ALERT MEMORANDUM

European Merger Control in Times of Crisis

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As the COVID-19 pandemic causes commercial and financial difficulties, many businesses will be considering M&A to address strategic issues, take advantage of market opportunities, and, in some cases, ensure their survival. This memorandum considers the merger control implications of the pandemic for businesses contemplating transactions at this time.

First, this memorandum provides an overview of how European agencies are responding to the pandemic. Second, it considers how the crisis may affect the substantive assessment of transactions, including the implications of changed competitive conditions, the availability of the "failing firm" defense, and agencies' evaluation of the counterfactual. Finally, we provide some practical guidance, which may be summarized as follows:

— In assessing potential transactions, account should be taken of the crisis, distinguishing between its short-term effects, which may not change an antitrust agency's assessment, and long-term consequences, which could impact the outcome.

— Companies contemplating transactions involving a distressed target should carefully consider the scope for relying on the "failing firm" defense, recognizing that antitrust agencies have historically accepted that defense only in exceptional circumstances.

— In some cases, it may be appropriate to consider whether merger-related efficiencies are sufficiently compelling to allow a transaction to be approved and/or whether the political context might shape the outcome.

— Finally, companies should take account of the implications of the pandemic when negotiating new transactions, both as regards completion timing and antitrust risk allocation.

This memorandum continues a series on antitrust topics that we expect to be particularly relevant at this time. It supplements the materials available at our Resource Center, including our agency status tracker.

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I. Procedural Challenges During the COVID-19 Pandemic

The COVID-19 pandemic has forced many businesses into remote working. While lockdowns have started to ease in several countries, widespread work-from-home policies are likely to continue for several months. Antitrust agencies are no exception. Most European agencies are now adapting well, and are functioning near normal capacity. Nevertheless, the situation is still creating procedural challenges.

At the start of the pandemic, the European Commission (the "Commission") asked companies to only notify transactions only where there were "very compelling reasons"[1] to do so. In the intervening period, the Commission has started to accept notifications of more complex transactions, including, in the past week, the *LSE/Refinitiv* and *Peugeot/Fiat Chrysler* deals. Even today, though, the Commission is concerned about its ability to undertake effective market investigations during the pandemic. As a result, pre-notification periods and post-notification review timeframes for more complex transactions may remain lengthy in the short-to-medium term. This reflects the following considerations in particular:

— Companies may struggle to respond to requests for information. The Commission and national competition agencies routinely request detailed qualitative information, quantitative data, and large sets of internal documents from merging parties. These requests are continuing during the pandemic, although many businesses are finding it challenging to collate the responsive information.

— Where those delays take place during a pre-notification process, they are likely to extend the time needed for the agency to accept a formal filing. Where they take place after notification, they may result in suspensions to the statutory review period. Indeed, there already appears to have been an uptick in the Commission's use of stop-the-clock powers that suspend its statutory review time periods in recent weeks.[2]

— Finally, third-party stakeholders may take longer to respond to Commission information requests (especially where doing so requires information from disparate parts of their organizations). This may, in turn, make it difficult for the Commission to reach an informed view on the merits of a given transaction within the Phase I review period.

The Commission (and other national antitrust agencies) have endeavored to remain open for business, notwithstanding the inevitable challenges. In some cases, this has involved a transition from in-person meetings to video conferences. By way of example, in May 2020, the Commission used video conferencing for an oral hearing in the *PKN Orlen/Lotos* case, although third parties were not invited to participate given the logistical issues involved.[3]

Our agency status tracker provides the latest available information on agency status during the pandemic.

II. Substantive Issues in Merger Control Assessment

The pandemic may also affect how mergers are assessed. In particular, agencies and merging parties will likely spend an increasing amount of time considering the relevance of changed competitive conditions, the probative value of historic data, and the availability of the "failing firm" defense.

Changed Competitive Conditions

The pandemic has had, and will continue to have, a profound effect on the majority of the world's industries. Certain of these changes may influence how agencies assess transactions.

[1] European Commission, Merger rules and coronavirus, available here.

[2] Case COMP/M.9569, *EssilorLuxottica/GrandVision*; Case COMP/M.9097, *Boeing/Embraer*; Case COMP/M.9162, *Fincantieri/Chantiers de l'Atlantique*; Case COMP/M.9343, *Hyundai Heavy Industries Holdings/Daewoo Shipbuilding & Marine Engineering*.

