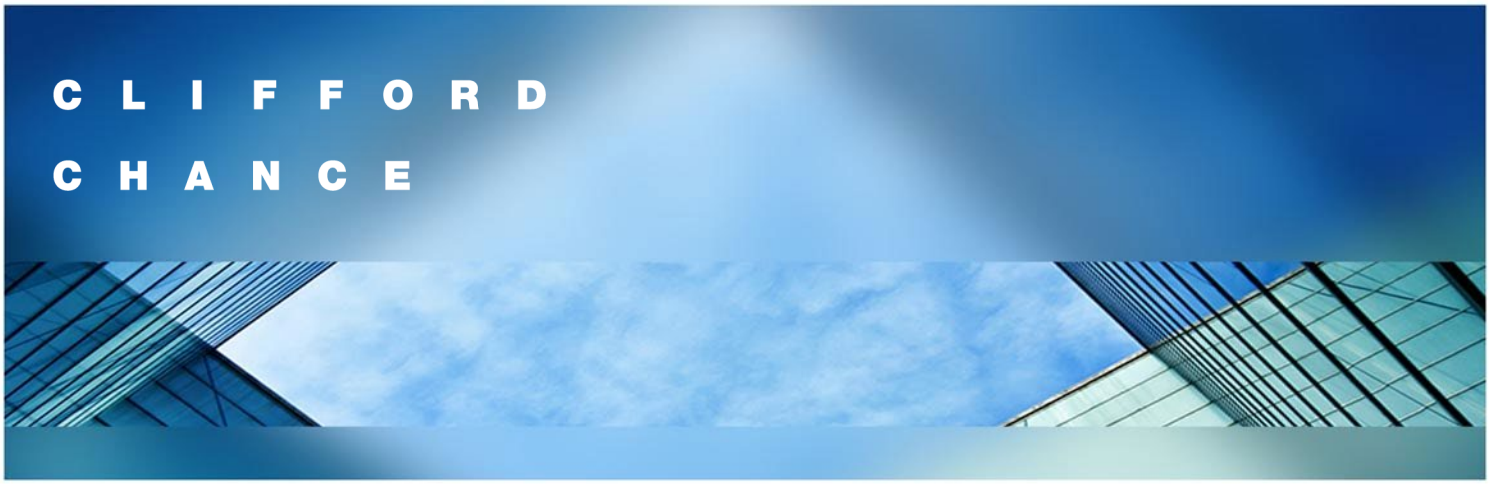

THE EUROPEAN COMMISSION EXPANDS ITS REMIT FOR MERGER CONTROL REVIEW

The European Commission (the "**Commission**") has published its long-anticipated guidance on its revised approach to the referral mechanism under Article 22 of the EU Merger Regulation (the "**Guidance**"). The new approach means that a national competition authority of an EU Member State ("**NCA**") can initiate a referral of a merger to the Commission, for review under the EU Merger Regulation, even if that transaction is not notifiable under the NCA's own merger control laws, or indeed those of any other EU member state. The Guidance represents a material departure from the Commission's previous practice and is expected to have significant ramifications for certain types of transactions.[1]

Key issues

- The Commission has published long-awaited Guidance on the new approach to the referral mechanism under Article 22.
- The Guidance confirms that the new approach is primarily intended to capture acquisitions of nascent competitors whose turnover does not reflect their actual or potential market position, to fill a perceived gap in merger control enforcement.
- The Guidance signals a major expansion of the Commission's merger control jurisdiction and introduces significant legal uncertainty as well as potential delays to current and future deal timetables.

Background to the Guidance

Article 22 of the EU Merger Regulation ("**Article 22**") enables one or more NCAs to request the Commission to review a transaction where the transaction affects trade between Member States and threatens significantly to affect competition within the territory of the Member State(s) making the request.

The Article 22 mechanism was initially introduced in 1989, when a number of Member States had yet to establish national merger control regimes, to ensure that potentially problematic transactions would not escape antitrust scrutiny and could be reviewed by way of referral to the Commission.

In recent years, following the adoption of national merger control regimes by nearly all Member States, the Commission's informal policy had been to discourage NCAs from requesting referrals in relation to transactions that did not meet the national merger control thresholds. It was the case, however, that once a competent NCA had initiated a referral request, NCAs lacking jurisdiction under their national merger control laws could join that request, thus allowing the Commission to assess the impact of the transaction in the latter Member States as well.

The new Guidance, published on 26 March 2021, confirms previous statements by Commissioner Vestager,[2] that the Commission has reversed its previous position and, from now on, intends to *encourage and accept* referrals initiated by NCAs even in respect of transactions for which these NCAs themselves lack jurisdiction. This shift in policy is driven by a perceived "enforcement gap" which allowed potentially problematic transactions (especially "killer acquisitions" of nascent competitors) that fell below EU and national merger

1 Commission Guidance on the application of the referral mechanism set out in Article 22 of the Merger Regulation to certain categories of cases.

