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An Indian Perspective on Merger Control in Digital Markets: Looking Ahead by Looking Across

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India is the third largest start-up ecosystem in the world with multiple firms operating across different sectors in the country. In 2022, Indian start-ups raised nearly USD 24 billion, more than twice the funds raised in 2020 (USD 10.9 billion) and 2019 (USD 12.8 billion), despite the challenging market conditions. The top five sectors that attracted funding were software as a service (SaaS), FinTech, Logi and AutoTech, EdTech and direct-to-consumer (D2C). The Indian start-up ecosystem also saw a sharp rise in mergers and acquisitions: strategic M&A deals grew 126% by value in 2022 as compared to 2021, and are expected to remain strong in 2023 as well.

Issues with threshold-based merger control in digital markets

In India, the Competition Act 2002 ("the Act") regulates mergers that have a local nexus to the Indian Territory. The Act provides thresholds regarding assets or turnover that trigger mandatory pre-merger notification to the Competition Commission of India (CCI). The threshold limits provided under section 5 of the act are as follows:

"Individual: Combined assets of the enterprises in India exceeds INR 2,000 crores or combined turnover of the enterprises in India exceeds INR 6,000 crores. In case either or both of the enterprises have assets/ turnover outside India also, then the combined assets of the enterprises exceed USD 1 billion or the combined turnover of the enterprises exceeds USD 3 billion.

Group: The acquirers' group and target have combined assets in India that exceed INR 8,000 crore or combined turnover in India that exceeds INR 24,000 crore. Where the group has a presence in India and outside India then the acquirers' group and target have combined assets globally that exceed USD 4 billion or combined turnover globally that exceeds USD 12 billion".

Additionally, in 2011, the Ministry of Corporate Affairs introduced the *De Minimis Exemption* whereby a transaction is exempted from notification to the CCI if the target enterprise's assets in India do not exceed INR 350 crore (EUR 39 million) or its turnover does not exceed INR 1,000 crore (EUR 110 million).

Using an approach involving a numeric threshold premised on turnover or assets has proved to be effective in identifying potential anti-competitive mergers in traditional markets however using the same approach to capture mergers in digital markets has raised challenges.

In 2019, the competition law review committee (CLRC) was set up by the Indian government to discuss the adequacy of the existing thresholds in examining M&A in the digital sector. In its report, the CLRC noted that certain significant transactions in digital markets do not meet the existing asset or turnover threshold. The committee perceptively observed that in digital markets, acquisitions derive value from data or some business innovation held by the target company. Moreover, often target companies do not have a huge asset base or offer products/services for free or generate insignificant turnover. Therefore, asset or turnover is a poor indicator of the transaction's significance for competition. Thus, the CLRC noted that the digital market in India has witnessed several M&A transactions such as the acquisition of Myntra by where parties were exempted from notifying the CCI due to the low turnover generated by the target enterprise.

A Case for Deal Value Threshold in India

The CLRC in its report noted that the CCI has no power to assess transactions unless the notification thresholds are met. It observed that the CCI under Section 20 of the Competition Act 2002 (the act) has the power to review only notifiable transactions. In other words, the CCI had no jurisdiction under the Act to review transactions where thresholds were not met. However, in countries such as Brazil and Ireland, regulators have the power to review transactions that fall below the threshold.

The committee noted that the Facebook/WhatsApp merger did not meet the turnover thresholds of the EC and was not eligible for notification to the EC. However, the EC was able to review the merger under the case due to the use of the referral system since the proposed transaction met the notification threshold in three Member States. However, no such option was available to the CCI to review non-notifiable mergers.

The committee further observed that countries such as Germany and Austria had decided to introduce a deal-value threshold as an additional threshold for notification. The German Act against Restraints of Competition was amended to include Section 35(1a) which prescribes a deal value threshold requirement of EUR 400 million for merger notification. Similarly, Section 9(4) of the Austrian Federal Cartel Act, 2005 prescribes a deal value threshold of EUR 200 million for merger notification. In other words, if an acquisition is valued at more than EUR 400/200 million, it is subject to merger notification requirements in Germany/Austria respectively.

In light of the above, the Committee concluded that there existed an enforcement gap in the CCI's ability to review transactions in the digital arena as it lacked a referral mechanism, the power to assess non-notifiable transactions and a deal-value threshold to consider mergers in digital markets. The Committee called for adopting a pragmatic and forward-looking approach to regulating mergers in digital markets and recommended introducing a deal-value threshold for merger notifications to address the legislative gap. This recommendation found its way into the Competition (Amendment) Act 2023.

One of the key amendments is the introduction of the deal-value threshold (DVT). According to the Standing Committee on Finance, the rationale for introducing DVT is to regulate mergers in digital markets. The Amendment Act received the president's assent on 11 April 2023.

Decoding the Deal-Value Threshold

According to the Competition (Amendment) Act, 2023, it is mandatory for parties involved in a merger to notify CCI of the transaction if the "*value of any transaction, in connection with the acquisition of any control, shares, voting rights or assets of an enterprise, merger or amalgamation exceeds INR 2,000 crores*" (EUR 220 million) and the target enterprise has "*substantial business operations in India*".

Substantial business operations in India

As per the Amendment Act, a transaction will be subject to merger control only if the target enterprise has "*substantial business operations in India*". This is a sound and logical approach to follow, as it ensures that only those transactions that have a strong local nexus to India will be subject to the CCI's review. However, the manner of the determination of "*substantial business operations in India*" calls for clarity from the CCI.

