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Christian Riis-Madsen, Sophia Stephanou, & Killian Kehoe

O'Melveny & Myers LLP

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Reform of the EU Merger Regulation: Looking Out for the Minority

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I. INTRODUCTION

The last few months have witnessed new episodes in the long-running litigation concerning whether or not the minority non-controlling stake held by Ryanair in Aer Lingus can, or should, be examined under merger control provisions. This ongoing saga has re-triggered an EU-wide debate on the nature of merger control at both European Commission ("Commission") and Member State levels, and whether there is an "enforcement gap" that needs to be plugged. Early indications are that the Commission is taking this seriously, and is considering an amendment to the Merger Regulation to capture minority stake acquisitions. Such a step could have far-reaching consequences for international business.

This article will outline the issues raised by the Ryanair/Aer Lingus litigation, before looking to the wider debate on the notion of "control" for the purposes of the Merger Regulation. It will also consider some potential options for reform and touch on the consequences of these various approaches.

II. THE BACKGROUND TO RYANAIR/AER LINGUS

Few cases have been as intensely litigated as Ryanair's attempted takeover of Aer Lingus, and its subsequent attempt to retain its minority non-controlling stake in Aer Lingus. The controversy surrounding the case not only lies in the fact that Ryanair's proposed bid for Aer Lingus was one of only three outright rejections under the current Merger Regulation, but also that five years following Ryanair's acquisition of the Aer Lingus stake, the question of a potential of a merger control review remains and is not likely to be resolved before some time in 2012.

Ryanair's acquisition of a 29.82 percent minority shareholding in Aer Lingus was part of a widely publicized acquisition attempt that was prohibited by the Commission in 2007. This prohibition decision was appealed by Ryanair to the General Court, which upheld the Commission's decision. In parallel, Aer Lingus sought an order to force Ryanair to divest its minority shareholding in Aer Lingus. This was refused both by the Commission and on appeal to the General Court, on the basis that the Commission had no competence to order a divestiture because the minority shareholding was non-controlling, and did not trigger the application of the Merger Regulation.

However, within a few weeks of the General Court's decision, the United Kingdom's Office of Fair Trading ("OFT") (which does have jurisdiction to examine certain minority shareholdings) began a merger investigation into this shareholding. Ryanair unsuccessfully appealed the OFT's decision to investigate to the Competition Appeals Tribunal ("CAT"), but following its subsequent appeal to the Court of Appeal, the OFT investigation was recently

[1] Christian Riis-Madsen is managing partner of O'Melveny's Brussels office and a member of the Antitrust and Competition Practice. Sophia Stephanou and Killian Kehoe are associates in the Brussels office and members of the Antitrust and Competition Practice.

stayed, pending the Court of Appeal's decision on whether or not the OFT was "out of time" to examine the case.

This case has highlighted a long-identified question of whether there is an enforcement gap that needs to be addressed with respect to the varying definitions of control at European and Member State levels for the purposes of merger regulation. Minority shareholdings are a common occurrence and, while the vast majority are wholly unproblematic, *Ryanair* illustrates how different jurisdictional tests can (on occasion) lead to unsatisfactory outcomes.

III. DIFFERENT VIEWS OF CONTROL

Certain minority shareholdings may lead to harm to competition. First, there could, of course, be direct exercise of influence by the shareholder on a competitor, which compromises the competitor and leads to reduced competition. Second, the purchaser could be acquiring the minority stake in order to block a potential takeover of the target by another competitor. Third, there is a risk that the minority shareholdings could give rise to coordination between the two competitors when they have access to each other's sensitive business information. In addition, an undertaking holding a minority stake in a competitor may incentivize the acquirer to compete less vigorously against the target to protect the value of the investment.

