IS THE EUROPEAN COMMISSION NOW ENTITLED TO REVIEW NON-NOTIFIABLE TRANSACTIONS - EVEN AFTER CLOSING?

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OVERVIEW

- On 26 March 2021, the European Commission (Commission) published new guidance on the application of the EU upward case referral system (Guidance), pursuant to which EU Member States can ask the Commission to review transactions. This announcement was made in the context of an ongoing review of the procedural and jurisdictional aspects of the EU merger control regime.
- The Guidance follows earlier statements made by the Commission's Executive Vice-President and Commissioner for Competition, Margrethe Vestager, who had announced in September 2020 that the Commission will introduce a policy to start accepting referrals of transactions from EU national competition authorities (NCAs) that do not meet the national merger control thresholds.
- This new policy is primarily aimed at (but not limited to) targeting the acquisition of nascent and/or innovative companies, which do not generate significant turnover but which nevertheless have a strong competitive potential (colloquially labelled as “killer acquisitions”). As it is not limited to any specific economic sector, the Guidance will put significant additional burdens on the M&A community and increase the level of legal uncertainty when assessing the reportability of M&A transactions for merger control purposes.
- The Guidance represents a sweeping change for dealmakers as it effectively opens the door for the Commission to review transactions that do not meet the EU merger filing thresholds, and allows for referrals from EU Member States which would not themselves have jurisdiction to review, at least during a period of six months after closing of the respective transaction.

BACKGROUND

Article 22 of the EU Merger Regulation (EUMR) allows EU Member States to request the Commission to review transactions which do not meet the EU merger control thresholds, but which: (i) affect trade between EU countries; and (ii) threaten to significantly affect competition within the territory of the EU country/ies making the request. Although it was in theory already possible for an NCA to make such a referral even when the applicable national merger control thresholds were not met, the Guidance marks a clear change of approach with the

Commission now signalling that it is indeed ready and willing to accept referrals of transactions that do not meet the national merger control thresholds.

During a speech on 11 September 2020, Executive Vice-President and Commissioner for Competition, Margrethe Vestager, foreshadowed this policy change and explained that the Commission would start to accept: "*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.*"

The reason for this shift in approach has its roots in the fact that, over the past years, the Commission observed that a number of transactions with significant impact on the market nonetheless fell below the EU merger filing thresholds, thus preventing the Commission from reviewing their effects on competition. This in particular concerns transactions in the digital, biotech or pharma sectors involving the acquisition of nascent or innovative companies with a strong competitive potential (colloquially labelled as "killer acquisitions"). While in many cases the risk of a referral will in practice remain low because of clear indications that the transaction will not threaten to significantly impede competition, irrespective of the likely frame of reference adopted, it will be important to identify those transactions which are at greater risk of such referrals.

While the Commission considers that the EU merger filing thresholds can remain unchanged, it expects that a revised Article 22 referral system would constitute a useful tool to catch transactions which fall below the EU and national merger filing thresholds, but which may have a significant impact on the market. In practical terms, this would allow the Commission to de facto widen the scope of its merger control review, while keeping the current legal framework as is.

THE NEW ARTICLE 22 REFERRAL POLICY

The Guidance supplements the Commission's Notice on Case Referrals and addresses the two Article 22 requirements that need to be met for a successful referral, namely: (i) the transaction affects trade between EU countries; and (ii) the transaction threatens to significantly affect competition within the EU. The Guidance clarifies that, in determining whether the first requirement is met, the following factors are relevant for consideration:

- The location of (potential) customers;
- Availability and offering of the products/services at stake;
- Collection of data in several EU countries; or
- Development and implementation of R&D projects whose results may be commercialized in more than one EU country.

