URÍA MENÉNDEZ

The European Commission's new policy to broaden the scope of merger control

Reinterpretation of the merger-referral mechanism to the European Commission

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Introduction

The European Commission has recently issued Guidance on the application of the referral mechanism established in Article 22 of the Merger Regulation. The Guidance allows the Commission to review transactions that meet neither European nor national notification thresholds. To date, such transactions have not been subject to prior review and clearance by the European Commission. The change in approach has created significant legal uncertainty (especially, among others, in the technology, health/pharmaceuticals and digital-market sectors) that will affect transactions' calendars and risk assessment, which will have to be carried out on a case-by-case basis.

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

The European Commission (the "**Commission**") has decided to implement a radical shift in connection with merger analysis and has *de facto* extended its authority to review specific transactions that it could not previously review (or, as asserted by the Commission, it had refrained from reviewing). Until now, concentrations that did not meet the thresholds for notification to the Commission or to Member States' national competition authorities (individually an "**NCA**" and, collectively, the "**NCAs**") could be implemented without prior notification and clearance, and there existed no risk of subsequent review by the Commission. The situation has changed drastically since last 26 March with the Commission's adoption of Guidance on the application of the referral mechanism under Article 22 of Council Regulation 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the "**Guidance**" and "**Merger Regulation**", respectively).

The Guidance will undoubtedly create significant legal uncertainty in M&A transactions given that it establishes the possibility of the Commission reviewing transactions that, without reaching the thresholds for notification to the European Union (the "**European Union**" or "**EU**", indistinctively) or the NCAs, affect trade between Member States and threaten to significantly affect competition. This review can be carried out both before the transaction is implemented and after its execution for an unspecified period of time, although it appears that the period should not exceed one year.

The goal of this new policy is to capture "killer acquisitions", as well as other types of acquisitions of companies that, despite having little or no turnover, either play, or have the potential to play, an important role in terms of market competition. While the Commission acknowledges that these transactions typically take place in the pharmaceuticals sector or in the context of the digital economy, the Guidance expressly states that the Commission's new interpretation could be extended to other sectors.

The manner in which the Commission's powers was chosen to be extended involved reinterpreting the mechanism for referrals of concentrations by national authorities to the Commission established in Article 22 of the Merger Regulation. To date, the Commission's approach has been to review transactions referred by national authorities only when the national authorities had jurisdiction over the concentration (i.e. the notification thresholds were met in at least one EU Member State) and the transaction had effects on trade between Member States and significantly threatened competition in the State requesting the referral. After issuing the Guidance, the Commission intends to accept referral requests even if the transactions do not meet the thresholds of either the Commission or those of any Member State; the Commission will even encourage national authorities to refer cases in which the transaction could constitute a "risk to competition in the European Union".

This change – which may potentially go unnoticed by many given that it is not an actual legislative amendment – is of immense practical significance in connection with the design and execution of M&A transactions. Firstly, it will require an analysis of the competition risks of the transaction that goes far beyond the mere verification of whether or not the notification thresholds are met, as has been the case to date. It will therefore be necessary to assess the best strategy on a case-by-case basis to limit the risk of the transaction being referred to the Commission or, at the very least, to obtain some certainty as to whether the risk is sufficiently high so as to require appropriate contractual clauses to cover the risk. Lastly, but not least, it will necessitate taking into account the impact that the new policy may have on the calendar for closing the transaction in order to adapt, if necessary, the long-stop-date clauses.

In short, the Guidance represents a highly controversial shift that will undoubtedly likely give rise to future litigation in EU courts. In the meantime, it is important to take this development into account, as it has the potential to significantly complicate and delay a transaction if the implications of the Guidance have not been properly taken into consideration at an early stage.

Background: the European merger-control regime and referral mechanism

1) The distribution of powers and jurisdiction between the Commission and Member States

The European merger-control regime establishes a dual, exclusionary system. The Commission retains jurisdiction and authority to review specific concentrations while NCAs have authority to review others. If the requirements (known as "thresholds") for notification to either the Commission or the Member States are not met, the transaction need not be notified prior to implementation or reviewed *ex-post* by the competition authorities (i.e. the Commission or the competition authorities of the 27 Member States) and, thus, the concentration is not subject to a standstill obligation.