But while the policy reasons for identifying the role of minority shares may be clear, the current divergence in approaches to minority shareholdings at European and Member State levels may create the potential for uncertainty for companies when it comes to the acquisition of shareholdings. Transactions that are not caught by the merger control rules at the European level may, in certain instances, be caught by merger control rules in certain Member States. Those concerned with the existence of an "enforcement gap" would argue that this undermines the objective of harmonized rule-making and creates the undesirable possibility of protracted scrutiny of a particular shareholding (as illustrated by the Ryanair example).

This divergence centers on the meaning of "control." To understand this fully, it is worth detailing the contrast between the approach of the Merger Regulation, on one hand, and the domestic merger control regimes in the United Kingdom and Germany, where minority shareholdings are examined as part of their respective merger control regimes, on the other.

A. The EU Approach

The Merger Regulation captures concentrations that have a "community dimension." In order for a transaction to qualify as a "concentration," there must be a "change of control on a lasting basis." Such control "shall be constituted by rights, contracts, or any other means, which, either separately or in combination … confer the possibility of exercising decisive influence on an undertaking."

The Commission's Consolidated Jurisdictional Notice on the Control of Concentrations Between Undertakings further clarifies that control involves decisive influence based on rights, assets, or contracts or equivalent means. This control must result in either the controlling undertaking enjoying the power to determine the strategic commercial decisions of the other, or one undertaking being able to veto strategic decisions of the other.

This control can be acquired on a *de jure* or *de facto* basis, and thus the Merger Regulation may apply to shareholdings that fall below the level of what constitutes control. *De jure* control may result where specific rights attached to a minority shareholding enable the shareholder to determine the strategic commercial behavior of the target. Alternatively, *de facto* control may be

found where a minority shareholder is highly likely to achieve a majority at shareholders' meetings based on surrounding circumstances such as the level of the particular shareholding, the attendance of other shareholders at past shareholder meetings, past voting patterns, the position and role of other shareholders, how dispersed other shareholdings are in the target, and any links other significant shareholders have with the large minority shareholder.[2]

Therefore, minority shareholdings may, in certain circumstances, be captured by the Merger Regulation where such shareholdings permit the shareholder to exercise decisive influence, but a minority shareholding that bestows on the shareholder anything less than *de facto* control is not captured by the Merger Regulation. This is in contrast to the equivalent tests in place in jurisdictions such as the United Kingdom and Germany.

B. The United Kingdom Approach

The Enterprise Act 2002 sets out three levels of control or influence that may trigger a merger control investigation, the last of which extends far beyond the scope of the Merger Regulation definition. The first level applies where there is ownership of a controlling stake in the target company. This generally involves a minimum shareholding of 50 percent. The second level applies where a shareholding confers *de facto* control, amounting to an ability to control policy, similar to the test in the Merger Regulation. Finally, control may also be found, where a shareholding confers an ability to "materially influence policy."

Material influence will be presumed where there is a shareholding of 25 percent or more, because this level entitles a holder to block special resolutions. However, even lower shareholdings may be investigated and material influence found where a shareholding enables the blocking of special resolutions or other factors facilitate influence. Such factors could include the distribution of the remaining shares, recent voting patterns, attendance at shareholder meetings, any industry expertise particular to the minority shareholder, an ability to influence the board of directors, agreements with the company, or any financial arrangements between the shareholder and the company.[3] Shareholdings as low as 15 percent or less may be found to afford material influence over the target company.

It is important to note, however, that the U.K. system is voluntary so that companies do not have to notify any shareholding acquisitions; although, as was the case with Ryanair, the OFT can open an investigation into a completed acquisition (subject to certain time limits) which may eventually result in the transaction being unwound. The OFT will generally open investigations only where it considers there could be substantial lessening of competition, and therefore would not normally investigate minority shareholding acquisition where the purchaser and target have no competitive relationship, even if it had jurisdiction to do so.