[3] Andrew Boyce and Lewis Crofts, "PKN Orlen to defend Lotos at EU virtual hearing", MLex (April 28, 2020).

— As demand declines, spare capacity will tend to increase. All else equal, this should limit the ability of merging parties to profitably raise prices, since rivals should be able to use spare capacity to increase output in response. (In *KME/MKM*, for example, the Commission unconditionally approved the combination of two copper manufacturers due to the presence of significant spare capacity in the low-end segments where the parties overlapped (and the prospect of entry by suppliers active in premium segments).[4])

— Conversely, as demand increases, spare capacity will tend to fall if there is no corresponding increase in supply. This may leave rivals with less room to respond to price increases by the merged firm, as they have no means to increase output. Tight capacity may also sustain or create a risk of coordination.

— Changes in supply may also be relevant. As workers stay home, some activity has inevitably halted, leading to supply reductions in certain industries. Where demand has declined in parallel, this may have little effect on competitive conditions. Conversely, where supply has declined but demand has remained unchanged, levels of industry capacity-utilization can be expected to increase, which could confer greater market power on merging firms.

The critical question is likely to be whether the relevant changes are permanent. The challenge for the Commission (and other agencies) will be to distinguish between temporary and permanent changes. This issue is apparent in the recent prohibition decision of the UK Competition & Markets Authority ("CMA") of JD Sports Fashion's acquisition of rival sports shoe and apparel retailer Footasylum. The CMA acknowledged the impact of the crisis on the retail trade, but gave it limited consideration "*[b]ecause we cannot predict the impact of COVID-19 with any confidence.*"[5] The concerns that the CMA had provisionally identified in February therefore remained, notwithstanding the collapse in demand and predicted long-term effect on high street shopping. JD Sports Fashion has contended that the CMA's decision "*materially fails to take proper account of the dynamic and rapidly evolving competitive landscape in which we operate, as well as the long lasting — and likely permanent — impact that COVID-19 has had on our industry*."[6]

Finally, the Commission's analysis, which is necessarily predictive, may be compounded by uncertainties as to the reliability of historic data. Agencies typically look to historical market shares and other data to predict the impact of a notified transaction. If, though, the assumptions underlying those data (*e.g.*, consumer preferences, substitutes, and demand levels) have changed, their relevance may fairly be called into question. In that circumstance, the Commission (and merging parties) may need to attach more importance to other types of evidence.

The "Failing Firm" Defense and Related Arguments

As companies come under stress, an increasing number of transactions may involve firms in financial difficulty. This may, in turn, lead to more cases where agencies come under pressure to approve acquisitions that would ensure the survival of those firms.

The Commission accepts that, where a company is expected to exit the market irrespective of whether a merger proceeds, the concentration may not be the cause of the deterioration in competition. This "failing firm" defense has in a small number of cases enabled the Commission to approve transactions that might otherwise be prohibited where the merging parties have demonstrated that: (i) the failing firm would exit the market absent the transaction; (ii) there is no less anticompetitive alternative purchase; and (iii) the

[4] Case COMP/M.8909, Commission decision of December 11, 2018, paras. 165–166, 176, 181–194, 210–226, 248–250.

[5] "Completed merger on the acquisition of Footasylum plc by JD Sports Fashion plc: Final report", UK Competition and Market Authority, decision of May 6, 2020, paras. 5, 16.

[6] JD Sports Fashion, "Update on CMA review of Footasylum acquisition" (May 6, 2020), available here.

assets of the failing firm would inevitably exit the market absent the transaction.[7] The origins of this test date back to 1993, when the Commission approved a merger to monopoly in the agricultural potash sector.[8]

There have been calls for the Commission (and other antitrust agencies) to relax their approach to the "failing firm" defense in the face of the pandemic. Similar calls were dismissed by the Commission in the aftermath of the global financial crisis, which took the view that "*the proposition that a more lenient failing firm test should be applied in times of recession must be rejected; just as much as the proposition that a tougher test should be applied in good times*."[9]

