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Ruling On EU Commission Merger Reviews Signifies U-Turn

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July saw the European General Court, a constituent court of the Court of Justice of the EU, confirm a major extension of the regulatory power of the European Commission competition watchdog under Article 22 of the EU Merger Regulation, or EUMR.

With the ruling in Illumina Inc. v. European Commission, the General Court has confirmed the validity of the EC's new policy to use Article 22 to review cases that do not qualify for review under the merger control rules of the requesting member state.

The General Court has sided with the EC in its new interpretation of Article 22 and its March 2021 guidance note, allowing the EC to assert jurisdiction over deals involving innovative companies with significant competitive potential, even if national thresholds were not met.

The General Court's decision gives significant new powers to Brussels and will encourage member states to refer deals for which they do not have jurisdiction to the EC to review them. This will lead to significant legal uncertainty for deal makers.

But how did we get here?

License to Kill Acquisitions?

Article 22, also called the Dutch clause, was originally designed to deal with the situation of member states that, at that time, had no merger control rules, such as the Netherlands.

For decades, however, the EC's policy, and established practice, was to discourage member states to refer transactions that would not meet their national merger control thresholds.

In addition, the EC used to advocate for the limited use of Article 22 requests, due to the "additional cost and time delay" involved for the merging parties. The EC also stated that Article 22 was "sometimes perceived to be slow and cumbersome."

However, on Sept. 21, 2020, U.S. life sciences company Illumina announced a takeover of U.S. outfit Grail, which would be the catalyst for a landmark U-turn on the EC's referral policy.

On March 26, 2021, the EC issued its new Article 22 guidance encouraging member states to refer mergers that fall below national merger thresholds if they:

(i) Affect trade between member states; and

(ii) Threaten to significantly affect competition within the territory of the member state or states making the request.

The main rationale was to limit so-called killer acquisitions, where larger corporate entities could snap up smaller businesses solely to discontinue the target's innovation projects and preempt future competition.

Specifically, the thinking behind this is that innovative start-ups could be picked off by powerful companies before they reach the turnover threshold and avoid merger control and scrutiny from competition authorities.

Old Thresholds

According to the EC, since Grail's turnover did not exceed the relevant thresholds — in fact, Grail had no activities in the EU — the concentration at issue did not have a European dimension, within the meaning of Article 1(2) of the EUMR and was accordingly not notified to the EC.

The EC added that the deal was also not notified in the EU member states or in states party to the Agreement on the European Economic Area, since it did not reach the relevant national thresholds either.

Under Article 22, a national competition authority has the option to request a referral to the EC for the examination of any concentration that does not have a European dimension, but which affects trade between member states and threatens significantly to affect competition in the territory of the member state concerned.

However, on Dec. 7, 2020, the commission received a complaint about the transaction, which was then raised with member states' competition authorities, inviting them to make a referral under Article 22 despite the transaction not meeting their national thresholds.

Subsequently, the French, Belgian, Greek, Icelandic, Dutch and Norwegian competition authorities joined the referral request. On March 11, 2021, the Commission informed Illumina and Grail of that referral request almost two weeks before the body published the latest guidance.

On April 28, 2021, Illumina brought an action for annulment against the contested decisions and the information letter, which is why the case finally ended up before the General Court.

Court in the Act

The case was the first time that the General Court ruled on the application of the Article 22 referral

mechanism in cases where a transaction does not meet any national thresholds, setting a new precedent in the process.

The ruling confirmed the commission's interpretation of Article 22, asserting the latter's power to review any concentration following a referral request made by a member state, even if that member state's national thresholds are not met.

In particular, the court found that the wording "any concentration" in Article 22 makes it clear that member states are entitled to refer concentrations that do not meet their national thresholds but still meet the cumulative conditions of Article 22(1).

The court also went on to say that if no notification is required under Article 22(1), a referral request must be made within 15 working days of the concentration being "made known" to the member state; "made known" being the "the active transmission of information" to the member state concerned, which is appropriate for it to be able to assess, on a preliminary basis, whether the necessary conditions for the purposes of a referral have been satisfied.

Finally, the General Court also rejected Illumina's claim that its legitimate expectations had been breached by the commission sending the invitation letter before the publication of the guidance.

The General Court noted that for the principle of legitimate expectations to be breached, an undertaking must have received "precise, unconditional and consistent assurances, originating from authorized, reliable sources," such as to lead him or her to entertain well-founded expectations.

The General Court cited public statements made by the vice-president of the commission in September 2020, where she stated that it was time to change the past referral policy but that "this won't happen overnight" did not constitute precise, unconditional and consistent assurances.

Deals or No Deals?

The ruling has several critical permutations for deal-makers looking at investments with a European angle.

First, takeovers involving attractive start-up companies or small and medium-sized enterprises in critical sectors, such as tech and pharma industries, now may face EU scrutiny even if the target's turnover does not appropriately reflect its competitive importance on the market.

This is the case when the target does not even generate any turnover in the EU. This substantially decreases legal certainty for companies who can face a lengthy and costly EU merger control review, even after the transaction has closed.

Faced with such uncertainty, companies involved in transactions must decide whether to proactively inform the commission.

Both scenarios have their pros and cons, whether that be clarity over whether a deal will progress smoothly versus creating unnecessarily bureaucracy, versus flagging up something that would have otherwise gone under the EC's radar versus risk a referral up to six months after a deal has closed.

This gives a significant power to Brussels, and it will encourage member states to refer deals for which

they do not have jurisdiction to the commission to review them.

Any deal that could have a competition impact or any deal that could risk a complaint by competitors is now at increased risk.

Parties will have to establish their regulatory filings strategy well in advance and include appropriate risk-shifting provisions, conditions precedent and long stop dates in their sale and purchase agreements.

Perhaps the biggest takeaway, however, is the message the ruling sends out. The judgment seriously impairs legal certainty in the EU.

Regulatory regimes require a level playing field and fair, transparent and clear policies where every participant plays by the agreed rules. With the General Court backing a sudden and significant U-turn in a well-established commission policy, it sends out the worrying message that the EC can apparently make up the rules as it goes along.

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