New EU Guidance Creates Legal Uncertainty for Merger Control and a *De Facto* 'Killer Acquisition' Review Power

Skadden

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One Manhattan West
New York, NY 10001
212.735.3000

Avenue Louise 523
1050 Brussels, Belgium
32.2.639.0300

The new Article 22 EU Merger Regulation (EUMR) Guidance[1] released by the European Commission (EC) enables the EC to review any acquisition, even those that do not qualify for notification under national (or EU) merger control rules.

Summary

- The new guidance indicates that the EC will actively monitor deal activity to identify transactions that may be candidates for an Article 22 referral. While a formal referral request should be made by a national competition authority (NCA), the EC will "encourage and accept" referrals and may proactively "invite" NCAs to make referrals, even if national merger control thresholds are not met. This is a major policy reversal, as the EC has previously always discouraged referrals of transactions from NCAs that lacked jurisdiction under their own merger control laws.
- The new guidance reflects the EC's policy focus on deals that involve high-value target entities that have low or no revenue and therefore fall below the merger control thresholds for review by the EC and most EU member states.
- The guidance suggests the existence of merger control review in one or more member states will be a factor in assessing whether a referral is warranted.
- The new approach is applicable to any deal globally with even the potential to affect the EU, although the scope of the EC's review would be limited to implications in the member states that have requested the referral.
- Once the EC informs companies that a referral request has been made, they are prevented from implementing the acquisition until completion of the investigation. Completed transactions can be subject to post-closing investigation, although the guidance suggests such investigations commence within a six-month cutoff period from the time at which the deal's material facts are "made known."
- The first case to fall under the new approach, *Illumina/Grail*, involved a transaction that did not meet the thresholds for review in any EU member state.[2] The EU requested the French and Dutch authorities refer the deal to the EC five months after the transaction was announced.
- The revised guidance should be considered in conjunction with legislative reforms for the digital sector (*e.g.*, the Digital Markets Act), which, once enacted, will require designated gatekeeper companies to inform the EC of any acquisition.
- The policy development suggests that parties should address the greater potential for an EC referral in their acquisition agreements and make early assessments whether, based on a substantive assessment of the deal parameters, a transaction may be deemed a candidate for referral, and therefore if briefing the EC may be advisable.

[1] Commission Guidance on the application of the referral mechanism set out in Article 22 of the Merger Regulation to certain categories of cases, 26 March 2021. The guidance complements the Commission Notice on Case Referral in respect of concentrations of 2005.

[2] Notably, no German or Austrian notification has occurred despite the transaction meeting the German and Austrian deal value thresholds, most likely because the German and Austrian nexus requirements (that there be some local impact) were not satisfied.

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Background

The guidance release follows the announcement in September 2020 by Margrethe Vestager, the EC commissioner for competition and executive vice president overseeing digital matters , that the EC would start using Article 22 more expansively to address the "handful of mergers each year that could seriously affect competition, but which we don't get to see because the companies' turnover doesn't meet our thresholds."[3]

The new policy focuses mainly on acquisitions, often by tech and pharma incumbents, of innovative potential rivals in their nascent stages which have generally been referred to as "killer acquisitions." The guidance primarily applies to acquisitions of small (or no) revenue targets that are or may become competitively significant through their access to or impact on competitively valuable assets, such as raw materials, IP, data or infrastructure.

- To be referred, transactions must affect trade between member states and threaten to significantly affect competition within the territory of the member state or states making the request. The guidance defines both concepts in broad terms, giving the EC and NCAs ample discretion.
- NCAs have 15 working days to refer a transaction after it is "made known" to them (with "made known" defined as implying sufficient information to make a preliminary assessment of the existence of the criteria relevant for the assessment of the referral). A referral remains possible even after a transaction has closed, ideally to commence within the six months after closing, though a later referral may be appropriate depending on the magnitude of the competition concerns.

Perceived Enforcement Gap

Debate has continued for years in the EU about whether the EC might be missing useful reviews of certain acquisitions by incumbents of nascent competitors, particularly in the tech and pharma industries, that could play a significant competitive role in the market in the future despite generating little or no revenues at the moment of the transaction.

Such transactions would not typically meet the EU's high revenue-based notification thresholds, and may also escape merger control review at a national level in the EU, as national thresholds typically require at least a minimum level of local target revenues or a market share increment.

[3] The Future of EU Merger Control, Speech at IBA Annual Competition Conference, 11 September 2020.

