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ANTITRUST CLIENT BRIEFING

New guidance on Article 22 EUMR referrals to the European Commission

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At a glance

The European Commission (EC) has published new guidance on the application of the referral mechanism set out in Article 22 of the EU merger regulation (EUMR) allowing for mergers falling below national merger thresholds to be referred to the EC.

Key Points:

- Effective immediately, the EC will start accepting referrals of transactions from EU national competition authorities (NCAs) that fall below the national merger control thresholds. To be referred to the EC, 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 Article 22 Guidance recognises that the EC has historically discouraged such referrals.

- The EC has changed its practice because of a perceived enforcement gap regarding potentially anticompetitive mergers falling below all merger thresholds in the EU. While digital and pharma/biotech mergers are in the eye of the storm, the EC's renewed practice is not limited to those specific sectors.

- NCAs have 15 working days to refer a merger to the EC after the transaction is "made known" to them. The Article 22 Guidance does not explain what level of knowledge would trigger this time period, leaving the parties uncertain as to whether their transaction might still be challenged, even after closing.

- This change is a very significant development for dealmakers. Any transaction that may be seen as potentially raising competition issues could end up being reviewed by the EC — no matter how small the target, and even after the deal has closed. Further, there is no clear time limit on when closed transactions can be referred to the EC.

- As these referrals may impact the timing, and even the feasibility, of transactions, parties to a concentration falling below national thresholds will now systematically need to assess whether their transaction can significantly affect competition in any EU Member State. Parties should also determine how to address any residual uncertainty — either by closing quickly and challenging a possible post-closing referral, or by seeking a modicum of certainty from the EC and relevant NCAs that they will not refer. Neither approach is without risks.

Background

On 11 September 2020 Commissioner Vestager (who oversees the competition portfolio and serves as vice president in charge of the EU's digital policy) announced that the EC planned "to start accepting referrals from national competition authorities of mergers that are worth reviewing at the EU level — whether or not those authorities had the power to review the case themselves". However, this change was not meant to "happen overnight — we need time for everyone to adjust to the change, and time to put guidance in place about how and when we'll accept these referrals". Six months later, without any public consultation or implementation period, the EC has now issued its Article 22 Guidance.

The EC has had a long-standing position of discouraging such referrals, despite being of the view that Article 22 EUMR already permitted referrals from Member States lacking jurisdiction to review a transaction under their national merger control rules. The Article 22 Guidance confirms this position, stating: "[T]his practice was notably based on the experience that such transactions were not generally likely to have a significant impact on the internal market".

The Article 22 Guidance represents a complete reversal of this position, with broad implications for merging parties.

What the Article 22 Guidance says

Only seven pages in length, the Article 22 Guidance leaves many unanswered questions.

Why is the EC changing its practice?

The EC claims that its change in practice is necessary because of a perceived enforcement gap in EU and national merger control, in particular with respect to so-called "killer acquisitions" involving targets which do not yet have significant revenues.

Thus, the intention is to catch transactions that otherwise would not have been subject to merger review. As the Article 22 Guidance says: "This change in approach will permit Member States and the [EC] to ensure that additional transactions that merit review under the Merger Regulation are examined by the [EC]."

What deals can be referred?

Article 22 EUMR allows referrals of transactions that "affect trade between Member States" and "threaten to significantly affect competition within the territory of the Member State or States making the request". In the context of "downward" referrals under Article 9 EUMR, the EC has traditionally interpreted this test restrictively. In contrast, the Article 22 Guidance contains broad criteria possibly applicable to any transaction, 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 or bundling."

Only time will tell what standard of proof the EC will apply with respect to how "significant" the transaction's likely impact on competition has to be for a referral. Meanwhile, merging parties have lost the jurisdictional legal certainty they had prior to the Article 22 Guidance.

Is the EC only targeting the digital and pharma/biotech sectors?

No. The Article 22 Guidance does explicitly single out digital and pharma/biotech as sectors in which potentially anticompetitive mergers have escaped scrutiny. But the Article 22 Guidance leaves the door open for any transaction to be a potential candidate for referral if the turnover of at least one of the undertakings concerned does not reflect its actual or future competitive potential. According to the EC, this includes the following situations:

- The target is a start-up or recent entrant with significant competitive potential and low (or no) revenues. The EC may also take into account whether the value of the consideration received by the seller is particularly high compared to the current turnover of the target.
- The target is an important innovator or is conducting potentially important research.
- The target is a an actual or potential important competitive force.
- The target has access to competitively significant assets (such as raw materials, infrastructure, data, or intellectual property rights).

- The target provides products or services that are key inputs/components for other industries.

When does the deadline for a referral begin?

If a notification is required, the NCA has 15 working days from the date of national notification.

For the cases targeted by the Article 22 Guidance, i.e. where no notification is required, the Member State(s) must request a referral within 15 working days of the date on which the transaction is "made known" to the relevant Member State(s). The EC interprets the notion of 'made known' as implying that the Member State has sufficient information to make a preliminary assessment of the criteria relevant for evaluating the referral. This is obviously a highly subjective assessment. The Article 22 Guidance does not provide any further guidance, such as a checklist with the minimum amount of information in possession of the NCAs for the clock to start running.