C. The German Approach

The Bundeskartellamt may review minority shareholdings that result in the acquisition of 25 percent of the voting rights in a target, or the acquisition of a "competitively significant influence" in the target. Shareholdings that exert "competitively significant influence" refer to those granting rights that are equivalent to the rights of a shareholder that holds more than 25

[2] For example, in Accor/Club Mediterranee a 28.9 percent holding was sufficient to confer control.

[3] E.g. with respect to BSkyB's acquisition of a 17.9 percent stake in ITV, the Competition Commission found that such a shareholding would confer material influence in light of past voting patterns, the position of BSkyB as ITV's largest shareholder, BSkyB's standing in the industry, and its position when compared to other shareholders.

percent of the voting rights. This threshold only applies if the target is an actual or potential competitor of the acquirer, and the parties are active upstream or downstream from each other.

This influence must have a bearing on the competitive behavior of the target company. This can be based on different factors, such as the right to appoint directors; significant veto rights that allow the acquirer to influence, but not necessarily control, the competitive behavior of the target; industry know-how held by the acquirer that far exceeds that held by other shareholders in the target; important ongoing business relationships; or call options that may lead to a majority share if exercised. There is no minimum level for the acquirer's shareholding in the target, although the lower the holding, the more significant the other factors ought to be to establish a "competitively significant influence."

While it is compulsory for companies to notify a transaction in Germany where certain thresholds are met, the law introduces an "effects" analysis into the jurisdictional test, where minority shareholdings are concerned. Therefore, as is the case with the OFT, the Bundeskartellamt will not generally review minority share acquisitions where the purchaser and the target operate in entirely unrelated fields.[4]

Both the German and the United Kingdom approaches to minority share acquisitions, therefore, extend beyond the scope of the Merger Regulation by capturing (although not necessarily examining) a wider array of shareholdings.

IV. POSSIBLE REFORM ON THE HORIZON?

In the past, the Commission has been reluctant to engage in debate on the potential enforcement "gap," but statements in 2011 from Commissioner Almunia indicate that this issue is being considered once more by DG Competition. Of course, any change would require an amendment to the Merger Regulation, which would require the approval of the Council and the Parliament, where it might face difficulties given the direct burden on business that a reform may cause.

However, the early signs are that the Commission is seriously considering a reform to the Merger Regulation to consider minority shareholding acquisitions. In November 2011, the Commission announced a tender for the creation of a database to support a study on the importance of minority shareholdings in the European Union. This will seek to map the current stock of minority shareholdings and the links created by minority shareholdings over the last 10 years.

While we do not seek to comment on the merits of whether an amendment to the Merger Regulation in this respect is justified, we see a number of different possible options for amending the Merger Regulation which might be considered by the Commission, (particularly in light of the fact that cases where any perceived "enforcement gap" is likely to be material are likely to be few and far between).

[4] Although the technical difference is that the OFT may have jurisdiction in such a case (if the target's turnover exceeded £70 million) but the Bundeskartellamt would not.

A. Option 1—Extending the Concept of Control Acquisitions Conferring "Competitively Significant Influence"

This option would be the most expansive legislative change that the Commission could opt for. It would require parties to assess whether any acquisition of a minority shareholding would give rise to a "competitively significant influence," if the parties were actual or potential competitors, or were active upstream or downstream from each other. Shareholdings that confer a particular percentage of voting rights (e.g. 25 percent) might be deemed to give rise to "control" and require a notification.

This option would likely increase the obligations and delays faced by businesses, as well as potentially overburdening the Commission with filings. However, the approach would have the obvious advantage of creating certainty and predictability for companies. The experience of the German system is that this process does work in practice, where only ten percent of notifications fall into the minority shareholding category, and only one percent fall into the "competitively significant" category (i.e. shareholdings granting rights equivalent to those of a holder of 25 percent of the voting rights). The risk of uncertainty could also be mitigated through guidelines to help self-assessment. In addition, the burden on business could be reduced by having lower fines (or no fines) in the event that a party does not notify a minority stake that is competitively significant.

