ALERT MEMORANDUM

European Commission Implements New Policy To Investigate Transactions That Would Otherwise Escape Merger Review

April 23, 2021

In March 2021, the European Commission ("**EC**") issued a guidance paper ("**Guidance Paper**") that, with immediate effect, encourages national competition authorities ("**NCAs**") to refer to the EC transactions that do not meet national merger control thresholds and would therefore otherwise escape merger control in the EU.

The new policy represents the most significant revamp of the EU merger control regime since the enactment of the recast EU Merger Regulation ("**EUMR**") in 2004. It was first outlined by Competition Commissioner Margrethe Vestager in September 2020 (*see* Alert Memorandum). The rationale for the change is to provide additional flexibility to review transactions that fall below national merger control thresholds but could nonetheless harm competition. The EC is particularly focused on capturing so-called "killer acquisitions."

The policy allows the EC to review transactions even after closing, although the EC will generally not consider a referral more than six months after closing or (if the closing is not public) after "*material facts about the concentration have been made public in the EU.*"

The new policy does not require formal amendments to EU merger control rules. Its effect has been immediate. On April 20, 2021, in response to a referral request from several NCAs, the EC asked Illumina to notify the proposed acquisition of cancer detection test maker Grail, a transaction that does not meet notification thresholds in any Member State.

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For many transactions that do not meet EU or Member State thresholds, the risk of referral will remain low, including because the EC can accept a referral only if a transaction "*affects trade between Member States*" and "*threatens to significantly affect competition*" in the referring Member State.[1] Further, the new policy does not impose a reporting obligation.

In some cases, however, the new policy will create uncertainty by increasing the risk of referral and merger review. Companies will need to consider how to reflect this risk in transactional documents, to assess how that risk can be mitigated, and to decide whether to close and implement deals in circumstances where a referral cannot be excluded.

The full text of the EC's Guidance Paper on the new referral policy is available here.[2]

Background and context

The EC's power to review transactions that are not reportable to the EC or NCAs has existed under Article 22 EUMR since the EUMR entered into force in 1990. The Article 22 referral mechanism was originally designed to address the situation that certain Member States had no merger rules when the EUMR was adopted in 1989 (including the Netherlands, which led to the provision being known as the "*Dutch clause*").

Today, all Member States but Luxembourg have enacted national merger control regimes, diluting the original rationale for the rule. The EC accordingly developed a practice of "*discouraging*" NCAs from referring transactions to the EC that the NCAs lacked the power to review themselves under their own merger control rules. This practice was informed by the experience that such transactions "*were not generally likely to have a significant impact on the internal market*."[3] As of March 31, 2021, requests for Article 22 referral have been made in 41 cases, four of which were made prior to 1998 by Member States that lacked national merger control rules at the time of the referral.[4]

The new policy arises out of the EC's years-long evaluation of whether the EUMR's jurisdictional thresholds have resulted in an enforcement gap and should be revised.[5] Interestingly, the EC's 2016-2017 public consultation did not identify a widely perceived enforcement gap (with only three of 15 respondent NCAs considering that there is an enforcement gap).[6]

More recently, however, the EC has observed transactions involving companies that have or may play a significant competitive role despite generating little or no turnover, particularly in the digital and pharmaceutical sectors. These include what are referred to as "killer acquisitions" (*i.e.*, acquisitions by strong incumbents of innovative nascent

[1] Article 22(1) EUMR: "*One or more Member States may request the Commission to examine any concentration as defined in Article 3 that does not have a Community dimension within the meaning of Article 1 but affects trade between Member States and threatens to significantly affect competition within the territory of the Member State or States making the request. Such a request shall be made at most within 15 working days of the date on which the concentration was notified, or if no notification is required, otherwise made known to the Member State concerned.*"

[2] The Guidance Paper is accompanied by the EC Staff Working Document, Evaluation of procedural and jurisdictional aspects of EU merger control, March 26, 2021, SEC(2021) 156 final, SWD(2021) 67 final ("**Staff Working Document**").

[3] Guidance Paper, paragraph 8.

[4] *British Airways/Dan Air* (Case M.278, referred by Belgium in 1992), *RTL/Veronica/Endemol* (Case M.553, referred by the Netherlands in 1995), *Kesko/Tuko* (Case M.784, referred by Finland in 1996), and *Blokker/Toys "R" Us (II)* (Case M.890, referred by the Netherlands in 1997). The EC has also accepted referral requests from Member States that lacked jurisdiction under national law where the request was made to join a pre-existing referral request by a Member State that had jurisdiction under national law. *See SCJ/Sara Lee*, Case M.5969, Commission decision of September 7, 2010.

