MINORITY SHAREHOLDINGS
AND INTERLOCKING DIRECTORATES

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> THE ISSUES SURROUNDING MINORITY SHAREHOLDINGS CURRENTLY LEAVE SEVERAL QUESTIONS OPEN. BEFORE TAKING ANY ACTION, **IT IS IMPORTANT TO DETERMINE IF AN ENFORCEMENT GAP EXISTS AND TO WHAT EXTENT"**

AN ENFORCEMENT GAP?

Already in 2001 in its Green Paper on Merger Review the EC acknowledged that minority shareholdings could have an impact on competition, but concluded at that point that no regulation was necessary. Almost a decade later, in light of the Ryanair / Aer Lingus case and the initiatives taken by the US, UK and German authorities, the debate has been relaunched. The main questions raised are, whether there is in fact an "enforcement gap" and if something needs to be done about it. The EC is currently preparing for a public consultation on the issue.

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Approaching the issue from an economic perspective, one should start by describing horizontal and non-horizontal effects of minority shareholdings. In fact, an acquisition of financial interest and/or control rights in a company can change the competitive behaviour of both the acquirer and the acquired company, regardless of whether the companies are competitors or vertically related firms.

First, as regards horizontal unilateral effects of minority shareholdings, once can consider them to be very similar to those of full mergers. Namely, these effects consist mainly in the incentive of the acquiring firm to raise prices. Depending on whether the acquiring firm can influence the acquired competitor, the acquirer will either push the acquired competitor to increase prices or raise its own prices, reaping the benefits either from its own increased sales or those of its acquired competitor. As in full mergers, the strength of these effects will depend on the market position of the parties, whether they are close competitors, as well as other usual countervailing factors. Elements more specific to partial acquisition are the size of the financial interest acquired and whether it allows the acquirer to exert material influence on the target.

While bringing examples of horizontal coordinated effects, one can notice somewhat ambiguous changes in companies' incentives to deviate and the risk that a minority shareholding facilitates strategic information sharing between the competitors. Having minority shareholder's representative on the board of acquired competitor certainly improves communication between the parties.

Concerning non-horizontal effects, input foreclosure is more likely to be profitable, and thus to occur, when a downstream firm owns a part of an upstream firm. Customer foreclosure, on the other hand, is more likely to occur when an upstream firm owns a part in a downstream firm.

The issues surrounding minority shareholdings currently leave several questions open. Before taking any action, it is important to determine if an enforcement gap exists and to what extent. Whereas Articles 101 and 102 TFEU could capture some of the anticompetitive behaviour described above, other cases with undesired effects might escape all scrutiny. Once the existence of an appreciable gap established, one is to find the best procedural way to address it.
It involves not only deciding if regulation is desirable, but also figuring out how to handle the notification, with options varying from mandatory ex ante to selective ex post control. ■

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MINORITY SHAREHOLDINGS: SOME ECONOMIC INSIGHTS AND COMMENTS

As acquiring less than a full ownership and control of a company is a very common practice nowadays, the issue of effects of minority shareholdings on competition is thus very topical. In the meantime, one does not necessarily need to look far to model and measure such effects. Conventional economic analysis and modelling tools used for full mergers can easily be applied to minority shareholdings.

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THE EC SHOULD TAKE A CAUTIOUS APPROACH AND CONSIDER REGULATING ONLY IF THE GAP IS MATERIAL, **THE ANTICOMPETITIVE EFFECTS SIGNIFICANT AND THE RESULTING ADMINISTRATIVE BURDEN ON THE COMPANIES MANAGEABLE"**

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Minority shareholdings can lead to horizontal and vertical anticompetitive effects. If there is a change in control, horizontal unilateral effects consist in the incentive for both the acquirer and the acquired firm to raise prices. In such case, the incentive for the acquired party is in theory even greater than in case of full control, because it will get all the profit, while sharing the costs arising from the changes in the market with the acquirer. There is no "enforcement gap" issue here, because acquisitions with change of control are already covered by the ECMR.

