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The Indian Government proposes to introduce an additional threshold test based on the deal size or transaction value of a transaction

MERGERS, MERGER NOTIFICATION, THRESHOLDS, REFORM, CONTROL (NOTION), INDIA, INTERNET, ONLINE PLATFORMS, BIG TECH

Ministry of Corporate Affairs, Government of India, *Key recommendations of Competition Law Review Committee (CLRC)*, Press Release, 14 August 2019

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Introduction

"We are all now connected by the internet like neurons in a giant brain," these were the words of renowned theoretical physicist, Stephen Hawking, and he couldn't have said it better. In today's digital age, internet and technology have permeated every sphere of one's life. Be it e-books, e-commerce, social media or food delivery, we live for and by the internet! In fact, even the massive global M&A deals are dominated by the ever dynamic digital and technology sector. Data compiled by Bloomberg in 2019 show that over the last decade, the big five – Alphabet, Inc., Amazon.com, Inc., Apple, Inc., Facebook, Inc. (Facebook) and Microsoft Corporation alone made 431 acquisitions worth USD 155.7 billion. [*1*]

The rapid transformations in the digital world and the rise of technology megastars have however created new challenges for antitrust regulators across the globe. From a merger control standpoint, non-reportability of exceptionally high value deals where prominent players have combined without a pre-merger approval have raised serious concerns about how well-armed conventional notification thresholds really are. This arguable lacuna became glaring with the 2014 merger of Facebook and WhatsApp, Inc. (WhatsApp) which escaped antitrust approval requirement in many jurisdictions despite the potential competition risks.

In order to bridge this purported enforcement gap, the Government of India is mulling to introduce an additional threshold test based on the "deal size" or "transaction value" of a transaction.

Indian merger control rules: Current position

The Indian merger control regime is an anticipatory regulation. The notification thresholds under the Competition Act, 2002 (Act) are quite straightforward and are based on the asset and turnover size of transacting parties. [*2*] If the prescribed thresholds are met, the transaction requires a prior review and clearance from the Competition Commission of India (CCI). The CCI is required to assess if the transaction poses any competition risks in the Indian markets. However, if the thresholds are not met, the CCI cannot review a transaction even if harm to competition is apparent.

The alleged enforcement gap in India

Most of the M&A deals in the digital space derive value from target's data or its innovation and revenue-generating potential, completely bereft from target's actual revenue. Led by world's technology giants who are on a constant look out to buy-out the innovative technology introduced by a budding start-up; these deals are akin to what is now popularly referred to as "killer acquisitions". The dominant company acquires its rivals to consolidate its market position and eliminate competition or potential threats. To this end, India has witnessed several strategic deals in its digital and data-driven markets. [*3*]

The Indian notification threshold tests were created keeping in mind the asset and turnover size of conventional business houses in India. These tests pre-suppose that if a target is not big enough (in terms of asset or turnover size), its acquisition will not adversely impact competition. However, in case of killer acquisitions, the target is always either asset light or has insignificant revenue to get caught by these threshold tests. As a result, even if such a deal impacts the competitive dynamics, the CCI lacks jurisdiction to review it due to the deal's non-reportability and this renders the above premise utterly flawed.

This lacuna stems from CCI's limited review powers. For context, antitrust regulators in Brazil, Ireland, Sweden and even United States enjoy a "residuary power" to call in and review non-reportable transactions. Similarly, the European Commission has a "referral system" (which ultimately led to the review of Facebook/WhatsApp merger) and the United Kingdom has a "share of supply" test. These mechanisms prevent non-reportable deals from falling through the cracks when the traditional turnover-based notification thresholds are not breached.

In India, while the Act empowers the CCI with claw- back powers to review transactions which were not notified to it, unfortunately, this power is only limited to notifiable transactions i.e., which breach the notification thresholds. [*4*] As such, the CCI has no residuary power to call in non-reportable deals and the Act does not provide any other mechanism to take cognizance of such deals.

Bridging the enforcement gap: Proposal for deal-size thresholds To plug the shortcoming, the proposal for introducing deal-size thresholds in the Indian merger control regime was first recommended by the Competition Law Review Committee (CLRC) [*5*] in its report in July 2019. It was prompted by a growing international concern regarding a rise in global M&A deals in the digital space which did not require a pre-merger approval. The CLRC noted that in such deals, the poor revenue of data-driven companies and other innovation-driven start-ups was not an accurate indicator of the deal's impact on competition since it did not reflect the target's true market potential.

The CLRC also noted that demanding ample empirical validation to justify introduction of deal-size thresholds made little sense since it meant waiting until a substantial number of non-reportable killer acquisitions have taken place and their anti-competitive effects have played out in the market. Thus, adopting a forward-looking approach and to ensure competitiveness of India's budding start up market, the CLRC recognized the need to brace the extant legislation for upcoming challenges in the digital markets and recommended introduction of deal-size thresholds.

