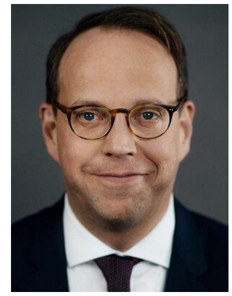
German Review Of Meta Deal Signals Greater Involvement

By **Daniel Wiedmann and Daniel Hoppen** (April 20, 2022)



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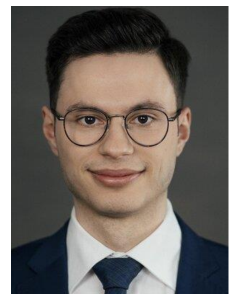

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On Feb. 11, the German Federal Cartel Office cleared Meta Platforms Inc.'s contemplated acquisition of Kustomer Inc., a U.S. developer of customer-service platforms.

The interesting part is not the clearance itself but rather that Meta was asked to notify the transaction in Germany, considering the fact that Kustomer had almost no domestic activity in Germany and the European Commission's parallel review of the deal.

Merger control practitioners should be aware of the case as the FCO's approach is likely to require more transactions to be notified in Germany in the future. In particular, the FCO considered that domestic effects may also be established on the basis of indirect links to customers in Germany and that, contrary to a frequent understanding, the threshold also applies to established markets characterized by traditional revenue-based business models.

Background

The size-of-transaction test was introduced in 2017 to supplement the traditional revenue-based jurisdictional filing thresholds, which require, inter alia, that two parties to a transaction generate revenues in Germany of more than €50 million and €17.5 million (or $53 million and $19 million), respectively.

In the context of the debate of so-called killer acquisitions, this new test was introduced to enable the FCO to also review the acquisition of targets with no or only very limited revenues. This test is met if:

- The parties have combined worldwide revenues of more than €500 million;
- One party has a domestic revenue of more than €50 million;
- No other party has a domestic revenue of more than €17.5 million;
- The value of consideration for the acquisition exceeds €400 million; and
- The target has a substantial activity in Germany.

In addition, as this test is supposed to supplement the traditional revenue-based thresholds, it requires that the revenues of a target do not adequately reflect its competitive potential.

Revenue Versus Competitive Potential

The FCO asked Meta to notify the transaction as it considered these requirements to be met. In particular, the FCO considered that Kustomer's revenues do not reflect its competitive potential.

First, the FCO considered that there is a significant discrepancy between the purchase price and the revenues generated by Kustomer when considering customary multiples. For this conclusion, the FCO compared the ratio of the purchase price to Kustomer's revenues with average valuation multiples according to industry surveys.

The FCO considered that the significantly higher revenue multiple can be seen as an indication that Kustomer's revenues do not reflect its competitive potential.

Second, the FCO considered that while Kustomer may be active on a market that is characterized by revenue-generating business models, it is expected to grow significantly with innovative software-as-a-service, or SaaS, offerings as growth drivers. Kustomer is a provider of cloud-based customer relationship management, or CRM, service that offers its services as SaaS. Its CRM services and software allow companies to manage their customer data and contacts across platforms and communication channels.

Third, it considered that the true value of Kustomer from the perspective of Meta is the data Kustomer obtains from the end customers of its own customers — which include, for example, online shops.

Domestic Nexus

The FCO established the required sufficient domestic nexus based on these end customers. According to the legislative materials and the FCO's own guidelines, the domestic nexus is typically either to be established based on customers or research and development activity in Germany.

However, the FCO did not look at Kustomer's (apparently few) own customers in Germany but at German end customers served by its direct customers. The FCO asserted that in addition to the licensees as users, the end customers of the licensees with whom the CRM service is used for communication must also be taken into account.

It considered it irrelevant that Kustomer has neither a direct nor an indirect business relationship with such end customers and that it did not commercialize their data.

As Kustomer obtained data from a substantial number of such end customers in Germany, it considered that Kustomer has a substantial activity in Germany. It should be noted that the FCO also updated its guidance paper on the transaction value thresholds to reflect this approach in the guidance.

Parallel Proceeding at EU Level

Another noteworthy feature of this case is that it exemplifies the limits of the European Union's one-stop-shop principle. Before the FCO's review, a review of the case by the European Commission was already pending for seven months following a referral under Article 22 of European Union Merger Regulation, or EUMR, by the Austrian authority.

The FCO argued that it could not join the referral without having confirmed whether it has jurisdiction itself. This approach evidences the FCO's disagreement with the commission's new guidance on Article 22 EUMR referrals, also motivated by the aim of a closer review of possible killer acquisitions, which states that the EU can also accept referrals in cases where the referring member state does not have initial jurisdiction over the case.

Outlook and Takeaways

The FCO's decision is now under appeal. A court decision is not to be expected before autumn this year. For the time being, the case shows the FCO's readiness to interpret the size-of-transaction test very broadly. In particular, when making an assessment whether a filing with the FCO may be required under these thresholds, it will not suffice to consider that a target is active on a market that is traditionally characterized by revenue-based business models.

The assessment should also consider whether the ratio of the purchase price to revenues is above average and, if so, for what reasons. When considering whether a target has a substantial activity in Germany, also indirect links may need to be considered.

This may be particularly relevant for target companies that process data of German end users, even in absence of a direct business relationship with such end users. Finally, deal makers should be aware of an increased risk of parallel reviews at the EU and the national level as consequence of the EU's new approach to referrals.

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