However, the gap may lay in the scenario where a company acquires a minority shareholding in a target, without change of control. In this case, only the acquiring firm will have an incentive to increase prices, even though the effect is supposedly still smaller than in a full merger situation. The focal issue in such cases is to understand what type of influence the acquirer, short of control, can exercise on the acquired competitor and whether that influence could reinforce the incentive to raise prices. Without change in control, these cases currently escape the scrutiny under the ECMR, if the acquisition of a minority shareholding is a stand-alone transaction. Unilateral actions by the acquirer are arguably also less likely to be caught by Articles 101 and 102 TFEU. It appears that the only way the EC would be able to assess the effects of such acquisitions is when they are part of a set of transactions falling under the scope of the ECMR, as was the case in COMP/M.3653 - Siemens/ VA Tech.

Turning to the coordinated effects resulting from minority shareholdings, one should consider two main mechanisms: information sharing that may facilitate reaching a collusive equilibrium and the change in incentives resulting from the minority share, such as decrease in incentive to deviate from collusive equilibrium. However, as with mergers reviewed under the ECMR, showing that anticompetitive effects are likely would require establishing a credible coordination mechanism for the industry. Furthermore, one would need to demonstrate that the tangible effects due to the minority shareholding make coordination more likely and stable. It can be considered that even with full ownership, recent practice has shown such cases are rare and very difficult to run. Articles 101 and 102 TFEU could arguably catch any such effects if they were really material. These circumstances seem to argue against the need to regulate.

When describing vertical effects of minority shareholdings, it can be concluded that anticompetitive effects may in certain circumstances arise through foreclosure. As regards input foreclosure, an example of case COMP/M.5406 - IPIC/ MAN Ferrostaal was brought, whereby the EC considered that a 30% ownership allowed MAN to exercise decisive influence over Eurotecnica. Consequently, the Commission found on the basis of a detailed vertical arithmetic exercise that by acquiring MAN, IPIC would have a reinforced incentive to foreclose other vertically non-integrated competitors on the high-grade melamine market previously supplied by Eurotecnica. Whether such a strategy would be sustainable given MAN's minority position in Eurotecnica was however not addressed in the decision.

With regard to input foreclosure, one should note that there is no considerable "enforcement gap" in this area. When an upstream firm acquires shares in a downstream firm, input foreclosure is less likely than in cases of full ownership. On the other hand, when a downstream firm acquires a share in the upstream firm, there can be no input foreclosure without existence of control. This, however, would fall under the scope of the ECMR. Any issues related to the access to confidential information could potentially be addressed under Article 101 TFEU.

To conclude, the EC should take a cautious approach and consider regulating only if the gap is material, the anticompetitive effects significant and the resulting administrative burden on the companies manageable. This could be the case in acquisition between close competitors in highly concentrated industries. But even in such cases there is a need to put in place well-designed safe harbours and ex post control may be preferred to limit the administrative burden on companies. ■

LEGAL EXPERIENCE
FROM THE UK AND GERMANY

The issue of minority shareholdings should also be considered from a legal perspective. It appears that the answer to the question, whether there is an "enforcement gap" and if something needs to be done about, is far from clear also from the legal point of view.

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The UK

In the UK, a merger situation may arise where two enterprises come under common ownership or control. The UK legal system recognises three levels of control: a controlling interest, the ability to control policy, and the ability to materially influence policy, bearing in mind that each move up to the next level of control may be considered a merger. These levels of control correspond respectively to an acquisition of 50% of the shares for a controlling interest and to de facto control or decisive influence for the ability to control policy. Cases of material influence are analysed on a case-by-case basis according to the OFT guidance.

Some of the main OFT criteria for evaluation of material influence are: the size of the voting shareholding (in itself and relative to other shareholdings), any special voting rights attached to the shares, attendance and voting at shareholder meetings, and the ability to block special resolutions. In addition, it is paramount to assess how many members of the board each shareholder is able to nominate and what kind of standing or actual influence those members have in the board. Industry knowledge and standing of the acquirer is also important.

