15 June 2018

Guidance on Transaction Value Thresholds for Mandatory Pre-Merger Notification

Draft for Public Consultation

Cisco Response

We would like to thank the Bundeskartellamt and the Bundeswettbewerbsbehörde for inviting industry and other stakeholders to provide comments to the draft guidance on transaction value thresholds for mandatory pre-merger notifications. We appreciate the efforts that both authorities have put into drafting the guidance, and very much welcome the additional clarity that the guidance provides. Legal certainty and predictability is key when engaging in M&A activities. It allows companies to make informed decisions around potential notifications and manage the timeline and costs we need to foresee when exploring and engaging in transactions.

Before elaborating on the details of the draft consultation, we do want to share some high level observations as competition authorities may be considering value of transaction based thresholds. While we appreciate the German and Austrian legislator has already taken a decision on this point, we do like to point out that we remain concerned about the introduction of value-based thresholds in particular by jurisdictions that do not have merger review processes that are as efficient and predictable as those that exist in Germany and Austria. Expanding the set of notifiable transactions to capture a large number of transactions that would not otherwise be reportable creates significant burdens on companies both in terms of cost and timing. We question whether those costs outweigh the benefits of possibly capturing a small number of deals (if any) that would otherwise not be reviewed or pose antitrust risks that could not be remedied. Furthermore, having to put such transactions on hold for a number of months may be detrimental in fast-moving technology sectors, where disruptive innovation – developed either internally or through acquisitions – is critical to remain competitive.

For those jurisdictions that do consider introducing such thresholds, or have already done so, it is important to make the relevant rules as predictable as possible. As mentioned above, we therefore sincerely appreciate the efforts by the German and Austrian competition authorities to provide clarity through the current guidance. We specifically also welcome the fact that both authorities have done so together, in an effort to seek as much convergence as possible on the interpretations of the relevant legislative provisions.

Finally, we also wanted to take the opportunity to thank the authorities' availability to date, and its commitment to remain available in case we have further questions around the application of the relevant thresholds in the future.

Below, we provide some comments to the specific sections of the draft guidance document.

Section A – Introduction

As far as the opening statements are concerned, we would like to point out that we tend to disagree with the statement that "[m]arket-leading companies are able to fully integrate emerging competitors or their assets into their own business by acquiring them in the early stage of their development and change or discontinue the original activities of the acquired company" (para 4; see also the similar statements in para 109). At least we would take issue with the impression that may be created by the

statements that buying an early stage company to change or discontinue its original activities is a frequent objective of M&A activities. Rather to the contrary. As a frequent acquirer of early stage companies, Cisco's experience is that a primary reason for acquiring is to avail ourselves of the innovations that a smaller company has introduced, innovations that would take too long to develop internally in fast-changing markets. We seek to combine those innovations with Cisco's sales and marketing capabilities and network of resellers. In this way, acquisitions can help expose a larger set of potential buyers to innovations of a smaller company that may not have been able to reach them in other ways, certainly not as quickly.

We agree with the need as expressed in the guidelines to protect innovation, and promote innovation competition in the market. We would however caution the authorities in taking an overly conservative approach in this regard, in particular in technology markets, where the speed of technological changes are rapid and barriers for market entry are often relatively low. The technology sector has relatively short innovation cycles and competition can emerge quickly.

Section C – Value of the consideration

The guidance provides helpful insights in how the value of the transaction is to be calculated. We list a few additional comments below.

Para 23 indicates that when the parties agree that the value of the consideration exceeds EUR 400 million or EUR 200 million, the project can be notified but that the "notification must include an *estimate* of the value of the consideration and state clearly that the thresholds will be exceeded" (emphasis added). In the same vein, para 25 states that if a precise value cannot be established but its likely upper or lower limits indicate that it will be clearly above or below the relevant thresholds, "it will be sufficient to explain and validate these limits". While we agree it is necessary for the relevant authorities to have clear insights into the application of the thresholds, we understand these provisions to mean that even in case of complex cases, *estimates* of transaction values should be sufficient.

In relation to possible changes over time, para 27 indicates that "a merger project that was initially not subject to notification can become subject to notification, for example, if the price of the foreign currency or shares offered as a consideration rise to such an extent that they now exceed the thresholds", in such a way that "an obligation to notify the merger may arise before the date of completion". While we appreciate the authorities' views to strictly capture any possible changes in circumstances, we consider that such consideration may become problematic, in particular when such changes arise shortly before the date of close. In deals where the target is paying in its own shares, parties sometimes use "collars" and other devices to limit the range of potential valuations. Nevertheless, one attraction of share deals for buyers is that they benefit from an increase in value of the buyer's shares that may occur between announce and close. If a significant increase may trigger merger notifications that only become necessary late in the acquisition process, the cost of share-based compensation will increase uncertainty regarding the timing of close. We therefore would like to propose that the timing of the relevant evaluations should not be set at the date of close, but at the date of the relevant notification assessment (for example the date of signing the purchase agreement).

Similarly, para 34 holds that the notification requirement will not be reinstated "if the components of the consideration value that had already been taken into account change in value after the merger is put into effect". We understand that the "putting into effect" of the transaction refers to the date of closure – but would welcome further guidance to confirm.

Section D – Substantial domestic operations

When referring to one of the key considerations in this regard, the guidance refers to the fact that at least as far as the German regulator is concerned, "when establishing domestic activity [...], the key factor is the **use of the asset for business activities** and **not the mere local allocation of the asset**" (para 66). It may be useful to clarify the meaning of the "use of the asset for business activities" by providing some example. We are not sure practitioners who must use the guidance to advise clients will necessarily understand the limitations that the clause aims to define, as 'business activities' can refer to a wide range of things companies do. Also, does this statement mean to refer to the "use of the asset for business activities" *in Germany*? Or could assets located in Germany but used for business activities mainly outside of Germany also be relevant?

As far as the significance of domestic activities is concerned, we have been encouraged by the Bundeskartellamt's introduction in the guidance of a EUR 5 million threshold below which the domestic activity is not considered to be sufficiently significant (para 79). In order to be aligned with the purpose of the value-of-transaction thresholds, we also understand the need for an exception in case the domestic turnover is not an adequate indicator because the company is active on a market that is not characterized by turnover. However, creating a further exception for products which only have recently come onto the market "so that the low turnover generated so far does not reflect the competitive potential" (para 79) seems to undermine the benefits created by the introduction of the basic turnover threshold. It seems intuitive that those transactions that are caught by the relevant value-of-transaction thresholds, and not by the mere turnover thresholds, will by definition be related to acquisitions of companies that have either not monetized their products or services, or where the products and services have not reached their full turnover potential – which is likely (we are tempted to say inevitably) also the reason why the buyer is willing to pay a large premium. While we appreciate the need to include transactions in the online world where value may be created by free product offerings, it would be useful if further guidance can be provided around the circumstances in which a transaction would require notification despite the target having less than EUR 5 million in revenue in Germany. We note that the assessment as to whether a company has reflected its full competitive potential is a subjective question that may be open to different interpretations.

While the EUR 5 million threshold is referred to apply to the Bundeskartellamt, the Austrian regulator seems to indicate to reserve its rights by stating in para 80 that it has not set such absolute threshold. While we appreciate the legal specificities of both jurisdictions, we believe it would be helpful if the Austrian authority could consider adopting a similar approach. Convergence between both authorities on this point would stimulate legal certainty, and facilitate the burdens for companies to evaluate their duties to notify.

We again thank both authorities for the opportunity to provide comments to the draft guidance, and remain available to discuss any questions you may have.

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