The Commission, in turn, retains exclusive jurisdiction to review mergers that exceed substantially high turnover thresholds, as set out in Article 1 of the Merger Regulation. These thresholds are based on the turnover generated by the undertakings concerned in the preceding fiscal year and, where appropriate, any subsequent variations until the signing of the transaction. If these thresholds are met, the transaction must be notified to the Commission. Moreover, the transaction must receive clearance from the Commission before being implemented; otherwise the parties may face fines for gun jumping.

If the transaction does not meet the thresholds for mandatory notification to the Commission, an assessment of whether the thresholds for prior notification to any of the competition authorities of the Member States are met must be made, with the transaction remaining at a standstill until authorisation is obtained.

National notification thresholds are set by each Member State on the basis of the competition and economic-policy criteria they consider appropriate (i.e. which transactions they consider to be potentially "dangerous" for future competition and those they do not). By way of example:

- in some Member States, the thresholds are linked exclusively to the parties' turnover of the parties, which must have some connection with the corresponding Member State;
- in others, however, such as in Germany and Austria, additional thresholds pertaining to the value of the transaction were introduced in 2017. The goal was to ensure that transactions in which the target

had limited turnover – but a high competitive potential in the future – would not circumvent the *ex-ante* control of the competition authorities;

- in other Member States – notably Spain and Portugal – in addition to turnover thresholds, alternative market-share thresholds of the concerned parties also apply. The market-share threshold makes it possible to capture transactions in small markets or markets where the parties have low turnover, but where the target is expected to have significant market position. In Spain, market shares are calculated on the basis of past turnover; in Portugal, depending on the case, projected future turnover can also be taken into account in exceptional cases.

Under the system described above, the distribution of authority and jurisdiction between the Commission and the NCAs to review a merger was relatively clear. While Merger Regulation established specific exceptions, they were generally, as explained below, well defined and limited, which afforded legal certainty to operators who decided to carry out transactions. Most importantly, one issue was entirely clear: if a transaction did not meet either the European or national notification thresholds, it would not be subject to the obligation of prior notification to any competition authority in the EU.

2) The exception of Article 22 of the Merger Regulation – The mechanism for referral of concentrations from Member States to the Commission

One of the exceptions to the distribution of jurisdiction between the Commission and the Member States is the "referral mechanism" established in Article 22 of the Merger Regulation. This mechanism allows **one or multiple Member States to request that the Commission** review a transaction that the Commission did not initially have authority to review since the European notification thresholds were not met.

Under Article 22, referral requests could only be made if the concentration met two requirements: ***(i)*** it affects trade between Member States and ***(ii)*** it threatens to significantly affect competition in the territory of the Member State requesting the referral.

If a Member State decided to refer a merger under Article 22 other Member States could join that request within a specified period of time. Once the Commission received the request, it adopted a decision accepting or declining the referral.

- *If the Commission accepted the referral request*, the States making (or joining the request) the request ceased to have jurisdiction over the merger, and the Commission analysed the concentration and adopted a decision on the merits taking into account the impact of the transaction on the Member States making (or joining) the referral request, in addition to trade between Member States in general. Member States that did not make a referral request – or that did not join to it – were entitled to analyse the merger in parallel if their national notification thresholds were met, limiting their substantive analysis to that particular Member State.

- Conversely, *if the Commission did not accept the referral*, there was no alteration of the distribution of authority under the Merger Regulation. In such case, the States requesting the referral (and the joining Member States) would review the transaction if it fulfilled the national notification thresholds, applying their national merger-control rules.

When deciding whether to accept a referral under Article 22(1) of the Merger Regulation, the Commission generally took into consideration ifthe referred transaction was likely to adversely affect competition in multiple Member States and whether the Commission was better placed than the NCAs to review the transaction. This was often the case where the affected markets had a European dimension and commitments to divest assets or other remedies would be necessary in order to authorise the transaction, with a scope going beyond the territory of the Member States requesting the referral.