Following several years of consultations and related analysis and debate, as summarized in the EC Staff Working Paper published together with the guidance, the EC concluded that "a number of cross-border transactions which could potentially have a significant impact on competition in the EU internal market have escaped review by both the Commission and the Member States."

Major Policy Reversal Without Legislative Change

To bridge this perceived enforcement gap, the EC first explored adopting revised notification thresholds at the EU level, including some based on the value of the transaction, as have been introduced in Germany and Austria. However, revised thresholds would have required legislative change, and potentially involved implementation challenges. The EC also doubted the effectiveness of such new non-revenue-based thresholds to bridge any enforcement gap, considering that Germany and Austria have yet to capture any additional problematic transactions through these thresholds since they took effect in 2017. Instead, the EC chose to revisit its existing powers under Article 22 EUMR, enabling its new policy to take effect immediately, without the need for input from legislators.

Article 22, famously known as the "Dutch" clause, was inserted into the EUMR at the Netherlands' request in 1989, because the country did not then have a merger control regime and wanted to be able to ask the EC to review deals that might harm competition. Importantly, however, in the years thereafter, almost all EU member states developed their own merger control regimes, and therefore it has been the EC's long-standing policy not to accept referrals of transactions that did not trigger national merger control laws. The guidance confirms this, justifying the EC's practice "based on the experience that such transactions were not generally likely to have a significant impact on the internal market."

Article 22 became a means for one or more concerned NCAs to refer to the EC an acquisition that seemed to generate EU-wide issues, serving as the vehicle by which deals well below the EU merger revenue thresholds, but potentially of wider interest, might be reviewed at the EU level. Recent examples include Johnson & Johnson/Tachosil (referred in 2019 by Germany and followed by five other NCAs) and Apple/Shazam (referred in 2018 by Austria and followed by six other NCAs). Still, Article 22 remained a rarely used provision, with only 10 referrals occurring between 2014 and 2020.

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Supercharged Referral Procedure, Major Uncertainties for Businesses

Framework

According to the new guidance, the EC will actively work with NCAs to identify transactions that may be potential candidates for a referral, even if the relevant company revenues do not meet any national notification thresholds. Merging parties looking for an "early indication" of the risk of a referral may voluntarily present their deal plan to the EC. Also, third parties may identify to the EC or the relevant NCAs possible referral candidates. If the EC is interested in gaining jurisdiction, it may inform the NCAs potentially concerned and "invite" them to make a referral request.

The EC will inform merging parties "as soon as possible" if a referral request is being considered, and they can choose (but are not obliged) to delay closing until a decision has been made on whether a referral request will occur. However, once the EC informs the parties that a referral request has effectively been made, a suspension obligation applies, and closing of the deal cannot take place until the EC has come to a final decision approving the transaction. The suspension obligation is lifted if the EC subsequently decides not to examine the transaction. In any event, NCAs can still request a referral even if a transaction has already closed, provided that the closing remains within the time frames identified.

A request for a referral pursuant to Article 22 must be made within 15 working days from the date of notification. Per the EC's new policy, NCAs that have no jurisdiction under national merger control laws to review a transaction may request a referral to the EC, provided they do so within 15 working days of the date on which the transaction is "made known" to the member state concerned. The EC should inform NCAs and the parties without delay once a referral request has been made, following which other NCAs have 15 working days to join the initial request. At the latest, 10 working days after the expiry of that deadline, the EC may decide to take up jurisdiction to review the competitive effects of the transaction within each of the member states for which the referral is accepted. If the EC does not make a decision within this period, it is deemed to have accepted and to be reviewing the transaction in accordance with the request.

Notably, a situation where a transaction has already been notified to one or more NCAs that did not request a referral or join a referral request is not a sufficient basis to rule out a referral to the EC by other NCAs that lack competence under their national merger control laws. However, the existence of merger control review in one or more member states will be a factor in assessing whether a referral is warranted.

Criteria for Referral

To quality for referral under Article 22, a transaction must affect trade between member states and threaten to significantly affect competition within the territory of the member state or states making the request.

Regarding effects on trade, the guidance highlights that a company's actual, current presence is not required, with the referral eligibility test being met once a transaction may have an influence, direct or indirect, actual or potential, on the pattern of trade between member states. The guidance refers to a number of specific factors, including the location of (potential) customers, the availability and offering of the products or services at stake, the collection of data in several member states, or the development and implementation of R&D projects whose results, including intellectual property rights, if successful, may be commercialized in more than one member state.

