. The draft clarifies that there is also market nexus if the activity is remunerated in another way (e.g., the user of a free App "pays" with user data or by consuming advertising), and/or may require payment in the future (e.g., the initially free App will require payment in the future). R&D activities do not have a market nexus if they concern basic research, and it is decisive whether the results will be marketable. It is not necessary that products have been launched. For example, in pharma, acquisitions of substances in (second or third stage) clinical trials would be sufficient, as well as in plant protection the acquisition of rights to molecules in the developments stage (vs. discovery stage).

IV. Comments

The draft is welcome as it provides helpful guidance on the new transaction value thresholds. In substance, one big drawback is that the merger completion serves as reference date for determining the consideration value. While this may be in line with legal theory in Germany, in practice it is not meaningful to have an often uncertain date, a monitoring duty after the filing assessment and possibly a last minute revelation that the deal is notifiable. Here it would be better to have a clear and earlier fixed reference point, e.g., at least the date of signing – when the parties actually decide on the consideration. It is unclear whether the agencies could set this out in guidelines or need legislative action. (But then the draft also refers to the notification date for assessing significant current domestic activities, i.e. closing is not always the reference point.)

It seems positive that future or conditional payment obligations can be discounted to the prospective value at closing. But the requisite calculation may also create quite a bureaucratic burden in critical cases. Identifying whether there is a filing obligation becomes more complicated and unpredictable. And it is unclear what to do if a reasonable estimate whether future payments will be achieved is impossible. The guidelines generally hint at possible discussions with the agencies on the assessment method and underlying assumptions, which may render pre-notification discussion lengthy and complicated, or worse, lead to the threat of dissolution proceedings – even if this may only concern few cases because the thresholds are quite high. Hopefully the agencies continue to adopt a pragmatic approach in this context.

***