INSIGHTS

European Commission Expands Antitrust Reviews to Non-Reportable Transactions

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In Short

The Situation: According to the European Commission ("EC"), an increasing number of competitively significant transactions have evaded merger notification because one or both of the transacting parties (but typically a small, high value target) did not meet EC or any Member State filing thresholds. Filing thresholds typically are based on sales in a country.

The Result: To address this perceived concern, the EC issued new guidelines ("EC Guidelines") that expand the types of transactions subject to its "upward referral mechanism," which permits EU Member State National Competition Authorities ("NCAs") to refer transactions to the EC for antitrust review. Effective immediately, the EC Guidelines encourage NCAs to refer for EC antitrust review acquisitions involving companies with little or no sales in the EC or any Member State if the acquisition target might be competitively significant in the future.

Looking Ahead: Unlike EC and NCA merger control thresholds, the new referral rules are subjective. As a result, it may be more difficult to predict whether the EC will review certain deals, even after closing. Although the referral rules apply equally to all industries, the EC warns that the greatest impact will be felt in the tech, biotechnology, and pharmaceutical

sectors where acquisitions of small targets are common and the EC has focused its attention in recent years.

Perceived Enforcement Gap

The EC historically discouraged referrals from NCAs under Article 22 of the EU Merger Regulation when no Member State had jurisdiction to review the transaction. The EC's view was that a transaction involving a target with little or no revenue in any Member State was unlikely to have an anticompetitive effect in the EU.

In recent years, some commentators argued that there is an "enforcement gap" in Europe's jurisdictional thresholds and referral mechanisms that fails to capture acquisitions of a high-value target with little or no revenue in the EU or any Member State, but that might be a significant competitor in the future. Those critics argue that the EC has missed reviewing acquisitions of "nascent competitors" and so-called "killer acquisitions." A killer acquisition occurs when a company acquires a product in development that could compete with its own product and then terminates development of the newly acquired product to prevent competition with its existing product.

In a March report, the EC identified acquisitions of potentially nascent competitors that did not meet the EU jurisdictional thresholds, but that might have warranted EC review given the target's potential future role in competition. According to the EC, such acquisitions are more likely in the tech, biotechnology, and pharmaceutical sectors.

Article 22 Referrals to the EC

Under Article 22, the 27 Member State NCAs have wide discretion to refer transactions that: (i) affect trade between Member States; and (ii) threaten to significantly affect competition within the territory of the Member State or States applying for referral. Member States each have 15 working days from the date when the transaction is "made known" to request EC review. According to the EC, "made known" means sufficient information to assess whether the Article 22 referral criteria could be satisfied. However, those criteria are highly subjective. The EC also may invite Member States to request an Article 22 referral. Notably, complaints from third parties (e.g., customers or competitors) sometimes lead to referrals.

Past EC and NCA guidance limited upward referrals to circumstances in which the Member State had jurisdiction and the EC was the more appropriate reviewing authority. The EC traditionally applied both substantive criteria (e.g., relevant markets wider than purely national)

and procedural criteria (e.g., avoiding parallel investigations or uncoordinated remedial action) to its referral decisions.

If the parties have not closed, the EC's notification of an NCA referral request triggers an obligation to suspend closing until the EC decides whether to accept the referral, or, if it does, close its investigation. The EC also has wide discretion about whether to accept a referral, but it must decide within approximately 40 working days after the transaction was "made known."

New Referral Guidelines

A referral to the EC must still meet Article 22's two jurisdictional requirements detailed above. The EC Guidelines, however, expand the circumstances in which NCAs can make and the EC will accept a referral. As noted above, the EC Guidelines attempt to catch acquisitions of high-value targets with little or no revenue in the EU or in a Member State, but that might be a significant competitor in the future. The EC Guidelines, which the Commission previewed in September 2020, now permit a referral where a Member State does not have jurisdiction and an acquisition target:

> 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 raw materials, infrastructure, data, or intellectual property rights); and/or

> Provides products or services that are key inputs/components for other industries.

The EC Guidelines also allow NCAs to request a referral of consummated transactions, which increases uncertainty. Although the EC indicated that it typically would not accept a referral if six months have passed since closing, that period starts only after public disclosure of "material facts" about the transaction in the EU. Moreover, the EC may consider a referral beyond the six month period in "exceptional situations" but provides little guidance about when it might do so beyond a consideration of the "magnitude of the potential competition concerns and of the potential detrimental effect on consumers."

In February 2021, the EC invited the French Competition Authority to refer a non-reportable transaction in the medical testing business.

Approach of Other Jurisdictions

In recent years, other jurisdictions also have expanded merger control rules to capture acquisitions involving nascent competitors. For example, as noted in our "Global Merger Control Update," in 2018, Germany and Austria introduced new "size-of-transaction" thresholds to supplement their local sales thresholds. When the target and one other party (Germany) or the parties combined (Austria) fail local sales thresholds, a filing can be required if the transaction value is "large" (€400 million in Germany and €200 million in Austria) and the target has significant "local activity."

In the United States, since its inception in 1976, the Hart-Scott-Rodino ("HSR") Act has featured both size-of-transaction and local revenue tests. The U.S. federal and state antitrust enforcers have authority to investigate transactions that are not HSR reportable or that the parties have consummated.

Four Key Takeaways

1. New EC Guidelines encourage National Competition Authorities to refer for EC antitrust review non-reportable acquisitions involving high-value targets that might become significant competitors in the future, even though the target has little or no EU sales.
2. Although the EC's referral rules apply equally to all industries, the EC has said it expects referrals to primarily affect deals in the tech, biotechnology, and pharmaceutical sectors. The EC Guidelines may encourage third parties, such as customers or competitors, to contact the NCAs or the EC and request a referral.
3. Predicting whether the EC will review non-reportable transactions will become more difficult as a result of the subjective referral standard. Parties to non-reportable deals will need to consider whether there is risk of an EC referral and how to account for that risk in the deal documents and the transaction timeline.
4. If there is risk of an EC referral, merging parties should develop an antitrust strategy, similar to the approach in the United States when a deal is non-reportable and there is risk of DOJ or FTC review. Parties also should evaluate whether voluntary EC or NCA outreach would be beneficial, as well as strategies to trigger the 15-working day period in which NCAs can request an EC referral.

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