Finally, Article 22(5) establishes that **the Commission itself** may identify the existence of a significant risk to competition and in trade between Member States, thus **inviting** the NCAs to request the referral of the transaction to the Commission (if they have not previously done so on their own initiative).

3) The interpretation of Article 22 of the Merger Regulation to date: referral is only possible if the notification thresholds are met in at least one Member State

Article 22, known as the "Dutch clause", has its origins in an atypical and anachronistic situation that no longer exists. Historically, the Netherlands lacked their own merger-control rules and requested the inclusion of a provision in the previous European regulation of 1989 that would allow the Dutch authority to refer mergers to the Commission that could significantly affect competition in that State and that escaped their national legislation.

Currently, every EU Member State other than Luxembourg has its own merger-control legislation, and hence, the original rationale of Article 22 of the Merger Regulation has become obsolete. The Commission had therefore made it clear in its decision-making practice, including in working papers reviewing the merger-control framework, that it discouraged referral requests from Member States that lacked jurisdiction over the case. In practice, this meant that if the transaction did not meet the notification thresholds in the State requesting the referral of the case, the Commission would not grant the request. Consequently**, if the transaction did not meet the notification thresholds in any Member State, the transaction was not in practice subject to any *ex-ante* or *ex-post* merger-control procedure**.

The logic behind the Commission's interpretation of Article 22 of the Regulation was relatively clear: given the existence of merger-control rules in the Member States, which set their own mandatory notification thresholds, and the existence of mandatory notification thresholds to the Commission, it was expected that transactions that did not meet the European or national notification thresholds should not have a significant adverse impact on competition. Therefore, in such cases, transactions do not merit review by the Commission either pre or post-closing.

4) Reasoning behind the Commission's recent interpretative change to Article 22 by virtue of the Guidance

It is inherent to the scheme of distribution of authority and jurisdiction described in the preceding sections that, if at some point the Commission or the Member States considered specific types of "risky" transactions were escaping the Commission's control, the most desirable option, and which would have afforded greater legal certainty to market participants, would be to modify the national-notification thresholds to adapt them to current circumstances. In fact, this was the path taken by Germany and Austria a few years ago when they introduced transaction-value thresholds to capture high-risk concentrations in which the target's business model had not yet generated sufficient revenue to meet the traditional turnover thresholds. Therefore, the Commission was able to learn through the Article 22 referral mechanism about transactions in the digital sector such as ***Apple/Shazam*** (initially referred by Austria in 2018 and subsequently joined by six other national authorities) or in the biotech/pharma sector, such as ***Johnson & Johnson/Tachosil*** (referred to the Commission in 2019 by the German authority, with five other Member States' national authorities joining the referral request).

Another option would be for the Commission to modify the thresholds of the Merger Regulation and establish clear criteria for notification and prior authorisation in order to capture the transactions that it considers most dangerous and that are currently beyond its reviewing powers, thereby respecting the principle of legal certainty. Indeed, this possibility was recently raised; however, after considering various alternatives, the Commission opted for a different approach, allowing it to achieve the same objective with heightened flexibility, discretion and, most importantly, without requiring a legislative amendment.

This option consists of **reinterpreting** Article 22 of the Merger Regulation through Guidance, **encouraging Member States to refer** transactions to the Commission that do not meet national or European notification thresholds when it considers that they may affect trade between Member States and generate significant risks to effective competition.

The European Commission's new approach to the referral of transactions

1) Main goal: capturing "killer acquisitions"

The Commission's new policy enshrined in the Guidance, which reinterprets the mechanism for referring transactions to the Commission under Article 22 of the Merger Regulation, is the result of a deliberation process that has been underway for at least a year and seeks to remedy a shortcoming of the current system of notification thresholds.

As announced at the end of last year by the European Commissioner for Competition, **Margrethe Vestager**, this change in approach is in response to the Commission's concern about the lack of the submission of "killer acquisitions" to review, which generally do not meet European or national notification thresholds.