2 Margrethe Vestager, The Future of EU Merger Control, 11 September 2020. See our earlier Client Briefing, *New Approach to Article 22 EUMR – A back door to close the "enforcement gap"?*

control thresholds to complete without review. The Guidance cites the digital economy and the pharmaceutical sectors as examples where such transactions are most likely to occur.[3]

The legal basis and process for referrals

The Guidance reflects a change in the Commission's approach to Article 22 but leaves unchanged the text of Article 22 and the applicable legal criteria for referrals by NCAs.

The substantive criteria remain that the transaction being referred must (i) affect trade between Member States and (ii) threaten significantly to affect competition within the territory of the Member State(s) making the request.

- **The first condition** has a broad ambit. The Commission will consider whether the transaction could have a *direct or indirect, actual or potential* impact on trade between Member States. The Guidance gives the Commission discretion to take into account a wide range of factors, including a very tentative nexus with the EU, including for example, R&D projects whose results, including intellectual property rights **may be commercialised** in more than one Member State.[4] The UK's Competition and Markets Authority ("**CMA**") has recently taken a similar position in its review of Roche's acquisition of Spark Therapeutics where, to establish its jurisdiction despite the fact that Spark was not marketing any products in the UK, the CMA argued *inter alia* that Spark's global R&D activities formed "*an integral part of the process of making* [the products] *available in the UK*" in the future.[5]

- To satisfy **the second condition**, the NCA needs to demonstrate, on a preliminarily basis and based on *prima facie* evidence, that there is a real risk that the transaction may have a significant adverse impact on competition. The Guidance sets out a range of relevant considerations in this regard, including the elimination of future or recent entrants, a merger between two important innovators, and the reduction of competitors' ability and/or incentive to compete.[6]

As detailed below, these substantive conditions evoke broad concepts which complicate the merging parties' *ex ante* assessment of the likelihood of a referral being accepted by the Commission.

Article 22 provides that a Member State must make a referral request within 15 working days of either (i) the transaction being notified to it or (ii) in the absence of a notification, the transaction being "made known to the Member State concerned," which implies that the NCA has received sufficient information to make a preliminary assessment as to whether the criteria for making an Article 22 referral request are met. This starting point is itself difficult to establish and may lead to a long period of uncertainty in respect of transactions that do not make headlines across the EU. Once notified of the request by the Commission, other Member States have 15 working days to join the referral request, following which the Commission has up to 10 working days to decide whether it will accept the referral.

The process before the Commission will then typically begin with an informal pre-notification phase before a formal filing can be made and the 25 working day Phase 1 review timeline commences. In this regard, while the Commission's acceptance of a referral does not

Key issues (cont.)

- The Guidance seeks to clarify the criteria for making and accepting referrals but fails to provide sufficient legal certainty as the criteria remain overly broad.

- The combination of the Guidance and the Digital Markets Act (once in force) will undoubtedly lead to a larger number of transactions entering the Commission's radar and potentially becoming notifiable.

3 Guidance, paragraphs 9-10.

4 Guidance, paragraph 14.

5 ME/6831/19 - Roche Holdings, Inc / Spark Therapeutics, Inc merger inquiry, Final Report, paragraph 94.

6 Guidance, paragraph 15.

prejudice the outcome of the substantive review, transactions referred under Article 22 have to date rarely been cleared without conditions after a Phase 1 review process.[7]

While referrals are technically at the discretion of the Member States, the Guidance notes that the Commission can *invite* Member States to make a request in respect of transactions that it considers as meeting the relevant criteria for referral under Article 22 EUMR.[8]

Which categories of cases does the Commission highlight as appropriate for a referral?

The Commission has previously emphasised that transactions in the digital and pharmaceutical sectors are at the centre of the revised referral policy, as competition in these industries may be driven by new products or services and therefore a company's importance on the market may not be reflected in its turnover.[9]

The Guidance confirms this reasoning and provides a non-exhaustive list of transaction types where the turnover of at least one of the parties does not reflect its current or future competitive potential. These include cases where one of the parties:

- is a start-up or recent entrant with significant competitive potential that has yet to develop or implement a business model generating significant revenues (or is still in the initial phase of implementing such business model);
- is an important innovator or is conducting potentially important research;
- is an actual or potential important competitive force;
- has access to competitively significant assets (such as for instance raw materials, infrastructure, data or intellectual property rights); and/or
- provides products or services that are key inputs/components for other industries.

In addition, the Commission may take into account whether the value of the consideration is particularly high compared to the turnover of the target.

What does the Guidance mean for transactions?

