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TRANSACTIONS INVOLVING DIGITAL MEDIA IN EUROPE: KNOW THE SOURCE

By Alistair Maughan and Kristina Ehle

The market in Europe for resale of software and other digital media is growing, and this represents an opportunity and a threat for companies involved in M&A activities.

The resale market for used software and other forms of media is increasingly attractive for small and mid-sized enterprises to acquire the digital assets upon which their business operations rely. From software downloads to e-books, online platforms have been created to facilitate the second-hand trade in different forms of digital media. While there may be obvious short-term benefits of such resales–not least in cost terms–the existence of resold digital media may cause issues in planned M&A transactions in Europe.

The growth of digital media resale as an issue in European M&A projects could be said to have started with a European Court of Justice (CJEU) decision in 2012, known as the *UsedSoft* case, that allowed the resale of "used" software downloads in some circumstances. But courts across

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Europe are still grappling with the consequences of that decision. Until either the EU enacts further legislation or the CJEU issues a clarifying decision, the pattern of which digital media resales are clearly allowed in which country will continue to resemble a patchwork quilt.

In the *UsedSoft* case, the CJEU ruled that, under European law, a software owner cannot prevent a lawful acquirer of software downloaded from the Internet from selling unwanted licenses to use that program to third parties. It does not matter if the software was originally downloaded with terms specifying that the right to use the software is both non-transferable and limited to the licensee's internal business purposes.

Under the EU Software Directive (2009/24/EC), the first sale in the EU of a copy of a computer program, by or with the consent of the copyright holder, is said to "exhaust" the right of distribution of that copy. The CJEU held that the right to distribute a copy of a computer program lawfully downloaded from the Internet is exhausted if the right holder grants the acquirer the right to use the copy for an unlimited period of time. That meant that the copyright holder cannot object to the resale of a copy of a computer program for which its distribution right is exhausted.

It is important to understand that the *UsedSoft* decision did not give free rein to any licensees of software to copy and sell that software to third parties under all circumstances, and that the decision was limited to software downloaded from the Internet under a perpetual license. But the *UsedSoft* decision seemed like a green light to a number of companies keen to establish trading platforms to allow resale of other forms of digital media in Europe, and those companies were not going to be put off by some of the limitations of the *UsedSoft* decision. The result has brought about material growth in the digital media resale market across Europe.

As the market has grown for different types of digital media, so have attempts by product owners to close down some of the platforms established to facilitate the trade but with varying success. So far, a Dutch court has refused to close down Tom Kabinet, a platform allowing the resale of e-books. Conversely, a court in Berlin has refused to allow the continued operation of a business reselling keys for computer games. One of the main issues has been whether the principle of exhaustion of rights in the EU Software Directive also extends to digital media covered by the EU Copyright Directive (2001/29/EC).

The variability in the European court decisions shows the level of uncertainty that exists in different countries in Europe and across different media as to the scope of application of the *UsedSoft* decision.

For businesses assessing M&A targets in Europe, this uncertainty has some practical effects:

- One aspect of valuing a target in the business of creating and licensing software or other digital media will be the exposure to a secondhand resale market. Extra diligence will be required to assess the proportion of a target's revenues that come from licensing under the EU Software Directive via the perpetual license model in respect of which resale was endorsed by the CJEU. Acquirers will need to understand what prospects exist for targeting and closing down second-hand resale models that undermine direct future license revenue.
- Where the acquisition target is a user of resold digital media, an acquirer must address the extent to which reliance is placed on such media, and whether in-bound licensing occurs made via a resale platform that conforms to the type and nature of resales typically permitted by the courts.
- Just as with open source software, forewarned is forearmed. Acquirers need to undertake adequate diligence about the original source of software and digital media acquisitions to enable an adequate risk assessment. Too often diligence checklists do not include adequate questions about the source and content of targets' software and digital media estates.
- An assessment of the risks presented by resold software and digital media ought to form a greater part of the planning of any M&A project where the target is a European company relying on software or other digital media.

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NEW FRAMEWORK ON MARKET ABUSE IN THE EUROPEAN UNION

By Chung-Hun Daniel Kim

This has the European Commission enacted the Market Abuse Regulation (No. 596/2014 – MAR) which aims to update and strengthen the existing framework governing market conduct in the EU. Until its entry into force in July 2016, the European Securities and Markets Authority (ESMA) and the European Commission will be called upon to implement technical standards and develop guidelines. MAR is complemented by the Market Abuse Directive (2014/57/EU – MAD) which requires all Member States to provide for harmonized criminal sanctions in the field of market abuse.