Killer acquisitions are transactions in which a company, usually a large one, acquires or absorbs a highly promising player with nominal turnover with the aim of eliminating a future competitive threat. The acquisition results in the dismantling of the competitor's (actual or potential) business or its inclusion in the acquirer's product portfolio, thereby ceasing to be a significant potential competitor for the acquirer.

According to the Guidance, the Commission will henceforth actively encourage requests for the referral of specific concentrations that, despite not meeting European or national notification thresholds, nevertheless meet the requirements of Article 22(1) of the Merger Regulation. The use of this provision by NCAs will be encouraged through two mechanisms:

(i) **the Commission will begin to accept referral requests** made by Member States **even if they lack original jurisdiction over the concentration** given that the national notification thresholds are not met; and

(ii) the use of **Article 22(5) of the Merger Regulation will be reactivated**, and thus**, the** Commission itself – either *ex officio* or in response to a complaint from a third party – will invite Member States to request the referral of the case to the Commission for its review of the

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concentration. This possibility exists even if the Member State lacks jurisdiction to review the transaction under its domestic law or the transaction has already been implemented.

2) Requirements for the referral of the concentration to the Commission pursuant to the Guidance

Article 22 of the Merger Regulation establishes two requirements for Member States to be entitled to refer a concentration to the Commission.

(i) The concentration **affects trade between Member States**. The transaction meets this requirement if it could potentially have some discernible influence on the pattern of trade between Member States. According to the Guidance, in order to assess this requirement, the Commission will study the location of (potential) clients, 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 – may, if successful, be commercialised in multiple Member States.

(ii) The concentration **threatens to significantly affect competition** within the territory of the Member State or States making the request. The requesting Member State must demonstrate, based on a preliminary analysis that takes into consideration *prima facie* evidence, that there exists a real risk that the transaction may have a significant adverse impact on competition. The Commission will essentially assess whether the transaction creates or strengthens the dominant position of one of the undertakings concerned; eliminates an important competitive force, including a recent or future entrant or the merger between two important innovators; or reduces the competitors' ability or incentives to compete.

The novelty of the Guidance is that it introduces a number of factors – not included in Article 22 of the Merger Regulation – to guide the decision-making of the Member States requesting the referral to the Commission, as well as the Commission's answer in response to the request.

Specifically, the Commission indicates that it would be appropriate to refer cases in which the turnover of at least one of the companies involved does not reflect its current or future competitive potential. This would include cases where the absorbed undertaking: ***(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; ***(ii)*** is an important innovator; ***(iii)*** is an actual or potentially important competitive force; ***(iv)*** has access to competitively significant assets (e.g. raw materials, infrastructure, data, intellectual property rights); and ***(v)*** provides products or services that are key inputs/components for other industries. In its assessment, the Commission may also take into account whether the value of the consideration received by the seller is particularly high compared to the target's current turnover.

Although the Guidance clarifies that the above list is not limited to any specific economic sector, the Commission's attention is actually focused on the digital economy and the **biotech/pharma sector.** While these are undoubtedly the most sensitive sectors at the moment, there is no guarantee that the Commission's focus will not in the future turn to other economic sectors or that the characteristics of a specific transaction will sufficiently attract its attention to request a referral.

Procedural aspects

According to Article 22 of the Merger Regulation, **Member States must request the referral** of a concentration at most **within 15 working days** of the date on which the concentration was notified to the Member State in which the notification thresholds were met or, if no notification is required under its domestic competition rules, when it is otherwise "**made known**" **to the Member State concerned**.

The Guidance, in line with the previous Commission communication on the application of Article 22 of the Merger Regulation, clarifies that "made known" implies that the requesting Member State has sufficient information to make a preliminary assessment of the transaction as to verify whether it meets the criteria for making a referral according to Article 22(1) of the Merger Regulation. In practice, this implies that the moment at which **a transaction is** "**made known**" **to a Member State does not necessarily coincide with the moment that the NCA becomes aware of the existence of a transaction** (for instance, through press releases or public information regarding the transactional parties entering into an agreement). A transaction is "made known" when the competition authority has been able to analyse in some detail – even if preliminary – the competitive risks of the transaction and has the information to make such analysis.

