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European merger control – key considerations for public M&A and private equity

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Until recently, merger control was the main consideration for M&A transactions in Europe: dealmakers only had to consider merger control approvals at the European Union (EU) and national levels.

After a couple of years characterised by strong geopolitical tensions marked by the coronavirus (COVID-19) crisis and then Russia's invasion of Ukraine, M&A in Europe is now facing increased merger control and regulatory scrutiny in the following three key areas.

First, merger control enforcement has become more expansive and more aggressive. Second, deals are now subject to multiple national reviews under the newly adopted or updated foreign direct investment (FDI) regimes across the EU and the UK. Third, the EU Foreign Subsidies Regulation (FSR) adds a third layer of regulatory scrutiny for certain large transactions.

In this article we provide a brief overview of each of these three trends, and we conclude with some key considerations for dealmakers both on the public M&A and private equity fronts.

More aggressive merger control enforcement

The European Commission (EC) and the UK Competition and Markets Authority (CMA) have become increasingly aggressive in their jurisdictional reach and their merger enforcement.

Unprecedented jurisdictional reach. On the jurisdictional front, the EC can now assert jurisdiction over any transaction, even when the target does not realise any revenues in the EU. This major jurisdictional expansion was endorsed by the EU General Court in the seminal *Illumina, Inc. vs EC* case, where the General Court upheld the EC's decision to assert jurisdiction over an acquisition in which the target had zero sales in the EU. In practical terms this judicial endorsement gave the EC unfettered power to assert jurisdiction over any transaction. Under its new guidance the EC will not apply this expanded reach in an indiscriminate way, but will instead focus on transactions raising so-called killer acquisition or innovation concerns, primarily in the tech and pharma sectors. The EU's General Court judgment is still subject to appeal by Illumina, but until and unless the Illumina judgment is reversed on appeal, the EC will continue to have the power to assert jurisdiction over any transaction regardless of whether the target has sales in the EU or not.

The UK Competition and Markets Authority (CMA) has also taken an equally

expansive approach on jurisdiction. In the *Meta/Giphy* acquisition, the CMA asserted jurisdiction even though the target had zero revenues in the UK, and blocked the deal. The CMA asserted this jurisdictional overreach through an overly expansive interpretation of the 25 percent "combined firm share of supply" test, which the CMA considered met even though Giphy had zero UK sales.

Aggressive substantive enforcement. In recent years, there has been an increasing concern in the EU that merger underenforcement has led to the creation of oligopolistic market structures that ultimately lead to less innovation and higher prices for consumers. This has led to more aggressive merger enforcement by the EC, based primarily on horizontal theories of harm, and a very expansive interpretation of the non-coordinated effects theory of harm. Under this theory, a merger can still lead to anticompetitive effects if it softens competition between the combined firm and the remaining market players, even if the combined firm is not the leading market player post-merger.

In parallel, the EC has been increasingly focused on the reduction of innovation competition as a standalone theory of harm. The trend started with the 2017 *Dow/Dupont* merger decision, where the EC applied the innovation theory of harm in a horizontal context. In that case, the EC assessed the competitive effects of the merger on innovation at the level of the industry as a whole and at "innovation spaces", which were not properly defined markets but rather areas of innovation efforts where the parties were close and important competitors.

The EC extended further the innovation theory of harm in vertical mergers with the *Illumina/Grail* case, where the EC blocked the deal based on vertical foreclosure concerns that Grail's downstream competitors would not have the ability or incentives to continue to innovate post-merger. The common denominator of these innovation theories of harm is that they are largely based on qualitative assessments by the EC – primarily selected internal documents and views of third parties – which makes them also harder for merging parties to defend.

The more aggressive enforcement of the EC is only surpassed by the more aggressive enforcement of the CMA. In the post-Brexit period, the CMA has sought to establish itself as a gateway jurisdiction for global cross-border deals, putting it on par with the US agencies and the EC. *KoneCranes/Cargo Tech* is a clear example of this more aggressive approach. The EC had cleared that acquisition subject to extensive divestiture remedies, but the CMA blocked the transaction in March 2022, on the basis that the remedies that the parties had offered were inadequate, despite the fact that the EC had considered the exact same remedies as sufficient to address virtually identical concerns in essentially the same markets.

FDI review required in certain sensitive sectors

Dealmakers not only need to consider the broad merger control regimes, but also the emerging foreign direct investment (FDI) control regimes that emerged or were strengthened across the EU and the UK in recent years.

At the onset of the coronavirus (COVID-19) pandemic, the EC actively encouraged member states to adopt or reinforce their foreign investment control regimes to protect key EU businesses from predatory acquisitions by foreign actors, which include in particular businesses that are active in sensitive sectors such as defence and national security, critical technologies, telecommunications, healthcare, energy, pharma, transport, critical infrastructure, inputs or otherwise have access to sensitive information. This led to a propagation of FDI regimes across the EU and a multiplication of amendments to existing FDI regimes to make FDI controls more restrictive. As of 2022, 25 of the 27 EU member states had adopted or were in the process of adopting an FDI regime, compared to only 11 member states in 2017.