In addition, EC may also *invite* Member States to request a referral under Article 22(5) EUMR.

Can closed transactions be referred?

Yes. The Article 22 Guidance states that Member States may request a referral of transactions already closed. As a rule of thumb, the Article 22 Guidance suggests that the EC will generally not consider a referral appropriate if a deal has closed more than six months ago. If the closing is not publicly known, the six-month deadline will be based on the date when material facts about the transaction have been made public in the EU.

The 6-month timeframe is generous. By way of comparison, the UK Enterprise Act requires the Competition and Markets Authority to complete its Phase I investigation within 4 months of deal closing.

However, the EC considers that it may be appropriate for a Member State to request a referral more than six months after closing based on certain factors, such as the magnitude of the potential competition concerns and the magnitude of the potential detrimental effect on consumers. The Article 22 Guidance does not elaborate further, thus leaving the door open for referrals potentially indefinitely after a transaction has closed.

What happens if a referral is requested?

If a referral is being considered by one or more Member States, the EC will inform the parties to the transaction "as soon as possible". The EC suggests that the parties may then decide to take measures they consider appropriate, such as delaying the transaction's closing until they know whether a referral request will actually be made.

Once the Member State has made a referral request, the EC will inform the merging parties and the NCAs without delay. Pursuant to Article 22(4) EUMR, once the EC informs the merging parties that a referral request has been made, they must suspend the closing of the transaction (if it has not yet occurred). The suspension obligation is lifted if the EC subsequently decides not to examine the transaction.

Other Member States may join the initial request within a period of 15 working days of being informed by the EC.

The EC may decide to accept the request and review the transaction no later than 10 working days after the expiry of the 15-working-day period for Member States to join the referral request. The EC will then assume competence 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 the referral request and to be reviewing the transaction.

Strategic implications for merging companies

How to determine whether a referral will be made

Previously, merging parties could rely on a particular NCA's lack of jurisdiction to exclude that jurisdiction from their merger analysis. Following the Article 22 Guidance, companies will instead need to verify whether the substantive conditions of Article 22 EUMR (particularly whether the transaction threatens to significantly affect competition) are met in one or more Member States — even if the transaction falls below the national merger control thresholds. Given the subjective nature of the criteria in the Article 22 Guidance, such an assessment will be difficult, burdensome (i.e. whenever the transaction has a cross-border element) and uncertain.

Various options are available for parties, depending on their desired strategy and the complexities of the case. Parties might contact the relevant NCAs and attempt to trigger the 15-working-day deadline. Alternatively, or in addition, parties might contact the EC to determine whether it is likely to accept (or even invite) a referral request by the NCAs (as explicitly permitted by the Article 22 Guidance). Parties may seek to close the transaction before taking any of these steps or to contact the EC/NCAs in advance of closing.

However, no strategy is without disadvantages. The Article 22 Guidance does not provide any timeline within which the EC must respond to initial contact from the parties and there is uncertainty as to when and how it would respond and the information that will require to provide an answer. The Article 22 Guidance simply states that the EC may either give an "early indication" that it does not consider a referral appropriate or inform the parties "as soon as possible" about whether a referral is being considered.

Similarly, trying to "run out the clock" on the relevant NCAs by making a *de facto* notification to them risks raising the transaction's profile with no objective justification and may be unsuccessful depending on the NCA's appraisal of the substantive conditions for referral and their interpretation of when "the concentration is made known" to them. For instance, some NCAs may consider that the 15 working days only start after the parties have responded to additional requests for information.

Parties can also decide not to approach the NCAs at all when the national merger thresholds are not met. However, as mentioned in the Article 22 Guidance, a referral is possible even after the transaction has been closed for more than six months, for instance following third-party complaints about the merged entity's post-closing practices.

The EC's change in position may increase the number of cases subject to parallel EC and Member State merger control review, where the EC accepts a referral request from one or more Member States with no competence to review the transaction but where some Member States — competent to review the transaction under their national merger control laws — do not join the referral. Such an outcome would undermine the "one stop shop" principle of the EUMR.

How should the risk of an Article 22 referral be reflected in the transaction documents

A referral to the EC could lengthen the review process significantly. Therefore, companies need to carefully assess the timeline of the potential referral scenarios at an early stage, which will be no easy task given the aforementioned uncertainties.

Conditions precedent in share purchase agreements (or other transaction documents) will need to consider the possibility that a transaction could be referred to the EC even by Member States without jurisdiction. Similarly, transaction documents may need to include efforts clauses to anticipate intervention outcomes by all potential regulators and ensure timely cooperation of both parties throughout the merger process. Finally, long-stop dates will need to accommodate a possible referral process. The transaction documents should at least foresee the possibility to renegotiate the long stop date should a referral be made.

Sources

The Article 22 Guidance

Latham & Watkins' *Antitrust Client Briefing* on Vestager's announcement of September 2020

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