B. Option 2—Voluntary Notification of "Material Influence" Type Shareholdings With the Possibility of Retrospective Examination of the Share Acquisition[5]

This option would create a balance between unnecessary and burdensome notifications and capture potentially harmful shareholdings. The Commission's "stick" in this case could be the fact that it could open an *ex officio* investigation into the acquisition post-completion, and unwind the relevant shareholding. In addition, where the shareholding is "hostile" (as, for example, in Ryanair/Aer Lingus) the company in which the stake was acquired would itself notify the Commission of the acquisition.

The concern would be, however, that the Commission may not discover all potentially harmful stake acquisitions. In addition, time limits could be an issue for debate here. In the United Kingdom, for example, the OFT has four months from when the shareholding became publicly known to exercise its jurisdiction to refer a case to the Competition Commission. The Commission may wish to have a longer period to examine completed acquisitions of stakes, particularly since it would need to monitor a much larger number of transactions.

C. Option 3—No Legislative Change but Change of Enforcement Priorities by Using Article 101 or Article 102

The Commission could seek to examine minority shareholding acquisitions without pursuing an amendment to the Merger Regulation. Articles 101 and 102 have, on rare occasions, been applied to minority shareholdings. Where a minority shareholding is likely to influence the parties' commercial conduct it can, in certain situations, be considered an anticompetitive agreement in breach of Article 101. Equally, where the acquisition of a minority shareholding is considered to facilitate an abuse of dominance, Article 102 may apply.

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[5] This was envisaged as a potential alternative for the U.K. competition system.

Such investigations can be seen as far back as the 1980s in the *Philip Morris* case where the Court of Justice identified that the acquisition of a minority shareholding may infringe Article 101 or 102. Similarly, in *Warner-Lambert/Gillette* the Commission also found that Gillette's acquisition of a minority shareholding (of 22 percent) in a competitor, Eemland, enabled Gillette to exercise "some influence" over Eemland's commercial conduct, in breach of both Articles 101 and 102.

In the context of the merger investigation process, the Commission already has, on a number of occasions, dealt with non-controlling minority shareholdings and even required them to be divested (albeit jurisdiction was not conferred on the Commission as a result of these minority stake acquisitions). In other cases, parties have even reduced stakes in competitors prior to notification. For example, in Santander/Abbey National the Commission had concerns about a cooperation agreement and cross-shareholding between Banco and RBS, and Santander agreed to reduce its stake in RBS from 5.06 percent to 2.54 percent prior to notification.[6]

D. Option 4—Commission is Conferred a Power to Order Divestment of Certain Minority Shareholdings

Lastly, a more targeted reform might involve the Commission being granted powers to order the divestment of a minority shareholding where the acquisition of such a shareholding was part of a wider bid for "control" under the current definition in the Merger Regulation, and was subsequently prohibited by the Commission.

This approach would have the advantage of preventing a Ryanair/Aer Lingus type situation arising. It would also minimize the impact on both businesses and the Commission in terms of certainty, cost, delays, and workload. However, this approach would obviously fail to capture potentially anticompetitive minority shareholdings that did not form part of an eventual bid for control of the target.

V. CONCLUSION

While a revision in the Merger Regulation may not be immediately forthcoming, the Commission appears to be seriously considering the options for reform. However, while the mismatch between jurisdictions can potentially lead to undesirable consequences (as illustrated by Ryanair/Aer Lingus), any expansion of the Commission's jurisdiction in this respect will likely be viewed unfavorably by the business community. If, and when, the Commission publishes its proposed reforms, one can expect a hot debate on whether there is in fact a "gap" and, if yes, how this should be closed.

[6] A further example was Volvo/Renault where the Commission raised concerns in the procedure that Renault would be able to influence the commercial behavior of two bus companies by virtue of it being the largest shareholder in Volvo, while also being the controlling shareholder in Irisbus. Volvo agreed to divest its shareholding in Scania.