In the EU, the FDI Screening Regulation, which entered into force on 11 October 2020, aims at streamlining and coordinating the national foreign investment reviews of EU member states. In its latest implementation report, the EC noted that the vast majority of FDI notifications (85 percent) came from five EU member states – Austria, France, Germany, Italy and Spain – while the main targeted sectors were information communications and technology (ICT), followed by financial services, wholesale and retail, and construction.

The vast majority of cases were cleared unconditionally. However, some exceptional cases were either subject to substantial modifications, such as Cosco's investment in a container terminal in Hamburg, which was only authorised after the parties agreed to reduce Cosco's stake from 35 percent to below 25 percent, or were prohibited, such as the prohibition of two Chinese acquisitions in two German semiconductor companies, where there was no remedy to address the underlying public security concerns.

The UK has also stepped up its FDI controls post-Brexit. The new UK National Security and Investment Act 2021 (NSIA) requires a mandatory notification to the UK government where the target is active in any one of a wide array of areas considered to be of national strategic importance, which include critical technologies such as artificial intelligence, cloud computing, quantum technology and computing hardware, among many others. Only a limited nexus to the UK is required to trigger a notification (UK sales alone may be sufficient, for example) and failure to obtain NSIA approval carries major consequences, including the risk of unwinding and criminal penalties. Like the EU foreign investment authorities, the UK secretary of state for business, energy and industrial strategy (BEIS) has already blocked at least three acquisitions since the entry into effect of the NSIA, which related to the high-tech and semiconductor sectors. In some other cases, BEIS cleared the transaction subject to behavioural commitments, ranging from ring-fencing measures to positive requirements relating to personnel and board composition.

The UK government has been keen to stress that the UK remains open to foreign investment. Indeed, in its first annual report

in June 2022, Kwasi Kwarteng, secretary of state for business, energy and industrial strategy at the time, emphasised, "the UK is securing itself against constantly evolving risks whilst maintaining a free and open economy".

Foreign subsidies subject to scrutiny for large M&A deals

The third layer of regulatory scrutiny for larger M&A transactions is the Foreign Subsidies Regulation (FSR). The FSR is designed to cover a 'regulatory gap', which is not currently covered by the existing merger control, state aid and FDI rules. In the context of M&A, the gap is the acquisition of EU companies through foreign state subsidies.

None of the existing rules can currently prevent or restrict foreign companies benefitting from foreign subsidies from increasing their market share in Europe and acquiring key technologies via acquisition by relying in whole or in part on foreign state funds. This could have distortive effects in the common market in the long term and ultimately undermine the EU's competitiveness vis-à-vis foreign actors.

The FSR entered into force on 12 January 2023, but it will apply in two stages: (i) as of 12 July 2023, the EC will be able to launch ex-officio investigations to investigate acquisitions or more generally any other market situation where there might be a distortive foreign subsidy; and (ii) as of 12 October 2023, the mandatory pre-closing notification obligation will apply for transactions that trigger the notification thresholds.

The merger notification thresholds under the FSR are that the target's EU turnover must be at least €500m and the buyer, or buyers, have received an aggregate of at least €50m in foreign financial contributions over a period of three years preceding the acquisition. In practice, once the €500m target turnover threshold is met, it will be very easy to trigger the additional €50m threshold, as the definition of financial contributions is extremely broad and covers not only direct state funding but also tax exemptions or even revenues from the provision of goods or services to state entities.

Once the EC establishes that the thresholds are met, the EC will then assess whether the foreign financial contributions constitute a foreign subsidy, and whether that subsidy has a distortive effect in the EU common market. It is still unclear at this stage how the EC will carry out its substantive assessment of distortive foreign subsidies, and it has committed to issue guidance in that respect in the coming years.

Key takeaways for deals in Europe

Merger control is no longer the only or even the main parameter for assessing deal feasibility and deal valuation. Dealmakers, both in public M&A and private equity, should take into account not only the increasingly aggressive merger enforcement, but also the FDI and FSR risks. The conditions precedent and the regulatory risk allocation provisions in the SPA should take into account the merger control, FDI and FSR risks.

The timing for closing should also be sufficiently flexible to allow for potentially extended FDI and FSR reviews, on top of the merger control reviews. The timing will remain tolerable for no-issues transactions, but if the deal raises substantive antitrust, FDI or FSR concerns, sufficient flexibility should be built in to allow extensions or drop dead or long stop dates. A bar on closing applies for each of the merger control, FDI and FSR reviews, so closing over any particular EU jurisdiction could result in significant liability, particularly for the acquirer.

Dealmakers should pay particular attention to document creation and interactions with third-party customers and competitors. They should also be attentive to the financing of their transactions, particularly when it involves foreign state companies.

Last but not least, public companies should pay attention to their strategic alliances and major shareholders, just like private equity firms should pay attention to the selection of their limited partners at the fundraising stage, to ensure that the structure of the fund does not raise FDI or FSR issues in future acquisitions in Europe. The presence of Chinese, Russian or other state-owned funds or companies in the capital or the fund of the acquirer will likely trigger much closer scrutiny on the FDI and FSR fronts, particularly if it rises above a purely passive minority stake. ■

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