Latham & Watkins Antitrust & Competition Practice

New Size-of-Transaction Test in German Merger Control

Proposed legislative amendment to include changes to merger control thresholds, dominance test, parental liability, and to implement EU private damage directive.

This Client Alert focuses on amendments to merger control, which if adopted would introduce new size-of-transaction and dominance tests. Important to US and multi-national companies, the changes significantly broaden the Federal Cartel Office’s (FCO) jurisdiction over foreign-to-foreign transactions.

The German Federal Ministry for Economic Affairs (Bundeswirtschaftsministerium (BMWi)) has now published its long-expected proposal for the amendment of the German Act against Restraints of Competition (Gesetz gegen Wettbewerbsbeschränkungen (GWB)). Public consultation has just started and the proposed amendment is set to enter into force by the end of 2016.

New Size-of-Transaction Test
The proposal supplements the current filing threshold with an alternative size-of-transaction, or "value of consideration" (Wert der Gegenleistung), threshold:

“The provisions on the control of concentrations shall also apply in cases where […] the value of the consideration for the transaction is more than €350 million […].”

Future transactions will also need to be notified in Germany if (i) the combined worldwide turnover of all companies exceeds €500 million, (ii) one of the parties to the transaction has a turnover in Germany of more than €25 million, and (iii) the value of the consideration for the transaction exceeds €350 million.

The new test is inspired by the size-of-transaction test used in the United States, where the current threshold is US$312.6 million. The current public consultation could change the ultimate amount of consideration in the GWB. The European Commission is also considering proposing a similar size-of-transaction test for the EU Merger Regulation.

No Sectoral Limitation
The proposed amendment is primarily aimed at the acquisition of early-stage technology companies, which may command significant purchase prices despite low or even no revenues. But it applies to all industries and sectors. As a practical matter, any multi-national company with global turnover of more than €500 million and German turnover of more than €25 million would have to notify in Germany any major acquisition anywhere in the world.

Limited Nexus to Germany Required

However, the new size-of-transaction threshold requires that the target "is active or is expected to become active in Germany." The BMWi's explanatory note suggests that this requirement will often be met. According to the note, "being active" does not require the generation of revenues, but could also be triggered, for example, by a German user taking advantage of free services provided by the target company via the Internet. "Expected to become" active would, according to the BMWi's explanatory note, cover a time frame of three to five years. Such a long period may lead to difficulties in interpretation, as the target's and acquirer's post-closing business plans may not reach this far into the future.

“Value of Consideration”

The calculation of the relevant “value of consideration” may raise difficulties in certain cases. According to the BMWi’s explanatory note, the purchase price should be determined according to common M&A practice – i.e., as the sum of all monetary payments, transfers of voting rights, securities or tangible and intangible assets, and including payments subject to “earn out” clauses. In taking into account assumed liabilities in share acquisitions, the definition may differ from the approach under US law, for instance in Debt-to-Equity-Swaps and restructurings where nominal purchase prices may be minute and the target’s liabilities significant. However, according to the BMWi’s explanatory note, the purchase price can generally be presumed to represent the value of the transaction.

Recognition of Markets for “Free” Services or Goods

The proposal establishes that the finding of a “market” does not depend on the exchange of pecuniary consideration (§ 18 (2a) GWB). The proposal thus aims to capture situations of two- or multi-sided markets in which goods or services on one side are offered “for free." The Düsseldorf Higher Regional Court (Oberlandesgericht) recently explicitly denied the existence of a "market" in such circumstances. The change may be significant in particular for the acquisition of early-stage technology companies that have not yet begun monetizing their services through advertising, so that the natural focus of any substantive analysis would be on whether the transaction entails any loss of competition on the “free” side of the market.

Network Effects and Access to Data Becoming Part of Substantive Analysis

The proposal (amending § 18(3a) GWB) also spells out the substantive criteria to assess the market position of companies in multi-sided or network markets. In the future, when assessing dominance, the FCO is to consider (i) direct and indirect network effects, (ii) multi-homing behavior of, and switching costs for, consumers, (iii) economies of scale in connection with network effects, (iv) the company’s access to data, and (v) innovation-driven competitive constraints.

It is unclear whether the codification of these factors will result in a different assessment of mergers, or the allegedly dominant position of a company suspected of an abuse. One could argue that the factors listed in § 18(3a) are inherent to a proper substantive assessment in any event, in industries characterized by multi-sided markets and network effects. Indeed, the proposal acknowledges that none of these factors individually could raise competitive concerns, and that the FCO needs to assess every case considering the specific circumstances.

Timeline of Further Legislative Procedure

Public consultations run over the summer with initial comments due as early as 15 July. In late August to early September, the Parliamentary Chambers will debate the draft with a view to adopting a final version
at the end of September to early October. The amendment would then enter into force the day following its publication in the German official gazette, which is currently planned for December 2016 at the latest.

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