Neither the Guidance nor previous Commission communications establish a specific deadline for the authority to decide whether it has sufficient information to be able to analyse whether the criteria of Article 22(1) are met in order to make a referral request to the Commission. This increases legal uncertainty and will most likely result in future litigation, especially if the NCAs or the Commission accept a broad interpretation. The fact that the Commission or NCAs previously accepted a broad interpretation of "made known" affected legal certainty and altered the time limits for authorising a transaction, but certainly less than following the adoption of the Guidance. Parties previously knew that they had to notify a transaction to the Member State requesting the referral prior to its implementation. Currently, however, even if the notification thresholds are not met and the parties did not intend to be subject to a merger-control procedure, they may find themselves involved in a referral to the Commission leading to a merger-control proceedings initiated many months after the transaction was signed (or even executed, as addressed below).

According to the Guidance, if a Member State, once a transaction has been “made known” to it, considers the possibility of requesting a referral of the case to the Commission, it must immediately inform the parties. At that point, an obligation to suspend the implementation of the concentration (if it has not yet been implemented) does not yet arise. However, once the referral request is made to the Commission, **the Commission must inform without delay** – although no specific deadline is provided – the NCAs and the undertakings concerned, which, as from that moment, **become subject to the obligation to suspend the implementation of the concentration** under Article 7 of the Merger Regulation (the “standstill obligation”). Other Member States may join the referral request within 15 working days of being informed by the Commission.

Once the previous term has expired, the Commission has 10 working days to **decide whether to accept or reject the referral**. If the Commission does not make a decision within that period, it will be deemed to have adopted a decision to examine the concentration in accordance with the request.

Additionally, and as previously stated, Article 22(5) of the Merger Regulation allows the Commission to invite Member States to request a referral regarding a concentration that the Commission considers fulfils the criteria under paragraph one of Article 22. It is worth noting that neither Article 22 of the Merger Regulation nor the Guidance establishes an exact term for the Commission to invite Member States to make a referral request. This will undoubtedly be a source of divergence and debate if the Commission proposes an expansive interpretation of “made known”.

Finally, the Guidance notes that, although a referral is subject to the time limits set out in Article 22, the **fact that a transaction has already been implemented does not prevent a Member State from making a referral request**. In principle, the Commission will take into account the time elapsed since the closing of the transaction and will be more reluctant to accept referral requests involving transactions where more than six months have elapsed since their execution. However, where the closing of the transaction is publicly known, this six-month period would, in principle, start to run from the time when material facts about the transaction have been made public in the European Union, **although the Commission does not rule out the possibility of accepting referral requests in exceptional circumstances even after these periods have elapsed**.

Practical implications

The practical implications of the Commission's new policy in relation to the referral mechanism for transactions that **do not meet the European or national notification thresholds of the Member States** are of the utmost importance for market participants:

Legal uncertainty: The Guidance constitutes a *de facto* extension of the Commission's merger-control regime. The fact that a transaction does not meet the notification thresholds in any European jurisdiction does not imply, as it previously did, that it cannot be scrutinised by the Commission. Consequently, the **competition analysis can no longer be limited to verifying whether the mandatory notification thresholds of the Member State or the Commission are met**. It is essential to correctly identify transactions with a higher risk of referral and to examine in such cases, even preliminarily, the transaction's foreseeable impact on effective competition.

Drafting of contracts and calendar of the transaction: The fact that a transaction is at risk of being referred may in some cases require the inclusion of conditions precedent in the contracts, management clauses as well as the assumption of the risks arising from a potential notification to the Commission as a result of a referral, as well as changes to the initially planned calendar for closing or even the long-stop date. It should be taken into consideration, on the one hand, that the process of referring a transaction to the Commission is lengthy – as explained in the previous section – and, on the other hand, that the time limits under Article 22 of the Merger Regulation can be considerably extended if the Commission adopts a flexible interpretation in connection with the determination of when a transaction has been "made known" to a competition authority.