Potential risks with deal-size thresholds

To catch killer acquisitions in digital markets, Germany and Austria have recently introduced an additional sector agnostic deal-size threshold test. This test, among other things, is based on the value of the deal as well as the target's economic nexus with German and Austrian markets. Other jurisdictions such as, France, United Kingdom, Europe, etc. have also evaluated the merits of introducing a similar threshold.

However, the real question is: was it successful? Statistics from Germany and Austria after a little over two years of the new thresholds coming into effect show that most of the merger filings made under the new thresholds were intended to be "precautionary" to obviate any risks surrounding non-notification. This is further bolstered by the fact that most of these filings did not actually breach the notification thresholds and were ultimately withdrawn. Additionally, while preliminary guidance on application of deal size thresholds has been provided by German and Austrian authorities, in the absence of sufficient application-based experience, they do not address all plausible challenges.

Thus, in the Indian context, if the deal-size thresholds are to work, they must be based on objectively quantifiable standards and should be simple and practical in application. Even the CLRC noted that any operational and practical challenges surrounding formulation of deal-size thresholds will require to be ironed out upfront.

For example, deals where the transaction value cannot be precisely determined (such as, transactions involving deferred consideration, or where the value involves future and variable price components or is conditional on satisfaction of certain conditions, etc.) will require a careful assessment to ascertain the "true" deal value. Similarly, guidance will also be required for assessment of target's local nexus with the filing jurisdiction to avoid catching transactions which have no impact in Indian markets. Especially, in global deals which require notification in multiple jurisdictions.

Additionally, any exchange of valuation reports between the seller and the buyer (prior to deal signing) to assess if deal-size thresholds are triggered will require appropriate ring-fencing measures which may put additional compliance burden on parties.

Other than the implementation issues, it will be also relevant to consider that the deal-size thresholds do not inhibit innovation and do not result in excessively capturing unintended transactions simply because of an omnibus threshold is met. This is because innovation-driven start-ups prefer to sell their business to monetize their investment. As such, the thresholds may have a counterintuitive effect of stifling innovation in niche markets by restricting companies from monetizing their innovation potential.

Conclusion

With little evidence of success and the international debate still ongoing, should India hasten to introduce deal-size thresholds? Given the above risks, it is possible that deal-size thresholds may pose a risk of opening a pandora box of merger filings where most (if not all) filings will be made in abundant caution without truly actually presenting a real competition risk. They may also increase the compliance burden on both the CCI and companies. This may therefore be counterintuitive to India's larger policy goals of supporting the budding start-up market and improving the ease of doing business in India.

The CLRC was aware of this issue and was cautious to note that any amendments to the Act should not be premature. It noted that alternatives to deal size thresholds may emerge as the CCI better understands the functioning of new age markets.

As noted above, empowering the CCI with a residuary power to call in non-reportable transactions which may be of interest is one alternative that balances the need to address the enforcement gap for transactions that warrant a scrutiny on one hand and on the other does not excessively capture non-problematic transactions. Its suitability is reinforced by its success in countries where antitrust regulators are entrusted with such power. A residuary power will ensure that the CCI calls in only those deals where there are genuine concerns of potential harm to competition. That said, it remains to be seen if India will adopt a wait and watch approach to gauge how the international community tackles the enforcement gap or will hasten to introduce the deal-size thresholds given that, India is undoubtedly a growing hub of unicorns in the world.

[*1*] David McLaughlin, Why were Facebook and Google allowed to get so Big?: Quick Take, 14 March 2019, available at: *https://www.bloomberg.com/news/articles/2019-03-14/why-were-facebook-and-google-allowed-to-get-so-* ↗ big-quicktake

[*2*] Section 5, Act

[*3*] For example, in 2014, Flipkart India Private Limited, an e-commerce platform acquired its rival, Myntra Designs Private Limited (available at: *https://economictimes.indiatimes.com/tech/internet/flipkart-acquires-myntra-here-is-why-it-makes-sense/articleshow/35471764.cms* ↗). In 2015, ANI Technologies Private Limited (Ola), an online ride-hailing service app provider acquired its smaller rival, Serendipity Infolabs Pvt. Ltd. (TaxiForSure) but had shut down its services a year later (available at: *https://www.business-standard.com/article/companies/ola-* ↗ cabs-acquires-taxiforsure-in-200-mn-deal-business-standard-news-115030200354_1.html).

[*4*] Section 20 (1), Act enables the CCI to review transactions within 1 year of their closing which were reportable since they breached the notification thresholds yet prior CCI approval was not sought.

[*5*] The CLRC was formed in October 2018 to review the extant legislation and recommend comprehensive changes to it keeping in mind the changing business environment.