[5] In 2014, the EC consulted on the possibility of extending the scope of the EUMR to apply to the acquisition of non-controlling minority shareholdings but decided against such a reform. More recently, the EC's focus has been on "killer acquisitions" and on whether such transactions could be captured by introducing filing thresholds based on transaction value, an approach adopted by national merger control regimes in Germany and Austria in 2017.

[6] Staff Working Document, paragraph 87 and footnote 110.

businesses that might otherwise have exercised strong competition, often with a view to terminating the target's innovations and thereby avoiding competition). According to the EC, a number of such transactions are not captured by jurisdictional thresholds at EU level or in Member States. The new Article 22 referral policy is intended to encourage and accept referrals where necessary to ensure that "*transactions that merit review under the Merger Regulation are examined by the Commission.*"[7]

Transactions that risk referral

Under the EC's new policy, it may seek a referral and assert jurisdiction over transactions that would previously have escaped review. According to Article 22 EUMR, a Member State may ask the EC to examine a concentration, even post-closing, that does not meet EU or the referring Member State's thresholds but:

— "*affects trade between Member States*"; and

— "*threatens to significantly affect competition*" within that Member State's territory.

To meet the first criterion, a Member State requesting referral must show that the transaction "*is liable to have some discernible influence on the pattern of trade between Member States*." The second condition is fulfilled where, "*based on a preliminary analysis, there is a real risk that the transaction may have a significant adverse impact on competition, and thus that it deserves close scrutiny.*"[8]

Deals that in the EC's view may be appropriate for a referral include transactions where the turnover of at least one of the parties "*does not reflect its actual or future competitive potential*," particularly if compared to the transaction value.[9]

According to the Guidance Paper, cases suitable for a referral are not limited to any specific industry and will typically consist of transactions where the 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 (such as a recent entrant or a competitor with promising pipeline products);

— has access to competitively significant assets (*e.g.*, raw materials, infrastructure, data, or intellectual property rights); and/or

— provides products or services that are key inputs or components for other industries.

The impact of the new policy will vary by industry. Mergers in the digital and pharmaceutical sectors are likely to be among the most affected.

— **Digital sector.** The EC's focus will be on the acquisition of businesses that "*launch with the aim of building up a significant user base and/or commercially valuable data inventories, before seeking to monetise the business.*"[10] The new policy will complement the EC's legislative proposal for the Digital Markets Act (DMA), which the EC expects to be adopted in mid-2022 and enter into force by 2023 at the earliest.

  According to the draft DMA bill published in December 2020, companies that offer "core platform services" and are designated gatekeepers by the EC[11] would have to inform the EC of all intended mergers and acquisitions involving "*another provider of core platform services or of any other services provided in the digital sector*" regardless of whether these transactions meet EU merger control thresholds.[12] The possibility of Article 22 referral will operate in tandem with the DMA by enabling the EC to take merger control

[7] Guidance Paper, paragraph 11.

[8] Commission Notice on Case Referral (2005/C 56/02), paragraphs 43–44.

[9] Guidance Paper, paragraph 19.

[10] Guidance Paper, paragraph 9.

[11] The Commission expects the gatekeeper thresholds to be met by 10 to 15 providers of core platform services.

[12] *See* Proposal for a Regulation of the European Parliament and of the Council on contestable and fair

jurisdiction over transactions of which they are informed pursuant to the DMA.

— **Pharmaceutical sector**. Likely candidates for Article 22 referrals will include "*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*."[13] Pharmaceutical mergers are high on the EC's agenda. Last month, the EC, together with its US counterparts the FTC and DOJ, the UK Competition and Markets Authority ("CMA"), and other enforcers, launched a multilateral working group to analyze the effects of mergers in the pharmaceutical sector.[14] As noted below, a merger between pharmaceuticals firms Illumina and Grail is the first non-reportable transaction referred to the EC under Article 22 EUMR in line with the new referral policy.

— **Other sectors.** The EC will consider Article 22 upward referrals of transactions across all industries, particularly "*where innovation is an important parameter of competition*" or transactions involving "*companies with access to or impact on competitively valuable assets, such as raw materials, intellectual property rights, data or infrastructure*."[15] It has been reported that the EC is also interested in reviewing acquisitions of "green" technologies in the industrial sector and acquisitions by large credit rating agencies of smaller but growing competitors.