Key changes under MAR are:

- A broadened scope of dealings covering financial instruments admitted to trading on EU regulated markets, and, in addition, financial instruments traded on multilateral trading facilities or organized trading facilities, e.g. on the Open Market in Germany, credit default swaps, contracts for difference and spot commodity contracts. Making a decision to cancel or amend existing orders for financial instruments on the basis of inside information will now count as insider dealing. MAR also introduces a number of exclusions and exceptions from its scope (so called *safe harbor* provisions), e.g. if a company has established a sufficient compliance-system.
- A broadened definition of inside information covering both non-public information that would be likely to have a significant effect on the price of the financial instrument, and information that a *reasonable investor* would be likely to use as part of his/her investment decision. In case of protracted processes, even intermediate steps may now be seen as inside information (adaption of the decision of the European Court of Justice in *Geltl/Daimler*).
- Market soundings are enabled under certain conditions, i.e. the disclosure of inside information relevant to potential investors in takeover or merger situations. The disclosing party has to obtain the consent of the person receiving the inside information, inform the person that he/she is prohibited from using this information and obligated to keep the information confidential.
- Increased administrative effort regarding the public disclosure of inside information, such as, maintaining inside information, once disclosed, on the website for at least five years and the possibility of delaying disclosure if this would prejudice legitimate interests of the company and not mislead the public, provided that the company can ensure the confidentiality of the information.
- New market abuse offences such as *attempted* market manipulation and algorithmic or high frequency trading which is solely undertaken to disrupt or delay the trading system as market manipulation.
- Significantly higher administrative sanctions for non-compliance that are dependent on the annual turnover (up to 15%), and the publication of cases of non-compliance by the competent national authority, e.g. the German BaFin, which is supposed to have a great deterrent effect (so called *naming and shaming*). Furthermore, the Member States need to implement the criminal sanctions for market abuse under MAD.

CURRENT DEVELOPMENTS

"Made in Germany" Attracts Foreign Investors

More than three million people in Germany (around 10% of all employees) owe their jobs to foreign investment in Germany. That is the result of a study by Germany Trade & Invest (GTAI), the foreign trade and inward investment agency of the Federal Republic of Germany.

For U.S. companies, Germany is the fourth most important place for investments abroad. For investments into research and development (R&D), Germany is ranked number one: out of the USD 46 billion that U.S. companies have invested into R&D worldwide, USD 7.3 billion have been invested in Germany.

For Japanese companies investing in greenfield projects, Germany is the most important place for investments in Europe. The most interesting sectors for Japanese investors are engineering (24%), followed by automotive (14%) and electronics and semiconductors (14%).

Chinese investments into Germany are also rapidly growing. When it comes to greenfield projects, no

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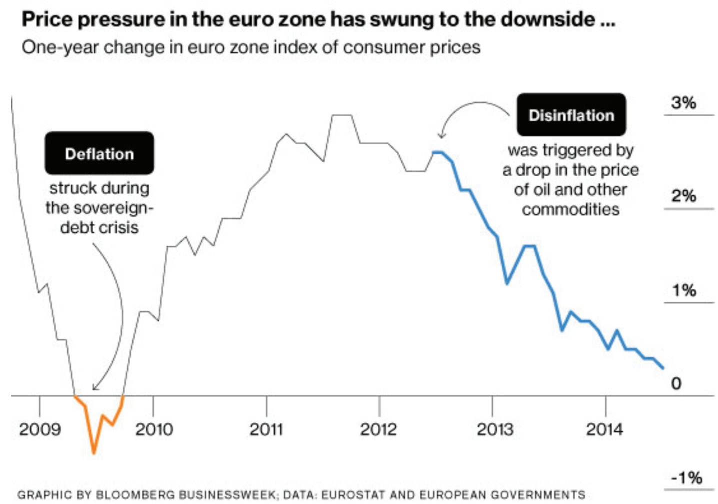
country is more popular with Chinese companies than Germany. In the last few years, more than 1,300 Chinese companies, with 16,000 employees, have been established in Germany.

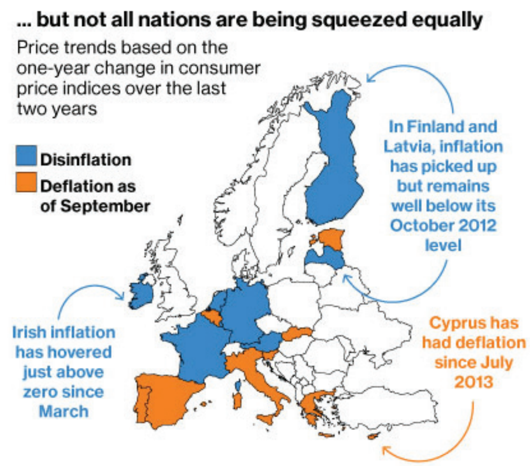
The reasons for investments in Germany are many-fold: its proven technological expertise, the strength in modern manufacturing technology, the quality standards and its highly trained workforce. Other incentives are to gain access to German know-how and a "Made in Germany" label.