With respect to the second requirement, the Guidance notes that a preliminary analysis of the transaction by an NCA may be based on prima facie evidence of a possible significant adverse impact on competition. In this respect, the Commission refers to the theories of harm laid down in its Horizontal and Non-Horizontal Merger Guidelines, and notes that a transaction may threaten to significantly affect competition if it:

- Creates or strengthens a dominant position;
- Eliminates actual or potential competition;
- Reduces competitors' ability or incentive to compete; or

- Allows the parties concerned to leverage a strong position from one market to another through tying, bundling or other exclusionary practices.

The Guidance also explains that the types of transactions likely eligible for an Article 22 referral are "transactions where the turnover of at least one of the undertakings concerned does not reflect its actual or future competitive potential." This serves as clarification that the Guidance is primarily aimed at applying to:

- Start-ups or recent entrants with significant competitive potential which are yet to start generating significant revenues;
- Innovators and companies conducting important R&D activities;
- Serious rivals to the incumbent players;
- Companies that have access to competitively significant assets, such as raw materials, infrastructure, data or intellectual property rights; and/or
- Companies whose products or services are key inputs/components for other industries.

However, the above-referenced list is provided by the Guidance just for purely illustrative purposes. It is not limited to any specific economic sector or sectors and cannot be deemed in any way comprehensive.

Finally, the Guidance clarifies that the Commission would "generally" not consider a referral appropriate where more than six months have passed after the implementation of the transaction. If the implementation 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. However, the Guidance even leaves the door open for referrals more than six months for exceptional situations based on certain factors such as "*the magnitude of the potential competition concerns and of the potential detrimental effect on consumers*."

PRACTICAL IMPLICATIONS FOR BUSINESSES

While the Commission claims that the Guidance aims to increase transparency, predictability and legal certainty, this new policy will in practice lead to deal uncertainties that parties to mergers and acquisitions do not currently have to face.

Prior to the introduction of the Guidance, businesses were able to rely on the turnover-based thresholds that apply at the EU level and in the vast majority of EU Member States to have comfort that, if a transaction does not trigger the EU and national merger filing thresholds, it would not be subject to regulatory scrutiny. This is no longer the case. Now, even if the EUMR or national thresholds are not met, a transaction may still end up being referred upwards to and reviewed by the Commission. This has very obvious implications for transaction timing as well as on deal negotiations on the allocation of merger control risk.

To address and anticipate the risk of a referral, companies will need to conduct detailed antitrust assessments of the competitive impact of a transaction, and do so at the outset of any deal. Whereas in most cases the risk of a referral to the EU will remain remote as and if the transaction will not threaten to significantly impede competition, it will become a new task to pick up those transactions which are at risk of a referral. Businesses will also need to consider how to deal with the allocation of risk of a referral in the transaction documentation.

Companies may opt to voluntarily approach the Commission or an NCA with information on the deal and its impact in certain EU countries to obtain further clarity whether their transaction would be a candidate for an Article 22 referral. Although this appears to be encouraged by the Commission in its Guidance, such approaches risk being interpreted as admissions that the deal does raise antitrust concerns, hence inviting regulatory review. It is worth noting that, if a transaction has already been notified to an NCA that has not itself requested or participated in an Article 22 referral, this may constitute a factor against the Commission accepting the referral, but it does not prevent the Commission from accepting such referral.

Finally, the six-month soft limitation period will in practice lead to businesses being hesitant to actually close their deals ahead of the expiry of this time, knowing that during this period there is an increased risk that the deal may be reviewed and, ultimately, deconstructed by the Commission.

HOW K&L GATES CAN ASSIST

K&L Gates' Antitrust, Competition, and Trade law practice group includes experienced lawyers across the EU, the UK, and beyond who are able to provide a one-stop shop for all antitrust and merger control considerations arising from a transaction, in particular:

- Drafting and adapting transaction documentation (e.g., provisions dealing with long-stop dates, risk allocation such as “hell-or-high-water-clauses” and “best efforts” obligations);
- Running preliminary assessments of potential referrals at an early stage of the process; and
- Reaching out to and liaising with the Commission and NCAs seeking guidance or assisting with voluntary submissions.

KEY CONTACTS

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