The types of transactions for which the EC may seek referral are illustrated by the EC's evaluation, which identified specific transactions from 2015-2019 that in the EC's view may have merited review. The EC's evaluation focused on transactions with a value exceeding €1 billion or involving "GAFAM" companies (Google, Amazon, Facebook, Apple, and Microsoft).[16] These consisted primarily of:

— Transactions with a deal value exceeding €1 billion and with a value/sales ratio higher than 5,[17] including healthcare deals *Shire/Dyax* (2015), *AbbVie/Pharmacyclics* (2015), *Pfizer/Medivation* (2016), and *Takeda Pharmaceuticals/ARIAD Pharmaceuticals* (2017); and tech deals *SS&C Technologies Holdings/Advent Software* (2015), *Ingenico Group/Bambora* (2017), and *Cisco Systems/Broadsoft* (2017).

— Transactions with a deal value below €1 billion but involving "*acquisitions of potentially nascent competitors*."[18] These included tech deals *Facebook/Giphy* (2020), *Facebook/Play Giga* (2019), *Amazon/Ring* (2018), *Apple/NextVR* (2020), and *Takeaway/Delivery Hero* (2018); healthcare deals *Merck/Immune Design* (2019) and *Roche/Spark Therapeutics* (2019); and industrial deal *Mitsubishi/Bombardier regional aircraft business* (2019).[19]

markets in the digital sector (Digital Markets Act) (COM/2020/842 final), Article 12.

13 Guidance Paper, paragraph 9.

14 *See* Commission Press Release ,"The European Commission forms a Multilateral Working Group with leading competition authorities to exchange best practices on pharmaceutical mergers," March 16, 2021. According to the Commission, the goal of the working group "*is to identify concrete and actionable steps to update the analysis of pharmaceutical mergers. It will bring enhanced scrutiny and more detailed analysis of these kinds of mergers in the future, for the benefit of consumers*."

15 Guidance Paper, paragraph 9.

16 Staff Working Document, paragraph 99.

17 Staff Working Document, footnote 139.

18 Staff Working Document, footnote 143.

19 During the Commission's evaluation, certain NCAs identified other transactions that were not caught by EU or Member State jurisdictional thresholds as evidence of an enforcement gap. These included *Bazaarvoice/ PowerReviews*, a merger that did not meet the U.S. deal-size threshold of USD 76 million and which was successfully challenged post-implementation by the U.S. Department of Justice, *Adidas/Runtastic* (a fitness app maker acquired for €220 million), and *PotashCorp/Kali+Salz*. Third-party respondents are reported to have mentioned acquisitions by Google of DailyDeal (2011 – USD 114 million transaction value), Waze (2013 – USD 1.1 billion), Nest Labs (2014 – USD 3.2 billion), Dropcam (2014 – USD 555 million), DeepMind Technologies (2014 – USD 600 million), Dark Blue Labs and Visual Factory (2014 – USD 50 million),

Referral procedure

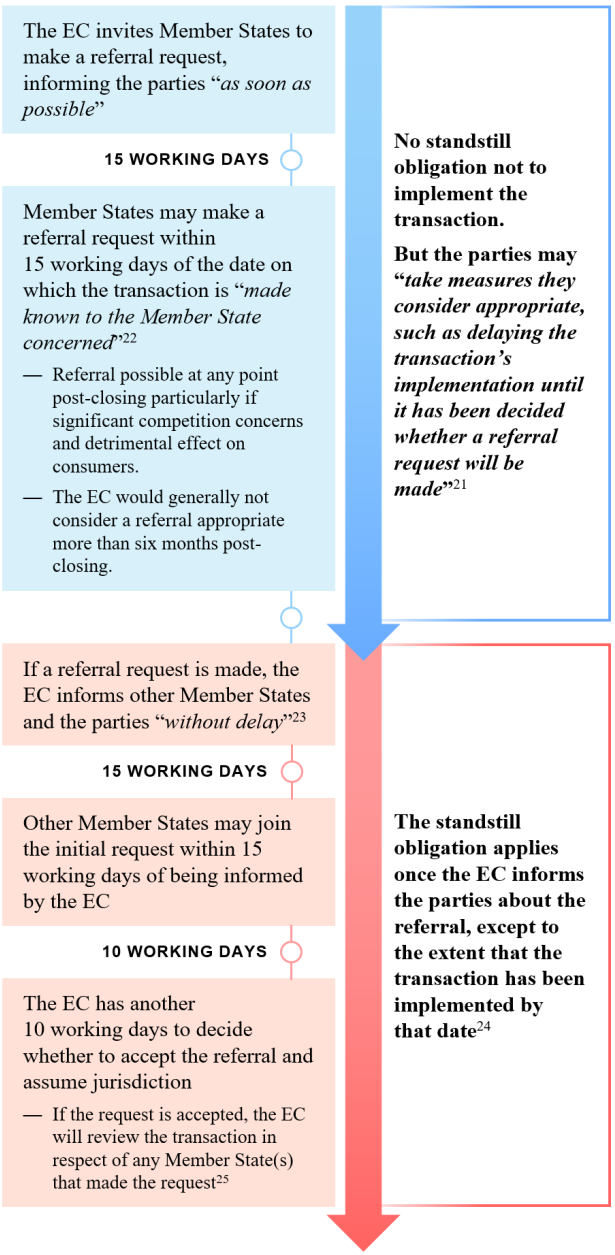
The EUMR permits a Member State to refer a transaction to the EC at any stage of the deal, including post-closing. The Guidance Paper encourages parties to voluntarily come forward with information about proposed transactions. The EC may give parties an early indication of whether a transaction would be suitable for referral to the EC if "*sufficient information to make such a preliminary assessment has been submitted*."[20]