In order to arrive at an appropriate metric for assessing "*substantial business operations in India*", the CCI can draw guidance from the joint guidance paper published by the Austrian and German competition authorities to address this gap. According to the joint paper, assessing whether the target company has substantial domestic operations (similar to substantial business operations in India) involves a systematic analysis of criteria relating to the measurement of domestic activity, local nexus of domestic activity and marketability and significance of domestic activities.

Firstly, the joint guidance paper states that different parameters may be relied upon in different sectors to measure domestic activity and criteria such as "*monthly active users*" or "*unique visitors*" or "*daily active users*" as possible indicators of domestic activities in the digital sector. Secondly, it establishes that the location of the target company or its research and development activities may be used to assess the local nexus of domestic activities. Thirdly, it asserts that domestic activity must have a market orientation and it may even be present when the service is offered free of charge but is monetised on a different side of the market. Lastly, it provides that activity must reach a significant level in the domestic market, in addition to the requirement of market orientation.

Suppose company M, a multinational technology conglomerate intends to acquire company W, the provider of a smartphone messaging app. This app is designed for end users worldwide including those in India. Currently, the app is offered free of charge by the target company and has gained a user base of ten million in India. If the CCI follows similar parameters as mentioned earlier and considers "monthly active users" as the industry standard for calculating the user count, this acquisition would need to be notified to the commission. The reason is that the target company i.e. company W has substantial business operations in India. The fact that the app is being used by ten million users in India indicates local nexus and the presence of market orientation at a significant level. Moreover, it is important to note that the app being offered for free does not preclude market orientation.

Value of the consideration

The Amendment Act provides that "*value of transaction*" includes every valuable consideration, whether direct or indirect or deferred for any acquisition, merger or amalgamation. The inclusion of indirect and deferred consideration in the definition of "*value of transaction*" allows the CCI to consider and evaluate the complete economic value exchanged in the transactions. Therefore, when investigating the deal value, the CCI may consider non-monetary benefits that are part of the transaction. These non-monetary benefits can include the value of consideration paid to the seller for the transfer of voting rights, securities, tangible and intangible assets or the value of liabilities assumed by the acquirer. Additionally, the CCI may take into account payments that are spread out over time or are contingent on certain conditions. The joint guidance paper elaborates on such contingencies or future developments and the CCI can again draw guidance from it.

Case 1 – Earn–out clauses

The joint guidance paper clarifies that the deal value should "*include considerations that are contingent on certain conditions, such as those specified in earn-out clauses, or other additional payments to the seller agreed in connection with the merger that are conditional on the achievement of certain turnover or profit targets at a specific point in future".*

Suppose company A acquires company B and includes earn-out clauses based on future performance in the merger agreement. The deal value is set at INR 1900 crore, with an additional payment of INR 500 crore contingent on company B achieving certain turnover targets within the next 3 years. In this case, the total deal value would be INR 2400 crore. This ensures that the valuation reflects the potential future performance of company B and provides a comprehensive assessment of the transaction's value.

Case 2 – Non-competition Payments and Milestone Agreements

The joint guidance paper further provides that *"Payments for non-competition by the seller must also be included unless they are already completely covered by other elements of the consideration. Consideration also includes future and variable purchase price components whose amount and time of payment are contingent on the future development of certain company parameters or certain conditions. This covers earn-out payments, which depend on the development of corporate key figures, such as the EBIT, turnover or sales figures, for example. Also included are payments that are conditional on milestones agreed between the parties involved, such as the achievement of specific steps in a drug approval process, and future licence payments*".

Suppose, Company A acquires Company B and they agree on a deal value of INR 1900 crore. As part of the deal, company B agrees not to compete in the same industry for a specific period. In return company A will make an additional payment of INR 500 crore over the next five years. In this case, the payment for non-competition should be included in the consideration unless already completely covered by other elements of the consideration.

Additionally, suppose company A and company B have milestone agreements related to specific achievements in their drug approval process. If these milestones are agreed upon between the parties and will result in future payments, the future payments should be recognized as part of the

consideration value.

Case 3 – Reliability of Future Value Assessment

The joint guidance paper also takes into consideration the fact that in some cases, the calculation of the deal value may depend on assumptions and expectations about the future performance of the merged entity. To improve the reliability of such information and facilitate the investigation of the consideration value, the joint guidance paper suggests providing written confirmation of the value and its assessment by the buyer's management.

For instance, if company X is acquiring company W and a significant portion of the deal value is based on future revenue projections and the achievement of specific company parameters, company X's management can submit a written confirmation detailing their assessment of the value. This document helps establish transparency and assists regulatory bodies like the CCI in evaluating the transaction value accurately.

In conclusion, a deal value threshold is an important tool for the CCI to regulate mergers in emerging sectors and industries, but its effectiveness will depend on the strength of the parameters set forth by the CCI either through a DVT regulation or through its decision-making practice.

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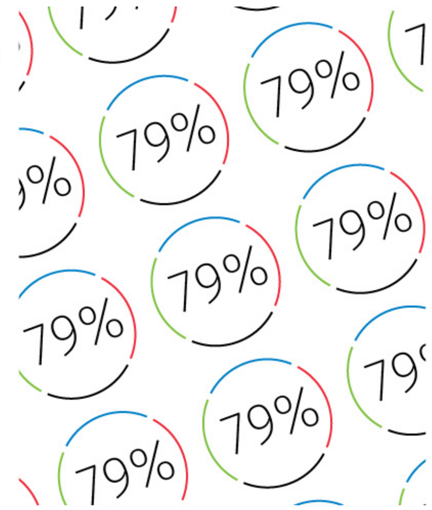

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