GIBSON DUNN

Significant Change in European Commission Merger Control Policy: Pharma and Digital Deals to Face Uncertainty and Additional Scrutiny in Europe

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On 26 March 2021, the European Commission (the "Commission") published guidance on the circumstances under which it is likely to accept requests from national competition authorities within the EU to investigate mergers that do not meet the EU or even national jurisdictional tests (the "Guidance").[1] The Guidance concerns the application of the referral mechanism under Article 22 of the EU Merger Regulation, a hitherto relatively little-used provision.[2] The Guidance firmly cements the Commission's change in policy towards deals in the pharma and digital sectors, in particular with respect to so-called "killer acquisitions", designed to address an apparent enforcement gap in these sectors.[3] The effect of the Guidance is likely to increase significantly the jurisdictional reach of the Commission, and may go so far as to lead to a *de facto* notification process in the absence of sufficient turnover to meet mandatory filing requirements.

1. A radical shift in the Commission's approach

In a speech to the IBA in September 2020,[4] Commissioner Vestager (in charge of EU competition law enforcement) looked back on 30 years of EU merger control, including whether it is still right that the EU turnover-based thresholds for filings are the appropriate way to identify "*mergers that matter for competition*". She noted that "*these days, a company's turnover doesn't always reflect its importance in the market. In some industries, like the digital and pharmaceutical industries, competition in the future can strongly depend on new products or services that don't yet have much in the way of sales*". In that speech, Vestager ruled out lowering the EUMR thresholds to capture such deals (as this would disproportionately capture a lot of irrelevant deals) and signalled that a change in approach to the Article 22 referral process "*could be an excellent way to see the mergers that matter at a European scale*".

The Article 22 referral mechanism allows one or more Member States to ask the Commission to review a concentration that does not meet the EU thresholds but that (a) affects trade between Member States and (b) threatens to significantly affect competition within the territory of the Member State or States making the request. Until now, the Commission's practice has been to discourage Article 22 referrals from Member States that did not have the power to review a deal under their own national merger control rules. This meant that deals that did not trigger national merger control in at least one Member State were not, in practice, referred for Commission review.

Vestager therefore stated that the Commission planned to "*start accepting referrals from*

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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 Guidance published on 26 March gives effect to this plan and sets out how the Commission foresees this new jurisdictional approach working.

2. What deals are likely to be caught by this new approach

The Commission can accept referrals with respect to any deal, regardless of whether national filings might be required or not, provided that it meets the two formal conditions noted above. The Guidance makes is clear that these are low thresholds:

- An effect on trade between Member States requires no more than "*some discernible influence on the pattern of trade between Member States*", whether direct or indirect, actual or potential. The Guidance highlights that customers located in different Member States, cross-border sales/availability, collection of data across borders or the commercialisation of R&D efforts in more than on Member State would all meet this requirement.
- Threatening to significantly affect competition within the territory of the Member State requires no more than a demonstration that "*based on a preliminary analysis, there is a real risk*" of such an effect. Here, the Guidance notes that this could include circumstances such as the " elimination of a recent or future entrant, making entry/expansion more difficult, or the ability and incentive to leverage a strong market position from one market to another.

Further, given the Commission's approach to date with respect to Article 22 referrals, in practice, we would not expect the Commission to take a restrictive approach to whether these conditions are met, particularly in cases where the Commission invites a national competition authority to make a referral request.

It is clear that the Commission's focus is not on all deals involving new entrants, but primarily on the pharma and digital sectors where "*services regularly launch with the aim of building up a significant user base and/or commercially valuable data inventories, before seeking to monetise the business*" and where "*there have been transactions involving innovative companies conducting research & development projects and with strong competitive potential, even if these companies have not yet finalised, let alone exploited commercially, the results of their innovation activities*".[5]

The Guidance also specifies that the Commission is most likely to exercise its discretion to investigate where the deal that has been referred to it is one in which the "*turnover of at least one of the undertakings concerned does not reflect its actual or future competitive potential*". This may occur where the value of the consideration received by the seller is particularly high compared to the current turnover of the target. It may also occur where one party:

- 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);
- is an important innovator or is conducting potentially important research;
- is an actual or potential important competitive force;
- has access to competitively significant assets (such as for instance raw materials, infrastructure, data or intellectual property rights); and/or
- provides products or services that are key inputs/components for other industries.

As the above, non-exhaustive list, shows, this new approach has the potential to catch almost any deal involving a new pharma or digital start-up, innovative company or

company exploring new market areas. It would also clearly catch so-called “killer acquisitions” of small companies with high potential future value.

