A Revised Merger Control Regime for Germany—Buyer Beware

The 9th Reform (the “Reform”) of the German Act on Restraints of Competition (“ARC”) comes into force today, 8 June 2017. It is intended to help the German Federal Cartel Office (“FCO”) address the challenges raised by the digital economy. The Reform adds a new “value of consideration” threshold (or “the New Threshold”) to German merger control which, together with a local nexus requirement, aims to combat a perceived “enforcement gap” a la Facebook/Whatsapp. Further amendments include changes to the FCO’s investigatory powers and the regulator’s approach to multi-sided markets.

The Reform presages a potential wave of merger control regimes across Europe that will introduce (e.g. Austria), or are considering the introduction of (e.g. the EU), a “value of consideration” threshold. The new “value of consideration” threshold is analogous to the “size of transaction” threshold under U.S. law (albeit the thresholds are not identical). The New Threshold will likely increase the number of filings to the FCO (which at approximately 1,200 cases a year, already requires the most transaction notifications in the EU). While the German government considers the additional filing burden to be limited, potentially numerous transactions will now need to undergo a more complex analysis as to whether a German filing requirement is triggered. This will also be true for foreign-to-foreign deals with limited German nexus.

The New Threshold adds further complexity to a German merger control regime that is characterized by relatively low revenue-based thresholds that already require notification of a broad range of transactions. It remains to be seen whether the introduction was necessary to close the FCO's perceived said “enforcement gap”.

Together with the New Threshold, the Reform provides clarification on the German “public interest” test and a revision to the market definition tool.

1 The perceived “enforcement gap” that the Reform aims to close is the FCO’s inability to review mergers where the target company has a “significant” presence, but insufficient revenue in Germany to confer FCO jurisdiction under existing revenue-based jurisdictional thresholds.

2 For comparison, in the same period, the EU reviewed 337 cases and the UK CMA reviewed 60 cases.

3 Under German merger control rules, non-controlling investments (such as 25% acquisitions of voting and/or non-voting shares, as well as the acquisition of competitively significant influence) are notifiable, in addition to acquisitions of controlling interests.
Changes to German Merger Control

The New Threshold: Value of Consideration and Significant Activities in Germany

In Germany, companies will now also need to file a pre-closing merger control notification to the FCO for transactions if:

1. the combined aggregated worldwide revenue of all parties was more than EUR500m;
2. the German revenue of at least one party was more than EUR25m;
3. the value of the consideration for the transaction exceeds EUR400m; and
4. the target “is active in Germany to a significant degree”.

The New Threshold will allow the FCO to review mergers relating to target companies with low revenues in Germany, but that are innovative and (potentially) of economic importance. The economic importance of the target company is measured on the one hand by the value of the transaction, and on the other by its significance on the market in Germany. Overall, the New Threshold will create an additional burden on merging parties. It will also necessitate additional information being provided to the FCO to allow the regulator to assess the value of the consideration and effects of the transaction on the German markets.

Germany anticipates that only three additional notifications will be submitted as a result of the New Threshold. This estimate seems rather conservative, as parties may want to seek comfort in borderline cases, given the hefty fines the FCO has levied in the past on parties that missed filing obligations.

The value of the consideration of the transaction is defined now as “1. all assets and monetary services that the seller receives from the purchaser in connection with the concentration … including 2. the value of any potential liabilities taken over by the purchaser”.

Valuation must be calculated by the parties according to an industry recognised method based on the company’s operation as a going concern. The guidance on the Reform also notes that the value will include not just cash payments, but also all assets and other non-cash benefits (e.g. inclusion of “earn out” provisions) that the seller will receive in exchange for the target company.

Whether a target company has a “significant” presence in Germany is dependent on the structure of the underlying market and – typically – customer location. Rather than quantify what constitutes “significant”, the guidance on the Reform provides two anecdotal examples:

- The first example suggests when a target company might have a “significant” presence in Germany. It is based on the Facebook/WhatsApp fact pattern, i.e. although the target has no (or minimal) revenue in Germany, it has a large user base in Germany.

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4 S.35(1a) No. 3 ARC.
5 S.35(1a) No. 4 ARC.
6 S. 38(4a) ARC.
7 Assets includes the transfer of voting rights, securities, fixed and intangible assets.
In such a case, the number of “monthly active users” is decisive, and at least one million users in Germany is sufficient. Important is the percentage of users affected, i.e. if the target company generally only offers to a small group of users, a large percentage thereof may also be sufficient. In other cases, a market standard can be applied to assess the significance on a market, e.g. the number of “unique visitors” to a website could be used to assess the presence of a hotel booking website in Germany.

- The second example suggests when a target company does not have a “significant” presence in Germany. The example given is that of a Canadian conglomerate that wants to sell a business division that is active in a “traditional” market where a large number of goods are sold and paid for. The underlying market structure is decisive, with a more predictable market and allowing for a clearer assessment of the potential of a target company.