Merger review of transactions post-closing: The Guidance clearly states that the fact that a transaction has already been closed does not preclude a Member State from requesting a referral. The risk of review by the Commission, even if the European and national notification thresholds are not met, may – as expressly indicated in the Guidance – extend up to six months after the closing of the transaction (or longer if the transaction was not publicly announced). Moreover, the Commission clarifies that, in exceptional situations, a referral may also be admitted even later in view of, for example, the magnitude of the potential competition concerns and the potential detrimental effect on consumers. In any case, the obligation to suspend the implementation of the transaction pending clearance by the competent authority only applies to the extent that the concentration has not been implemented as at the date on which the Commission informs the undertakings concerned that a referral request has been made. If the standstill obligation is breached in such a case, the parties are subject to the risk of significant fines for gun jumping. The standstill obligation ceases if the Commission subsequently decides not to examine the concentration.

Increase of the administrative burden for the undertakings concerned: Following the publication of the Guidance, the fact that a transaction does not meet the notification thresholds in EU jurisdictions is not a sufficient guarantee that it will not be scrutinised by the Commission. In order to rule out the risk of referral and the corresponding impact on the transaction's timing, the corresponding companies may submit a consultation to the Commission and/or verify that no national authority intends to make a referral request. In fact, the Guidance itself calls for the parties to voluntarily inform the Commission prior to the implementation of the transaction, providing all the information necessary for the Commission to carry out a preliminary analysis and to assess whether the referral mechanism should be activated. Strictly speaking, this would not be a formal notification of the concentration, but rather an informal communication mechanism, whereby the Commission undertakes to give the parties "an early indication that it does not consider that their concentration would constitute a good candidate for a referral under Article 22 of the Merger Regulation".

Third parties intervention: The Guidance allows third parties to contact the Commission or the competition authorities of the Member States to inform them of the existence of a transaction that, in their view, could be a candidate for a referral. The third party must provide the competition authority with sufficient information to enable it to make a decision on the referral request. In any event, there is no obligation on the NCAs or the Commission to take action after being contacted by a third party.

Litigation: The significant discretion afforded to the Commission and the Member States to apply this new interpretation of Article 22 (even in sectors other than pharmaceuticals or the digital economy) and, consequently, the degree of legal uncertainty it generates will encourage litigation by market players in mergers and acquisitions. In fact, the US multinational Illumina is in the midst of a legal battle to stop the Commission's efforts – supported by France, Norway and the Netherlands – to review the acquisition of Grail, the multi-cancer early-detection start-up, even six months after the deal was announced. For the time being, both Illumina and Grail have appealed the French competition authority's decision to request the referral of the transaction to the Commission, as well as the Dutch competition authority's decision to join France’s request. The corresponding domestic courts have dismissed the appeals and have held that the European courts should have jurisdiction to settle the dispute. In any case, the Commission has just accepted France's request for referral and Illumina will have to notify the acquisition of Grail to the European authority. It is notable that, in the case of Illumina and Grail, it was the Commission itself that invited the Member States to request the referral of the transaction, which had been publicly announced six months earlier and which did not meet any European notification threshold. The Commission’s “invitation” occurred even prior to the publication of the Guidance.

Increased scrutiny of the digital sector: The Commission’s new interpretation of the merger referral mechanism further increases scrutiny of the major players in the digital sector. With the entry into force of the Digital Markets Act, major technology companies will be obliged to inform the Commission of their planned mergers. Once these plans are known, the Commission’s new policy will allow it to initiate the referral procedure for transactions that to considers potentially problematic, inviting Member States to refer transactions to Brussels even if they do not meet the European or national notification thresholds.

Contact lawyers

Patricia Vidal
Partner
+34 915 860 161
patricia.vidal@uria.com

Cristina Areces
Associate
+34 915 860 161
cristina.areces@uria.com

Alfonso Gutiérrez
Partner
+34 915 860 657
alfonso.gutierrez@uria.com

Antonio Guerra
Partner
+34 915 860 753
antonio.guerra@uria.com

Edurne Navarro
Partner
+32 2 639 6464
edurne.navarro@uria.com

Jaime Folguera
Emeritus partner
+34 915 860 657
jaime.folguera@uria.com

Tomás Arranz
Partner
+34 915 860 753
tomas.arranz@uria.com