The Guidance Paper also invites third parties to inform the EC or the NCAs about transactions that could be good candidates for referral. We expect EC staff to monitor companies' public announcements and the deal pipeline (*e.g.*, by screening transactions recorded in Bloomberg's deal list financial database) and to invite NCAs to refer transactions that it considers as meeting the relevant criteria.

Given that NCAs would have no jurisdiction to review the transaction themselves in any event, NCAs have no evident incentive to decline any EC invitation to refer a deal. That said, while questionable in view of the primacy of EU law, several NCAs are reported to have taken a view that their national laws do not empower them to request a referral to the EC of a transaction that does not meet the national jurisdictional thresholds. It therefore remains to be seen how the system will work in practice.

For transactions that do not meet EU or Member State jurisdictional thresholds, the referral process takes at least 40 working days from the time the transaction is "made known" to the NCA. If the EC accepts the referral and asserts jurisdiction, parties must also plan for a pre-notification process with the EC (which on average lasts for about four months in referral cases) before being in a position to formally notify the transaction to the EC.

The referral process consists of the following stages:



The EC's decision whether to accept or reject a referral request will take into account the time elapsed since the closing. The EC will generally not consider a referral appropriate more than six months after closing. If the information about closing has

Skybox (2014 – USD 500 million), and Moodstock (2016); the acquisition by Microsoft of Mojan AS (2014 – USD 2.5 billion); and the acquisition by Facebook of Oculus VR (2014 – USD 2 billion). *See* Staff Working Document, paragraphs 88–89.

[20] Guidance Paper, paragraph 24.

[21] Guidance Paper, paragraph 27.

[22] Article 22(1), second paragraph, of EUMR.

[23] Guidance Paper, paragraph 29.

[24] Article 22(4) EUMR.

[25] Article 22(3) EUMR.

not been available in the public domain, the six-month period would run from the moment when "*material facts about the concentration have been made public in the EU*." In "*exceptional situations*," however, the EC may accept a referral beyond this deadline if justified by, for example, "*the magnitude of the potential competition concerns and of the potential detrimental effect on consumers*."[26]

The first referral case under the EC's new policy

On February 19, 2021, the EC invited NCAs to request a referral of the *Illumina/Grail* transaction,[27] which does not meet EUMR or any EU national jurisdictional thresholds. Grail has not launched a product on the market and has no sales in the EU. The $7.1 billion biotech deal was announced in September 2020 and is being reviewed in the United States, and the parties are reported to have received information requests from the CMA. On March 30, 2021, the Federal Trade Commission voted unanimously to file a complaint to block the proposed acquisition on the basis of a vertical effects theory. The FTC claims that Illumina is the "only viable supplier" of next-generation sequencing (NGS) instruments and consumables, and could foreclose Grail's competitors in the development of multi-cancer early detection (MCED) tests in the United States.[28]

In response to the EC's invitation, on March 9, 2021 the French NCA, the *Autorité de la concurrence*, requested that the *Illumina/Grail* transaction be referred to the EC under Article 22 EUMR. The French agency's request was subsequently supported by Belgium, Greece, the Netherlands, Iceland, and Norway. This is the first time since 2004 that an upward referral to the EC has been requested by a Member State that does not have jurisdiction over the transaction.

