

EU-China competition week

Joint ventures and acquisition of minority shareholding: CMA's practice

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Overview

- **Background – Jurisdiction**
 - Material influence
 - Level of shareholding
 - Plus factors
- **JV - Competitive analysis**
 - Cooperative / concentrative JV
 - R&D
 - Extraterritoriality
- **Minority shareholding**
 - Theories of Harm
 - Case study: *Ryanair/Aer Lingus*

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Background - Jurisdiction

- Relevant merger situation: (i) *de jure* control (ii) *de facto* control and (iii) material influence
- “common ownership or common control”
- No ‘full-functionality’ requirement either for the creation of JV or change from sole to joint control.
- Other countries with powers to investigate minority shareholding acquisitions are the US, Germany and Austria.
- In 2014 the European Commission consulted on proposals to extend its jurisdiction to non-controlling minority shareholdings.

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Material influence

- Material influence – lowest level of control
- Ability to influence policy relevant to the behaviour of the target in the marketplace, including strategic direction and ability to define and achieve its commercial objectives
- Level of shareholding, voting rights and/or additional plus factors
- Case by case analysis – CMA will “have regard to all circumstances of the case”
- **Phase two minority shareholding cases are relatively uncommon:**



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Level of shareholding

- Exceeding 25% - (rebuttable) presumption of material influence due to ability to block special resolutions
- Between 15% and 25% - CMA may examine to see whether ability in practice to influence policy
- Below 15% - exceptionally might attract scrutiny if other factors present
- **“commercial realities and results of transactions...the focus should be on substance and not legal form”**

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Plus factors

- Distribution and holders of remaining shares - largest shareholder, widely dispersed
- Patterns of attendance and voting at AGM – in practice ability to block special resolutions
- Veto rights, special voting arrangements or other special provisions
- Status and expertise – influence policy formulation at earlier stage
- Board representation (may alone confer material influence) – corporate/industry expertise, experience, incentives
- Other sources: agreements; financial arrangements

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JV – Competitive analysis

- In the analysis of a standard merger, it is assumed that the merged firm will act as a single party, maximising joint profit.
- Analysis of minority shareholding / JVs requires us to open the black box of the firms' corporate organisation, and think about the incentives and influence of different parties in greater detail.
- Different transactions will involve **different levels of financial interest** and confer **different degrees of corporate influence**.
- *Sky/ITV*: "it is not appropriate to treat the acquisition of material influence as equivalent to the acquisition of full control (de facto or de jure)" and "the OFT should recognise the differences between the various qualities of control in its substantive analysis".

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Cooperative v concentrative JV

- JVs cover a broad range of commercial operations: from fully-fledged merger-like operations to co-operation limited to particular functions (production, distribution or R&D).
- Distinction between 'cooperative' (Horizontal Agreement) and 'concentrative' JV (merger control):
 - EU – full-functionality/structural change in the market
 - UK – whether the activities/assets transferred to JV are sufficient to constitute an enterprise (broader, but eg transfer of R&D may not qualify as an 'enterprise').
- Implications for relationship between EU and national controls and application of block exemptions (eg R&D Block exemption)
- 'Spill over': 'concentrative' JVs that has as its object or effect the coordination of the behaviour of its parents outside the JV

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JV – Competitive analysis

- JV: economic analysis does not differ substantially whether the JV is treated as an HA or a merger, but...
- HA: the partners continue activity in the sector, after merger the parents 'disappear', as their assets tend to be entirely transferred (eg implications to the assessment of ancillary restraints)
- Initial screening: market power of the parents/partners
- Trade-off between market power and efficiency
- Anti-competitive effects: ascertain the degree to which the participants retain the freedom, ability, and incentive to compete with the JV and/or each other.