Below we examine the key practical implications of the Guidance for merging parties and their legal advisors, in particular with respect to deal negotiations and timing:

- **Increased complexity of jurisdictional assessment**: Under the revised approach to Article 22, falling below the EU and national merger control thresholds will no longer suffice to exclude antitrust risk. This means that, even in jurisdictions where there are no revenues, or where the national thresholds are not met, parties to some deals may need to assess whether the transaction is nonetheless likely to be deemed to "significantly affect competition," bearing in mind the very broad yet non-exhaustive list of factors identified by the Commission in the Guidance. Depending on the facts of the case and the relevant sector, such an assessment may be far from clear-cut and may lead companies to seek informal comfort from the Commission and/or NCAs on the (un)likelihood of the proposed transaction being referred under Article 22.
- **Third party risks**: The Guidance confirms that third parties may contact the Commission or NCAs to notify them of transactions which may be a candidate for referral under Article

[7] Over half of the Article 22 referrals have led to Phase 1 or Phase 2 decisions with conditions & obligations, prohibitions or filing being withdrawn.

[8] Guidance, paragraph 26.

[9] Margrethe Vestager, The Future of EU Merger Control, 11 September 2020

22.[10] While the Commission and NCAs have no obligation under Article 22 to take action following such communications, the possibility of third party intervention nevertheless adds an additional element of uncertainty to deal considerations.

- **Complexity of merger review proceedings**: Article 22 referrals are an exception to the "one-stop-shop" principle that applies in the EU: the Commission only has jurisdiction to review the impact of the transaction in the *referring* Member States, which means that NCAs that did not join the referral request remain competent to review the same transaction if their national filing thresholds are met. The Commission has also clarified that it may accept referrals even if a filing has already been made in one or more Member States which did not request or join the referral. This will increase the risk of parallel review by the EC and NCAs, creating an additional burden for the parties.

- **Reduced legal certainty as transactions can be referred even post-closing**: While Member States are in principle required to request a referral within a short timeframe (15 working days), this period does not start until the NCA has received "sufficient information to make a preliminary assessment as to whether the criteria for making an Article 22 referral request are met," which may occur very late in the process, and potentially following completion. The Commission has clarified in its Guidance that it will accept referrals even if these are submitted after the transaction has closed and that, while it would generally consider that a referral is no longer appropriate if more than six months have elapsed since closing, this six-month period would only start from the moment material facts about the transaction have been made public in the EU. Moreover, the Commission may decide to review a transaction even after this six-month period in exceptional cases (*e.g.*, based on the magnitude of potential competition concerns and effects on consumers).[11] Once the Commission informs the parties that a referral request has been made, the transaction may not complete prior to receiving clearance, even if the transaction did not trigger mandatory and suspensory merger control filings in any EU member state.

With this change in the application of Article 22, the Commission has succeeded in considerably expanding the reach of its merger control regime, without entering into a lengthy EU legislative process to amend the text of the EU Merger Regulation. The significance of this new approach to Article 22 should also be considered in light of the Commission's draft Digital Markets Act[12] ("**DMA**"), which proposes a duty for so-called "digital gatekeepers" to inform the Commission of all their transactions in the digital sector.

While the DMA reduces uncertainty regarding filing obligations for digital gatekeepers, non-gatekeepers and businesses operating in other sectors face a choice between approaching the Commission or NCAs to obtain comfort (but without much legal certainty) or simply waiting (with no legal certainty). Parties therefore need to consider the likelihood of the Commission accepting a referral and the risks related to completing a transaction prior to the Commission taking jurisdiction. Parties may also consider taking this risk into account in the transaction documents (*e.g.*, in determining the closing conditions or the transaction's long-stop date), which makes receiving antitrust advice early in the process critical.

What next?

For stakeholders hoping that it would shed light on how such referrals would work in practice, the Guidance will likely come as a disappointment: this document seems designed to encourage NCAs to request referrals and allow flexibility in reviewing transactions which do not meet EU or national thresholds, and does not provide much legal certainty to businesses.

10 Guidance, paragraph 25.

11 Guidance, paragraph 21.

12 The DMA is currently undergoing the EU legislative process and its final form is not yet confirmed.

In practice, much will still depend on the proactivity of the Commission in inviting NCAs to request referrals and on the NCAs' appetite to request referrals of transactions falling below the national thresholds. While the French Competition Authority has already made public its intention to make use of this new tool and request referrals of cases that fall below national thresholds, other NCAs may be more reluctant.

The Commission's ongoing consultation into simplifying the merger control regime,[13] including by expanding the categories of simple cases and by streamlining the information required during the review process, offers scope for cautious optimism that the burden imposed on parties under the new approach to Article 22 may be partly offset by a simpler merger review process in the future.

13 Commission impact assessment: Revision of certain procedural aspects of EU merger control, 26 March 2021.

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