A significant effect on competition may be established on a *prima facie* basis, and without prejudice to the outcome of a full investigation. The guidance nonexhaustively refers to a number of theories of harm, both horizontal and nonhorizontal, including the creation or strengthening of a dominant market position of either the target or the acquirer; the elimination of an important competitive force, including the elimination of a recent or future entrant or the merger between two important innovators; the reduction of competitors' ability and/or incentive to compete, including by making their entry or expansion more difficult or by hampering their access to supplies or markets; or the ability and incentive to leverage a strong market position from one market to another by means of tying, bundling or other exclusionary practices.

Primary Candidates for Referral

The guidance indicates that the EC is mainly concerned with transactions where the revenues of at least one of the parties do not reflect its actual or future competitive potential. The guidance provides a nonexhaustive list of examples, including cases in which the target (i) 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), (ii) is an important innovator or is conducting potentially important research, (iii) is an actual or potential important competitive force, (iv) has access to competitively significant assets (such as raw materials, infrastructure, data or intellectual property rights), and/or (v) provides products or services that are key inputs/components for other industries. The guidance further clarifies that, although there will be no dedicated thresholds based on the value of the transaction, the EC will take into account whether the value of the consideration received by the seller is particularly high compared to the current target revenues.

Time Frames and Process

The guidance lacks clear limitations on the time period for making a referral request.

According to the guidance, NCAs have 15 working days to request a referral after a transaction is "made known" to them, clarifying that this "should be interpreted as implying sufficient information to make a preliminary assessment as to the existence of the criteria relevant for the assessment of the referral." Further practice will have to determine what form would satisfy these factors.

Regarding transactions that have closed, the guidance states that the time elapsed since closing is "a factor" that the EC may consider, and that it "would generally not consider a referral appropriate when more than six months have passed," without specifying when that time period would start. The guidance also clarifies that the EC may accept a later referral, for example, based on the magnitude of the potential competition concerns and the potential detrimental effect on consumers, leaving a material degree of uncertainty as to the potential time frame for review.

Outlook and Implications

The new guidance reflects a landmark change for dealmakers, as an EC filing can no longer be excluded solely because none of the applicable bright-line revenue thresholds at the EU or national level are exceeded. Moreover, lack of clarity on the applicable time frames for such review leaves companies with material uncertainty, not only regarding the scope of applicable merger control review, but also regarding the potential risk of merger enforcement post-closing.

The new guidance has taken immediate effect, and Article 22 has already become a basis for expanded merger control review. Several weeks prior to the adoption of the guidance on March 26, 2021, the EC reportedly invited NCAs to make an Article 22 referral of Illumina's proposed acquisition of Grail, although that transaction reportedly would not meet any national notification thresholds in the EU. The French and Dutch NCAs subsequently agreed to request a referral, and national courts have confirmed their right to do so. Additionally, the Belgian NCA is understood to have signaled its intent to join the referral request.

The director-general for the EC Directorate General for Competition, Olivier Guersent, has publicly indicated that once the EC has gathered initial case experience, the Article 22 EUMR Guidance may be updated fairly quickly to reflect that experience. Also, merging parties may challenge EC decisions on referral eligibility before the EU courts, whose deliberations may also provide further clarity on the EC's new policy.

Meanwhile, merging parties will need to carefully analyze whether their transaction presents an Article 22 referral risk, irrespective of whether the transaction is notifiable to one or more NCAs. Parties will need to assess every case on its merits in each relevant member state to determine whether to proactively contact the EC and/or relevant NCAs to set out why the transaction is not a suitable candidate for a referral (similar to submitting a briefing paper, as is common in the U.K.), to volunteer a filing, or to close the transaction and run the risk of enforcement at a later stage. This assessment should also factor in the risk that third-party complainants may generate support for an Article 22 referral directly with the EC and NCAs. Finally, transaction documents should include the risk of an Article 22 referral in the analysis regarding closing conditions, long-stop dates, risk allocation and cooperation provisions.

Contacts

Bill Batchelor
Partner / Brussels
32.2.639.0312
bill.batchelor@skadden.com

Giorgio Motta
Partner / Brussels
32.2.639.0314
giorgio.motta@skadden.com

Niels Baeten
Associate / Brussels
32.2.639.0321
niels.baeten@skadden.com

Frederic Depoortere
Partner / Brussels
32.2.639.0334
frederic.depoortere@skadden.com

Ingrid Vandenborre
Partner / Brussels
32.2.639.0336
ingrid.vandenborre@skadden.com