Download the study (only in German) www.gtai.de/fdi

Eurozone Faces Disinflation

Over the last year, prices for commodities have been decreasing in Europe, which has also resulted in decreasing prices for goods and services. The Euro region as a whole faces a disinflation, i.e. a slowing inflation but still remaining above zero. Some countries, e.g. Italy, Spain and Greece, are experiencing a deflation, with falling prices and slower hiring trends.





Source: http://www.businessweek.com/articles/2014-10-23/euro-region-faces-deflation

NOTEWORTHY DEALS

ZF Friedrichshafen to Merge with TRW Automotive Holdings

ZF, one of the ten largest automotive suppliers worldwide, headquartered in Friedrichshafen, Germany, is merging with its American car parts rival TRW Automotive Holdings Corp., a supplier for automotive safety, based in Livonia, Michigan. According to the merger agreement, ZF will acquire TRW for approximately USD 12.4 billion, paying USD 105.60 per each share of TRW stock. Prior to this deal, ZF reached an agreement with Germany's Robert Bosch GmbH which acquires ZF's stake in steering components venture ZF Lenksysteme GmbH, and by which a potential large regulatory obstacle for the proposed merger was removed. The transaction is expected to close in the first half of 2015.

Qualcomm to Acquire British CSR

Qualcomm, Inc., a world leader in wireless technology, based in San Diego, California, in the U.S., has announced the acquisition of the entire issued and to be issued ordinary share capital of CSR plc, the fabless semiconductor company, headquartered in Cambridge, United Kingdom, by an indirectly wholly owned subsidiary. The acquisition will strengthen Qualcomm's position in the important growth categories of Internet of Everything and automotive infotainment. Qualcomm has agreed to pay GBP 9.00 per share, amounting to a total transaction value of approximately GBP 1.6 billion. The deal is expected to close in summer 2015.

Siemens to Take Over Dresser-Rand

German technology company Siemens AG has reached an agreement with Dresser-Rand, a world-leading supplier for the oil, gas and energy industries, listed on the NYSE and with headquarters in Houston, Texas, in the U.S. and Paris, France, to purchase all issued and outstanding common shares by way of a friendly takeover bid. Siemens will pay USD 83 per common share in cash, amounting to a total transaction value of approximately USD 7.6 billion, complementing its offering with compressors and turbines for the oil & gas industry.

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United Internet to Acquire Fiber-Optic Network Provider Versatel

German Internet services company United Internet AG, headquartered in Montabaur, Germany, entered into an agreement with private equity company Kohlberg Kravis Roberts & Co. L.P. (KKR) to purchase 74.9% of shares in Versatel GmbH, a Berlin based fiber-optic network provider. KKR manages funds which indirectly hold these stakes. United Internet is paying an amount of approximately EUR 586 million in cash. Upon completion of the transaction, United Internet will gain access to Germany's second-largest fiber-optic network with a length of around 37,000 kilometers, becoming the second-largest DSL provider after Deutsche Telekom.

Bayer Successfully Acquired Consumer Care Business of Merck

German healthcare company Bayer AG has closed the acquisition of the consumer care business of Merck & Co., Inc., expanding Bayer's over-the-counter business. The transaction has a value of USD 14.2 billion. As a result of the transaction, Bayer assumes the global number two position in non-prescription medication, and becomes OTC leader in North and Latin America.

Novartis and GlaxoSmithKline Enter into Major Three-Part Transaction

Swiss pharmaceutical company Novartis AG and British GlaxoSmithKline (GSK) have announced a major three-part transaction: GSK agreed to acquire Novartis' Vaccines Business, excluding the Influenza Vaccines Business, by a payment in the amount of USD 5.25 billion. Furthermore, both parties reached an agreement to form a consumer healthcare joint venture through the combination of GSK's Consumer Healthcare Business and Novartis' OTC Business, with GSK holding the majority control with an interest of 63.5%. At the same time, Novartis acquires the Oncology business of GSK for an amount of USD 16 billion. The deal is said to be the most significant transaction for GSK since its creation in 2000.

Pfizer Fails to Acquire British-Swedish Rival Astra-Zeneca

U.S. pharmaceuticals company Pfizer, Inc. has failed to take over the British-Swedish drug-maker Astra-Zeneca plc. Pfizer offered to pay GBP 55.00 per share, amounting to a total value of GBP 69.4 billion, which was rejected by Astra-Zeneca's management which asked for, at least, GBP 58.50 per share to consider entering into negotiations. According to UK takeover rules, Pfizer has to rest for a mandatory cooling-off period of six months following the initial bid. However, a new approach is less likely since the U.S. government announced a clampdown against tax inversion by means of merging and shifting the corporate tax domicile overseas. Another reason for the failure is said to be the concern raised by UK politicians that, after the closing of the transaction, Pfizer might reduce the workforce, putting jobs at risk. The deal would have formed the world's largest drug manufacturer.

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