Illumina appealed the Dutch and French NCAs' decisions before national courts, which dismissed Illumina's appeals on March 31 and April 1, 2021, respectively.[29] In France, the Conseil d'État held that the referral decision is "*inseparable from the* [European] *Commission's review of the transaction*," which "*falls under the control of the* [EU] *Court of Justice*" and therefore the parties' claim was inadmissible before the French court.[30] In the Netherlands, the Hague District Court reviewed the parties' appeal on the merits but dismissed the claim that the Dutch NCA, the *Autoriteit Consument en Markt*, did not have the power to join the French NCA's request because the transaction does not meet the jurisdictional thresholds in the Netherlands.[31]

On April 20, 2021, the EC announced that it has accepted the referral request submitted by the six NCAs and has asked Illumina to notify the Grail acquisition (which is now subject to the standstill obligation pending the EC's clearance).[32] The Commission determined that the deal meets the criteria for referral under Article 22 EUMR on the grounds that:

— the combined entity "*could restrict access to or increase prices of next generation sequencers and reagents to the detriment of GRAIL's rivals active in genomic cancer tests following the transaction*";

— "*GRAIL's competitive significance is not reflected in its turnover, as notably evidenced by the USD 7.1 billion dollar deal value*";

— "*Genomic cancer tests, having the potential to identify a wide variety of cancers in*

[26] Guidance Paper, paragraph 21.

[27] On September 21, 2021, Illumina, a U.S.-based pharmaceutical company announced its intention of acquiring Grail, a U.S. start-up that has developed multi-cancer early detection ("MCED") tests.

[28] Federal Trade Commission Press Release, "FTC Challenges Illumina's Proposed Acquisition of Cancer Detection Test Maker Grail : Agency alleges vertical merger would harm competition in the U.S. market for life-saving Multi-Cancer Early Detection tests," March 30, 2021.

[29] Conseil d'État, *Illumina-Grail v. Autorité de la concurrence*, order n° 50878 and 450881 of April 1, 2021.

[30] Translation from the original French text. *See* Conseil d'État, *Illumina-Grail v. Autorité de la concurrence*, order n° 450878 and 450881 of April 1, 2021, paragraph 4.

[31] *Rechtbank Den Haag*, *Illumina Inc.- Grail Inc. v. De Staat der Nederlanden*, judgment n°31C/09/609526 of March 31, 2021.

[32] *See* Commission Press Release "Commission to assess proposed acquisition of GRAIL by Illumina," April 20, 2021.

asymptomatic patients, are expected to be game-changers in the fight against cancer."[33]

Illumina issued a press release disagreeing with the EC's decision and noting that the two companies do not compete in any way. Illumina stated that the company does "*not believe that the European authorities have jurisdiction to review the GRAIL acquisition*" but that it would continue to work with the EC "*to bring the investigation to conclusion.*"[34]

Navigating the regulatory uncertainty

The EC's new policy will create uncertainty for transactions that do not meet EU and Member State thresholds. It will add more regulatory complexity in the context of anticipated stepped-up merger scrutiny under the U.S. Biden administration, increasingly vigorous merger enforcement by the CMA, the Australian Competition and Consumer Commission (ACCC), and other authorities, and the proliferation of foreign investment review regimes that capture a broader range of transactions.

In one signal of anticipated stepped-up merger enforcement, on April 20, 2021 Germany's Federal Cartel Office (*Bundeskartellamt*), the CMA, and the ACCC released a joint statement "*on the need for rigorous and effective merger enforcement.*" The statement questions the presumption that mergers are generally efficiency-enhancing and discourages the use of behavioral remedies (as opposed to structural remedies – prohibition or divestment of a standalone business) for addressing concerns in merger cases.[35]

It would be difficult as a policy matter to argue that potentially anticompetitive transactions should automatically be exempt from regulatory review merely because the target firm's revenue falls below prescribed thresholds, as has been the case in practice in the EU. Not all merger control regimes operate like this. The U.S. merger control system, for example, allows the FTC and the DOJ to open investigations into transactions that fall below Hart-Scott-Rodino reporting thresholds, and they do so routinely. The UK system, based on voluntary notifications, operates to similar effect. Rigid, turnover-based jurisdictional thresholds are not the only basis for a workable merger control system.

