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Small Shift in EU Merger Policy: High Impact on Nascent Competitor Deals

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On 26 March 2021, the European Commission (EC) issued guidance to close an enforcement gap concerning acquisitions of nascent, innovative companies. The guidance clarifies that if a deal does not hit the revenue thresholds of the EU Merger Regulation (EUMR), but may have an adverse effect on competition, EU Member States can use Article 22 of the EUMR to refer the deal to the EC, effective immediately. Critically, the guidance permits them to do this *even if* the deal does not meet the merger control thresholds of the referring Member State(s). Also, a referral up is possible *after* the deal has closed, which is a deviation from the EU's pre-closing notification system.

This policy shift marks a significant change in the application of the EUMR, effectively giving the EC the power to call-in transactions that could raise competition issues, similar to the regimes in the US, Canada and the UK. For deals potentially meeting the Article 22 criteria, this will have far-reaching consequences in terms of timing, legal certainty and legal documentation.

How does this change the current situation?

Article 22 was originally created as a mechanism to allow Member States who did not have national merger control systems to refer cases to the EC which did not meet the EUMR thresholds but which potentially raised competition concerns.

Over time, almost all EU Member States introduced their own merger control regime, so Article 22 was largely redundant. It has been used once or twice a year on average to enable the EC to take jurisdiction over deals which impact competition across several Member States but do not meet the EUMR thresholds. The EC's unwritten rule

in recent times has been that Article 22 could *only* be used by Member States who had jurisdiction over the transaction under their national merger control laws.

The new guidance does away with this unwritten rule: if a transaction is too small to be caught by either the EUMR or national merger control thresholds, but if there are competition concerns, Article 22 will be the hook to enable the EU to take jurisdiction.

Why has the EC taken this step?

In the tech and pharmaceutical sectors, in particular, antitrust agencies around the world are increasingly focused on intervening early to prevent companies with perceived market power from acquiring small disruptive forces in the market (also referred to as "killer acquisitions"). The EC has felt hamstrung here, as the EUMR jurisdictional thresholds are revenue based, so it would miss acquisitions of start-ups (unless they are referred by Member States). It has alighted on Article 22 as a convenient existing tool that it can re-purpose to capture those deals in future.

The EC is not restricting the use of the tool to the digital and pharmaceutical sectors. Whilst the guidance highlights those two, it also expressly states that the use of Article 22 is not limited to any specific sectors or industries.

What are the criteria for a referral to be made?

Only deals which may have a significant impact on competition in more than one EU Member State will be suitable for referral up. In the absence of revenues, factors such as the location of potential customers, where product/services may be offered, location of data, and where R&D projects could be commercialized, as well as risk to competition, will be relevant in assessing whether the criteria are met.

If those criteria are met, deals which will be liable to be caught are those where the current revenue of one of the parties "*does not reflect its actual or future competitive potential*". Aside from start-ups, smaller businesses that are market disruptors through innovation would be in scope, or that in some other way have a stronger market impact than their revenues imply, for example through having access to assets (intellectual property, raw materials, infrastructure, data) that are competitively significant, or providing key inputs/services for other industries.

In addition, the EC will also look at the deal value — and whether this is particularly high compared to current revenues of the target.

What impact could this have on transactions?

The re-purposed Article 22 looks set to impact deal timing, deal certainty and deal documentation for transactions that fit the criteria:

- **Potential delay to closing:** Once the EC informs the parties it has received a referral request under Article 22, there is a legal obligation prohibiting closing until the EC has decided to reject the Article 22 request or has taken the case and has issued a clearance decision. Breach of that suspensory obligation can be subject to fines of up to 10% of global revenue.

  A Member State has 15 working days from the time the merger was "made known" to it to make a referral request. The guidance lays out that "made known" means having sufficient information to make a preliminary assessment as to whether or not the criteria for referral are met; a standard press release may not be sufficient.

  So parties run the risk that a case gets picked up by a Member State late in the deal timetable and the Member State makes a referral request — throwing a wrench in the whole process.

  In practice the EC is looking to encourage parties to come forward early. This is clearly preferable to the EC, as this means the EC and Member States will not have to hunt out deals, and may be preferable to the parties to avoid uncertainty and/or risk of breaching the suspensory obligation.

  The EC has 25 working days from the time of the referral request to decide whether or not to accept the case. If accepted, the parties will have to submit a merger filing to the EC and progress through the usual review process — i.e., a period of pre-notification and then a formal 25 working day review period (and potentially longer if remedies are required and/or the EC opens an in-depth Phase II review).

- **Deal certainty — After the fact review and intervention possible:** The guidance makes clear that Member States are able to request a referral even if a deal has closed. It indicates the cut-off for a referral is generally going to be six months after closing, but leaves open the possibility of accepting referrals later than this also. Transactions could therefore be called in by the EC many months after closing, and

potentially be subject to remedies if concerns are found. (They would not be subject to fines for having closed, as the suspensory obligation only kicks in after the Article 22 referral request.) Even if some Member States have reviewed and cleared a deal, it is possible (even if unlikely) that others could still refer it up to the EC for further review.

- **Deal documentation — consider adding further provisions to cover the possibility of an Article 22 referral:** In some cases it may be advisable to insert a condition to closing to cover off the possibility of an Article 22 referral request, even if no merger control filings are triggered in the EU. This would likely be done in cases that are identified by the parties as being at risk of referral up and therefore the parties decide to approach the EC/Member States to raise the Article 22 question.

Outlook

Whilst the Article 22 guidance provides some clarity, it leaves considerable discretion for the EC to accept referral cases under its new policy. It will therefore be important that the EC builds a precedent base of clearly identifiable cases that can be expected to be referred up and to give robust informal advice to the parties where needed. If, however, the new referral approach is applied too broadly by the EC, this could potentially impact M&A activity and result in increased challenges to EC decisions before the European courts.

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