Based on the examples, transactions likely caught by the New Threshold are those in the digital/IT and pharmaceutical sphere, where startup companies and R&D focused businesses provide potential value in the future.

**Less Merger Control Scrutiny for Broadcasting Mergers**

In line with many other jurisdictions, Germany traditionally views concentrations in the press and media sector as more sensitive. To allow for a review of smaller transactions in this area, where the parties would otherwise remain below the jurisdictional turnover thresholds, German merger rules apply a multiplier of eight to the turnover of newspaper companies and a multiplier of twenty to broadcasting (radio/TV) and broadcasting advertising companies. The Reform now also lowers the multiplier for broadcasting mergers to eight. As a result, broadcasting mergers will now need to be notified under the turnover test only if:

1. the combined aggregated worldwide revenue of all parties was more than EUR62.5m;
2. the German revenue of at least one party was more than EUR3.125m; and
3. the German revenue of at least one other party was more than EUR625k.

**The German “Public Interest” Test**

Additionally, the Reform aims to ensure greater transparency, certainty and accountability in the process for obtaining ministerial approval for a merger (the German “public interest” test). Germany is one of few merger control jurisdictions within the EEA that allows a political override by the Minister of Economic Affairs and Energy (the “Ministry”) of a merger control prohibition issued by the FCO based on non-competition considerations, such as the preservation of high value technical potential or know-how, the settlement of a structural crisis or the restructuring of the enterprises involved.

The Reform aims to ensure that the public interest review is accelerated by (1) requiring the Ministry to inform the German Parliament why a decision was not taken within four months and (2) stating that if a decision is not taken within six months, the requested override of the FCO prohibition is presumed to be rejected (this period can be extended by up to two months). In addition, in an attempt to de-politicize the process, an expert opinion is obtained from the so-called Monopoly Commission (Monopolkommission (or the KEK, Kommission zur Ermittlung der Konzentration im Medienbereich, in case of media mergers). If the Minister now decides to deviate from the expert opinion, any differences must be justified separately in the decision.
The Reform was deemed necessary after the resolution of the controversial *Edeka/Tengelmann* merger review. The *Edeka/Tengelmann* merger was prohibited by the FCO in April 2015, after which the parties applied to the Minister for approval. The parties argued that the number of jobs that the merger would save outweighed the significant competition concerns raised by the FCO. After eleven months, the Minister (then Sigmar Gabriel) cleared the transaction. However, the Minister’s clearance was challenged by a competitor in the courts and overturned. Ultimately, the parties settled out of court following a number of meetings with the Minister behind closed doors; the merger closed in December 2016.

**Revision and Clarification of the Definition of Markets**

The Reform has revised the market definition tool to include free services and products. Traditionally, the tool had been used to define the boundaries of competition between companies through assessing a customer’s willingness to switch following a price increase. However, the change was necessary following several cases in the past two years across Europe concerning free services on multi-sided markets (e.g., in Germany - VG Media/Google).

The Reform now permits the market definition to include multilateral markets where services are offered for free (e.g. the use of Google’s search engine). The Reform makes clear that the market definition will now look at competition at the point where supply and demand meet.

Therefore, although not new to merger control, the ability to assess markets where products and services are offered for free may allow the FCO to make use of its new customer protection powers sooner rather than later.

**Points to Consider**

Although the impact of the Reform remains to be seen, companies should be aware that:

- The introduction of the New Threshold will likely result in an increase in notifications to the FCO. It will also result in more complex filing assessments, given the introduction of a test that is novel in Europe.

- Although the German Reform refers to the US “size of transaction” threshold, there are notable differences to the new “value of the consideration” threshold. In fact, the threshold resembles more closely the US notion of the “acquisition price,” although it remains to be seen how closely the thresholds will be aligned in the future.

- Also, the guidance to the Reform considers that the aim of various exceptions to the US “size of transaction” thresholds is to avoid filing requirements that do not have a sufficient domestic nexus. Conversely, the guidance considers that a similar safeguard against overreaching jurisdictional regime can be achieved by way of adding the requirement of the target having significant German activities.

- Interestingly, a similar additional “value of consideration” threshold has been introduced in Austria (which enters into force 1 November 2017). In parallel, the European Commission is consulting

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8 Decision of the Higher Regional Court Düsseldorf on 12 July 2016 – VI-Kart 3/16 (V).

9 Decision of the FCO on 08.09.2015, in B6-126/14 – VG Media/Google
as well whether a “value of transaction” test should also be added to the EU merger control regime.

- Acquisitions of smaller broadcasting companies may escape a filing obligation as the relevant turnover thresholds are effectively raised (to bring them in line with the test for newspaper mergers).
- The revised German “public interest” test creates greater certainty in terms of timing, while attempting to de-politicize the process by adding an obligatory (albeit non-binding) expert consultation.
- The revision of the market definition will add complexity to the substantive review of a transaction, as the effects of the transaction will also have to be assessed on markets where the target company did not generate revenues.

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