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New European Commission Referral Guidance Creates Uncertainty for Merging Parties

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The European Commission (EC) recently published new guidance on the application of the referral mechanism set out in Article 22, which permits the EC to review any transaction referred to it, even if the transaction does not meet national or European Union merger thresholds.

The guidance marks a significant shift in EU merger control. Previously, the EC only reviewed transactions that met national or EU-wide thresholds, typically based on turnover. Under the new guidance, the EC can now review transactions that do not reach any national thresholds, provided that the transaction may have an adverse effect on competition and a national competition authority (NCA) refers the case to the EC. The guidance has immediate effect.

The EC's stated goal for the policy change is to capture potentially anticompetitive transactions involving parties with low turnover, but which may have significant future competitive potential (e.g., promising startups or innovative companies). While the new policy applies to all industries, the guidance explicitly mentions the digital and pharmaceutical sectors as targets, which suggests that they will be a focus of the EC's enforcement efforts using this new approach.

The guidance also allows for referrals of completed transactions.

This alert reviews the types of transactions that are likely to be caught by the new guidance, the procedural and timing implications of transactions reviewed through this mechanism and the practical implications for parties considering a merger.

What transactions are likely to be referred under the new guidance?

While it was possible under the letter of the law, the EC previously discouraged referrals under Article 22 of the EU Merger Regulation (EUMR) in cases where Member States did not have jurisdiction, reasoning that if a transaction did not meet national thresholds, it was unlikely to have an effect on the internal market. The EC is now reversing this approach.

The new guidance sets a much lower standard for referral conditions to be met under Article 22 EUMR:

- A transaction "*affects trade between Member States*" as long as it has "***some discernible influence on the pattern of trade between Member States***"[1]
- A transaction "*threatens to significantly affect competition*" if "***based on a preliminary analysis, there is a real risk that the transaction may have a significant adverse impact on competition***".[2] The guidance underlines that this would be the case where:
    - "*A dominant position*" is created or strengthened
    - "*An important competitive force*" is eliminated, i.e., a recent or future entrant or two important innovators merge
    - "*Competitors' ability and/or incentive to compete*" is reduced by making market entry or expansion more difficult, or by hampering access to supplies or markets
    - The merger results in "*the ability and incentive to leverage a strong market position*"[3]

The guidance further points out that the referral of a non-notifiable transaction could be requested in particular

where the turnover of at least one of the undertakings concerned does not reflect its current or future competitive potential. This could be the case for deals in which:

- A party is a **startup or a recent entrant with significant competitive potential** that has yet to develop or implement a business model generating significant revenues
- A party is an **important innovator or conducting potentially important research**
- A party is 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[4]

In addition, the EC may take into account whether the value of the consideration received by the seller is particularly high compared to the current turnover of the target.

While the new policy is not limited to any sector, the new guidance specifically mentions the digital and pharmaceutical industries. Notably, the EC seems concerned about transactions:

- "*In the **digital economy**, 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*"
- Involving **pharmaceutical** "***companies** conducting research & development projects and with strong competitive potential*" that have not yet exploited the results of their innovation activities [5]

In a Staff Working Document accompanying the new guidance, the EC concluded that in the period 2015 – 2019, there were 87 transactions that might have potentially merited review under the EUMR. Out of these transactions, 42 occurred in the digital sector and 24 in the pharmaceutical and biotechnology space. [6] The EC also assessed the size of the transaction compared to the turnover of the parties for the period 2015 – 2019. It held that out of 27 transactions where the value exceeded the target turnover by a multiple of 10 and which may have been of interest for EU scrutiny, seven deals involved companies in the digital sector and 10 concerned undertakings in the pharmaceutical and biotechnology industry.[7]

Timeframe and procedure

Even a referral request that does not result in EC scrutiny may expose the transaction to a delay of up to 40 working days. Transactions that raise significant issues may face even more substantial delays due to an EC review.

Under Article 22(1) EUMR, NCAs may submit a referral request to the EC within 15 working days from the date of the notification or, if no notification is required, from the date the merger is "*otherwise made known to the Member State concerned*". According to the guidance, this is the case when sufficient information is available to make a preliminary assessment as to the existence of the criteria relevant for the referral.[8]

It is unclear whether press coverage or information provided by the parties on an informal basis would be enough to start the clock or if a more detailed and formal account of the merger would be needed (e.g., a response to a request for information). In line with Article 22(5) EUMR, the EC may also reach out directly to NCAs and solicit a referral.

Once a referral request is made, the EC informs the NCAs, which have 15 working days to join the initial request. After this deadline has expired, the EC then has a maximum of 10 working days to decide whether to examine the concentration. If the EC accepts a referral, it may request a notification to be submitted.

Following receipt of a referral request, the EC also informs the parties involved, triggering the suspension obligation under EUMR to the extent that the concentration has not yet been implemented. If the EC decides not to examine the concentration, the suspension obligation is lifted.

At odds with the pre-closing nature of EU merger control, the new guidance allows for deals to be subject to referral post-completion. The time limit for referrals relating to implemented transactions is six months from

closing or, if closing was not disclosed, from the moment material facts about the concentration have been made public. In exceptional circumstances, also later referrals could be accepted. [9]

What is the impact of the new policy for businesses?

The new guidance introduces substantial uncertainty, particularly for digital and pharmaceutical deals and for transactions with values that are a high multiple of the target turnover. Before the new guidance, parties had certainty to whether the EC would review a particular transaction – it either met the thresholds or did not.

Now, given the low standards introduced by the guidance, all transactions are at least theoretically exposed to EU review, and there is a new mechanism through which completed mergers may be referred.

In addition, merging parties will be exposed not only to the NCAs' considerations, but also to competitors' adversarial strategies. The guidance envisages the possibility for third parties to provide information to the EC or national authorities concerning transactions that could result in a referral.

Parties to deals that may draw interest, either from the EC or NCAs, should prepare deal documents with this risk in mind. Parties should consider closing conditions that contemplate a EC referral and anticipate delays in case the Article 22 referral process is triggered (up to 40 working days, even assuming the EC does not investigate), plus the EC review if one ensues.[10] They should also consider the risk of a potential post-closing review by the EC.

Notes

1. Guidance, para. 14.
2. Guidance, para. 15.
3. *Ibid.*
4. Guidance, para. 19.
5. Guidance, para. 9.
6. European Commission Staff Working Document, Evaluation of procedural and jurisdictional aspects of EU merger control, 26 March 2021, para. 105.
7. *Ibid.* para. 107.
8. Guidance, para. 28.
9. Guidance, para. 21.
10. This should include both the time period for the preparation of a notification, in case it is requested, as well as the Commission review (25 working days for a phase I decision, 90 additional working days for a phase II, excluding extensions).

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