At the same time, however, such rules bring valuable predictability that should not be compromised without good reason. The EU merger control regime now departs from the International Competition Network's recommendations to adopt "clear and understandable" notification thresholds.[36] Since its inception, a hallmark of the EUMR – widely followed around the world – has been its clear, objective jurisdictional thresholds, disputes over the application of which have been relatively rare. These rules also reflect legislators' judgment as to the appropriate balance between freedom to conduct business and the need for regulatory oversight to protect competition.

In the longer term, the EC's revised policy may inspire other jurisdictions to introduce discretion in calling in transactions for merger control review. This would be an unfortunate evolution from the current situation where clear and objective tests are the norm, increasing the burden of what is already a highly complex and unwieldy global merger control system.

The reversal of the EC's policy gives rise to a number of considerations for companies involved in transactions that do not meet jurisdictional thresholds at EU level or in any Member State.

— **Assessment of the referral risk.** Buyers will have to assess the risk of an upward referral of transactions that do not meet EU or Member State thresholds. For many deals such risk will remain low, since the EC can accept a referral only if the transaction "*affects trade between Member States*" and – more importantly – "*threatens to significantly affect competition*" in the referring Member State. The EC's intention is not to call in more competitively benign deals for review. But difficult issues will arise: for example, assessing the geographic nexus may be

[33] *Ibid*.

[34] Illumina Press Release, "Illumina Remains Committed to GRAIL Acquisition to Accelerate Access to Breakthrough Multi-Cancer Early Detection Blood Test," April 20, 2021.

[35] 'Joint statement on merger control enforcement', April 20, 2021.

[36] Recommended Practices for Merger Notification and Review Procedures, issued by the International Competition Network (2018), Section II.D.

challenging for transactions, such as *Illumina/Grail*, where the target has no sales in the EEA but concerns are raised about potential future competition in the EEA. While the EC will decide whether to accept referrals on a case-by-case basis, a consistent and transparent approach will be critical if the new policy is not to undermine the prior system's valuable predictability.

— **Impact on closing conditions and deal terms**. If a transaction does not require any antitrust or regulatory approvals, buyers will need to decide whether they are comfortable closing in the knowledge that there could be a subsequent review by the EC. Buyers may also want to consider the risk of the EC's requesting a remedy, pre- or post-closing. Deal documents may provide for the possibility of adjusting the long-stop date and antitrust risk allocation, particularly if the EC informs the parties about having invited Member States to make a referral request (at which point the standstill obligation would not yet apply) or if the EC informs the parties about Member State(s) having already made a referral request (which would trigger the standstill obligation prohibiting the parties from closing the deal pending the EC's review).

— **Proactive engagement with the EC and NCAs?** Obtaining certainty that a referral will not be made may not be straightforward. A buyer will need to assess the benefit of voluntarily informing the EC about the intended transaction in order to seek an early indication that the EC does not consider the deal to be a good referral candidate. Such outreach would require a buyer to provide the EC with "*sufficient information to make such a preliminary assessment*."[37] While the EC is open to providing such guidance, it is not clear how much information a buyer would need to provide and how long it will take for the EC to give its indicative view.

To increase legal certainty, a buyer may also want to consider informing the NCAs about intended deals. The NCAs must make referral requests within 15 working days from the date on which the deal is "*made known*" to the NCA (defined somewhat ambiguously as when a Member State has "*sufficient information to make a preliminary assessment as to the existence of the criteria for the making of a referral request*").[38] If each of the NCAs has been so informed and has not made a referral request within 15 working days, the EC should not be able to assert jurisdiction over the deal.[39] There are, though, various reasons why a buyer might be reluctant to alert the EC and NCAs to a transaction that might otherwise not receive scrutiny, not to mention the practical challenges of approaching 27 competition authorities.

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[37] Guidance Paper, paragraph 24.

[38] *See* Commission Notice on Case Referral, footnote 43.

[39] There is uncertainty about the extent to which NCAs' decisions to make a referral request could be appealed before national courts of the Member States concerned. As noted above, in *Illumina/Grail* the French Court ruled that the Autorité de la concurrence's decision cannot be appealed before the French court, while the Dutch court reviewed the parties' appeal on the merits. Uncertainty also exists as to the ability to challenge the EC's decision to accept an Article 22 referral (and to request a notification) before the EU General Court upfront, or whether a jurisdictional challenge could be reviewed only as part of the EC's final decision on whether the transaction is compatible with the internal market (*see*, *e.g.*, *Endemol Entertainment Holding B.V. v. Commission*, Case T-221/95, EU:T:1999:85, paragraphs 42–47).