Early indications are that the Commission will take a similar approach in response to COVID-19. In April 2020, Commissioner Vestager excluded a more permissive approach and warned that the crisis "*shouldn't be a shield to allow mergers that would hurt consumers and hold back the recovery.*"[10] Her comments followed guidance issued by the CMA, which has reiterated its framework and stated that "*[t]he Coronavirus (COVID-19) pandemic has not brought about any relaxation of the standards by which mergers are assessed or the CMA's investigational standards*."[11]

Interestingly, the CMA did accept the "failing firm" defense in approving the *Amazon/Deliveroo* transaction in April 2020, concluding that "*as a result of the Coronavirus (COVID-19) crisis, Deliveroo is likely to exit the market*" and finding that "*the loss of Deliveroo as a competitor would be more detrimental to competition and to consumers than permitting the Amazon investment to proceed.*"[12]

More generally, though, the CMA and other agencies, including the Commission, have been at pains to stress that the standards for the "failing firm" framework are, and will remain, demanding. Businesses may instead want to consider the availability of a broader set of "counterfactual" arguments concerning the competitive environment and position of the merging parties in the absence of the transaction. Arguments of this kind may be expected to play a role in the aftermath of the pandemic where merging parties can point to significant and long-lasting changes in competitive conditions.

III. Practical Guidance

With these considerations in mind, we conclude with some practical guidance.

First, we recommend that companies discuss transactions that could raise substantive issues with antitrust counsel at the earliest opportunity. In doing so, account should be taken of the crisis, distinguishing between its short-term effects, which may not change an antitrust agency's assessment, and long-term consequences, which could impact the outcome.

Second, businesses contemplating transactions involving a distressed target should carefully consider their strategy as regards the "failing firm" defense and related arguments.

— Short-term liquidity issues are unlikely to alleviate competition concerns. Conversely, agencies are more likely to take account of long-term changes in competitive dynamics if they can be expected to permanently undermine the viability of the merging firms.

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7 Paras. 89–91, Commission Communication, Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings (Official Journal C 31, 5.2.2004, p. 5-18).

8 Case No. IV/M.308, *Kali + Salz*, Commission decision of December 14, 1993.

9 OECD, "Roundtable on Failing Firm Defence", DAF/COMP(2009)38, (August 10, 2010), available here.

10 Nicholas Hirst, "Crisis no "shield" for anticompetitive mergers, Vestager says", MLex (April 24, 2020); and Lewis Crofts, "Failing firms won't get more EU leeway to plead for mergers, Vestager says", MLex, April 24, 2020).

11 UK, Competition and Market Authority, "Annex A: Summary of CMA's position on mergers involving "failing firms"" (April 22, 2020), available here.

12 "Anticipated acquisition by Amazon of a minority shareholding and certain rights in Deliveroo: Provisional findings report", UK, Competition and Market Authority, decision of April 16, 2020, paras. 4.1–5.2.

— Merging firms that are contemplating relying on the “failing firm” defense may want to consider conducting auctions to demonstrate the absence of a less anticompetitive purchaser, recognizing of course the possibility that any such auctions might attract interest from bidders that present lower antitrust risks.

— Given the difficulties associated with satisfying the relevant criteria for the “failing firm” defense, it may be more effective to develop a strategy focused more broadly on the counterfactual to the notified transaction.

Third, it may be appropriate to consider whether merger-related efficiencies are sufficiently compelling to allow a transaction to be approved and/or whether the political context might shape the outcome (notwithstanding the Commission’s resistance to political pressure), especially where a transaction would lead to compelling consumer benefits, strengthen firms in critical industries, or support security of supply.

Fourth, in addition to merger control, parties should consider the potential for foreign direct investment (“FDI”) review of contemplated transactions. These regimes are growing in number and coverage, including as a result of the COVID-19 pandemic, where the Commission and other regulators have signaled an intention to protect “strategic industries” from foreign takeover. Companies would be well-served to consider the potential for additional deal complexity upfront, as part of their initial planning process.[13]

Finally, companies should take account of the implications of the pandemic when negotiating new transactions, both as regards completion timing and regulatory risk allocation.

We will continue to monitor how merger control agencies are dealing with, and reacting to, the COVID-19 pandemic. And we stand ready to help with any points of difficulty at this time.

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[13] See, for example, our International Trade and Sanctions Watch Blog post on the Commission Communication, Guidance to the Member States concerning foreign direct investment and free movement of capital from third countries, and the protection of Europe’s strategic assets, C(2020) 1981 final, March 25, 2020.

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