3. How will the process work?

The Article 22 mechanism requires a Member State that wishes to make a referral to send a reasoned request to the Commission within 15 working days from when the concentration is made known to it.[6] The Commission then informs the other Member States and they have a further 15 working days to join the request if they so wish. After the expiry of this period, the Commission must decide within 10 working days if it accepts the referral request. Upon receipt of a referral request from a Member State, the Commission must inform the parties of the request. Once the parties are informed of this, the suspension obligation under the EU Merger Regulation applies and the transaction cannot be closed unless it has already been implemented.

Importantly, whilst the European merger control system is a pre-closing suspensory one and companies are used to assessing the need to factor in a Commission investigation prior to completion, the Guidance specifies that referrals can be made post-completion provided they are within a suitably short period. In this respect, the Guidance states that a period of six months is likely to be an appropriate period, although this may be longer if the deal is not made public on completion or if there is a sufficiently large potential for competition concerns or detrimental effect on consumers.

4. What does this mean for deals?

The new approach has the potential to significantly reduce legal certainty for companies engaged in M&A activity in these sectors and to increase the procedural burdens on parties.

By moving the possibility of an EU-level review away from turnover-based thresholds, towards a more qualitative assessment of potential effects, and allowing for investigations to be opened post-completion, the Commission’s change in approach means that the EU system now mirrors that of the UK (with its broad “share of supply” test and post-completion review process) for deals that do not meet the EU merger review thresholds. The level of uncertainty that the UK’s system has meant for deals in these sectors in light of recent CMA decisions (see client alert on Roche/Spark) will now be felt at wider, EU-level.

Additionally, there is little likelihood that the Commission would refrain from using its new approach to referrals extensively. The Guidance states that the Commission will engage actively with Member States to “*identify concentrations that may constitute potential candidates for a referral*” and encourages third-parties to contact either the Commission or the Member States to inform them of potential referral cases. Additionally, the Commission has, at the same time as it issued the Guidance, consulted on changes to the “simplified procedure” process to allow for easy/fast review of cases that do not raise competition concerns. The implication is that the Commission is “clearing the decks” to allow it to focus on these more interesting digital and pharma deals. We can therefore expect the Commission to actively seek out deals that might warrant an EU-level review and to secure their referral by one or more Member States.

For companies active in the pharma and digital sectors, their M&A planning will need to include not just an assessment of the relevant thresholds and filing requirements across EU Member States, but a more general assessment of the potential for an EU referral.

With the possibility that a Commission investigation could be initiated months after completion, with the attendant substantive risks, companies may find that it is advisable (at least in some circumstances) to proactively engage with the Commission to provide the information necessary to determine whether a deal is a good candidate for referral.

Indeed, this type of *de facto* voluntary notification is expressly provided for in the Guidance.[7]

Companies' M&A planning process will also need to factor in the potential impact on deal timing of this new approach. As section 3 above shows, the time period involved before the parties will even know if a deal is being investigated, not to mention the time involved for the actual Commission investigation, is significant.

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[1] Commission Guidance on the application of the referral mechanism set out in Article 22 of the Merger Regulation to certain categories of cases, C(2021) 1959 final, available at: https://ec.europa.eu/competition/consultations/2021_merger_control/guidance_article_22_referrals.pdf.

[2] In the last 30 years, Article 22 referral requests by Member States have been made only 41 times: See https://ec.europa.eu/competition/mergers/statistics.pdf (statistics to end February 2021).

[3] In announcing the Guidance, together with the results of the Commission's evaluation of the procedural and jurisdictional aspects of EU merger control, Executive Vice-President Margrethe Vestager, in charge of competition policy, said: "*A number of transactions involving companies with low turnover, but high competitive potential in the internal market are not reviewed by either the Commission or the Member States. A more frequent use of the existing tool of referrals under Article 22 of the Merger Regulation can help us capture concentrations which may have a significant impact on competition in the internal market*".

[4] Available at: https://ec.europa.eu/commission/commissioners/2019-2024/vestager/announcements/future-eu-merger-control_en.

[5] See Guidance, paragraph 9.

[6] This means being in receipt of sufficient information to make a preliminary assessment as to the existence of the criteria relevant for the assessment of the referral. It is unlikely that a newspaper article or press release would qualify as providing sufficient information for the national competition authorities to make an assessment. In practice, national competition authorities can be expected to request information from the parties about deals that have attracted their (or the Commission's) attention and the 15-day period will start running upon receipt of the parties response to their information request.

[7] Guidance, paragraph 24.

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