A shareholding of at least 25% is presumptive of material influence in the UK. However, such influence has in practice been also found in cases of shareholdings below this benchmark. Namely, in case BSkyB/ITV (CC. Jan.2008, CA Judgement Jan. 2010), an acquisition of 17.9% in ITV by BSkyB was ordered to be reduced to a shareholding below 7.5%. Based on the assessment of several factors, the Competition Commission found that a shareholding above 7.5% would already enable BSkyB to block special resolutions of ITV.

However, the most marking case in the area of minority shareholdings is Ryanair/Aer Lingus. The saga that has lasted since 2007 has spurred a wide debate over the issue of possible anticompetitive effects of such shareholdings. After having acquired 29.3% of Aer Lingus, its closest competitor on the Irish market, Ryanair has since 2007 been trying to acquire all shares in that company. Although the merger has already been blocked twice by the EC, Aer Lingus continues fighting in UK courts to obtain divestment of Ryanair's "hostile" shareholding.

The Competition Commission, whose decision is expected to be delivered on July 11, 2013, has mainly to consider, if Ryanair's 29.8% share gives it material influence over Aer Lingus, as well as whether a significant lessening of competition may be expected from such acquisition. To determine this, the Competition Commission has fortunately the benefit of an ex post view of the situation, as the transaction was completed already in 2006. Besides the more "traditional" horizontal effects, the main risk in this case is that Ryanair weakens Aer Lingus' competitive position. This could, for example, be the case if Ryanair restrict its ability to follow certain competitive strategies, including forming alliances with other airlines, and deters other investors.

Germany

German merger control regime catches any acquisition of a share of the company's capital or voting rights resulting in an overall shareholding of at least 25% or 50%, as well as any other combination enabling one or several companies to directly or indirectly exercise a "competitively significant influence" over another. If the acquirer and the acquiring party are either competitors or vertically related, such influence is presumed to exists with at least a 25% shareholding.

The lower the share acquired, the more so-called "plus factors" will be taken into account in the assessment. Those include looking at the rights to appoint board members, to veto decisions, as well as analysing ongoing business relationships between the parties. However, the authorities are likely not to intervene in cases of acquisitions below 10% of the shares.

In practice, acquisitions of minority shareholdings account only for 1% of all notifications filed in Germany and for 11% of all prohibition decisions. That is an alarming disproportion.

In conclusion, it is apparent from the experience in the UK and Germany that there is a substantive issue to address with minority shareholdings. UK's Competition Commission's investigation in Ryanair/Aer Lingus may re-enforce this. Final decisions made in this case are likely to be decisive for the EU. In the meantime, many open questions remain. If there really is a gap in the enforcement, is an alternative process required or it is the EC that has simply failed to use the existing mechanisms of Articles 101 and 102 TFEU? If the EC decides to change the ECMR, how can the process ensure that the potential benefits do not outweigh the costs? This involves answering the questions of what cases would be covered, would the filing be made mandatory, and what information would need to be submitted. At this stage, there are more questions than answers. ■

"IF THERE REALLY IS A GAP IN THE ENFORCEMENT, **IS AN ALTERNATIVE PROCESS REQUIRED OR IT IS THE EC THAT HAS SIMPLY FAILED TO USE THE EXISTING MECHANISMS OF ARTICLES 101 AND 102 TFEU?"**

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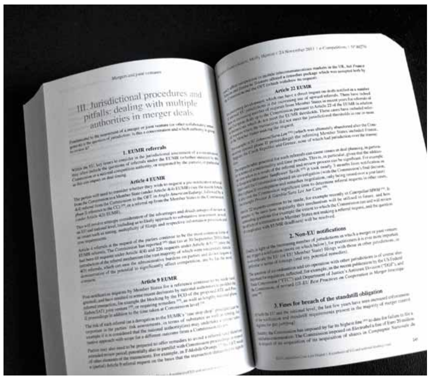

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