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JV – R&D

- Different forms of JV tend to carry different implications for the *ex post* and *ex ante* competition effects.
- R&D and production JVs are less likely to infringe Chapter 1 of CA (or more likely to be exempted), but the CMA would examine *ex ante* effects closely.
- R&D block exemption: apply to HA JV subject to certain conditions. The partners must be free to use the results of R&D independently in production and distribution.
- If R&D block exemption does not apply, possibility of individual exemption
 - Application of the EU Guidelines of Horizontal Cooperation Agreements: 'centre of gravity of the agreement' to define type of agreement
 - Article 101(3) individual exemption

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JV – Extraterritoriality

- EUMR jurisdictional thresholds: undertakings concerned include any entity exercising control over the JV and that entity's corporate group.
- The jurisdictional thresholds can be met solely on the basis of the parents' turnover, irrespective of geographic location
- EU jurisdiction over JVs with no tangible link to EU market
- In *WorldCom/Sprint*: no jurisdiction to examine the effects of a merger absent "immediate, substantial and foreseeable effects" on the EEA.
- Simplified procedure
- *EU's Evaluation of procedural and jurisdictional aspects of EU merger control*: exemption or lighter information system
- UK's voluntary system

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Minority shareholding – TOH

- We can distinguish between the incentives and actions of the acquiring party ('**buyer**') and the acquired party ('**target**'). Three main types of theory of harm (TOH) which might arise:

1. Reduced unilateral **incentives** to compete

(a) Incentives of buyer

(b) Incentives of target

2. Buyer uses its **influence** over the target to make it a less effective competitor

3. Increased likelihood of **coordination**

#1 and #3 are fairly similar to standard unilateral and coordinated effects stories, with additional considerations arising from the specifics of the shareholding. #2 may be less familiar.

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JV – Competitive analysis: TOH 1 (a)



Post merger, the buyer competes less strongly with the target, as it now shares its rival's financial success.

Relevant factors

- The principles underlying this TOH are very similar to in a standard horizontal merger, and similar analytical tools can be used.
- Key difference is the question of the extent to which the buyer actually shares in the target's profits. Factors such as the size of the shareholding and the target's dividend policy will be relevant here.
- There may also be potential questions around information to answer: does the buyer have sufficient information about the target to jointly profit maximise?

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JV – Competitive analysis: TOH 1 (b)



Post merger, the target seeks to further the interests of the new owners (the buyer) by competing less vigorously with them.

Relevant factors

- Key question: to what extent is the target incentivised to act in the interests of the new shareholder (the buyer)?
- Among other factors, this requires considering the size of the buyer's shareholding, the composition of the remainder of the shareholder base, how the firm is governed
- If the target is likely to take the interests of the buyer into account, then again standard analysis helps us to understand the strength of the incentive they face (trading off reductions in their own profits with gains to the buyer)

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JV – Competitive analysis: TOH 2

Post merger, the acquirer is able to use its minority shareholding to weaken the effectiveness of the target as a competitor.

Relevant factors

- This TOH depends on the rights that the shareholding confers to the buyer:
 - Ownership of the shares
 - **Voting rights:** vote on specific strategic decisions (eg around raising finance, entering new markets, acquisitions) to influence the governance of the target.
 - **Board representation:** right to appoint board member(s), giving it direct influence of management decisions of the target
 - **Hassle:** distract / undermine management
- This TOH is conditional on the buyer having the incentive to undermine the target as a competitor. Relevant factors: closeness of competition, relative profitability of the companies

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JV – Competitive analysis: TOH 3

The minority shareholding facilitates coordination in the relevant market

Relevant factors

- Minority shareholding transactions may affect likelihood of coordination in a number of ways:
 - Information flows – access to privileged information about the target and increased ability to monitor each other's behaviour.
 - Communication – additional avenue for communication between the two firms, improving their ability to reach a less-competitive equilibrium
 - Incentives – increases gains to coordinate or alter incentives to punish? (although incentive effects are ambiguous)
- **Key question:** Are conditions for coordination met and are there any signs of pre-existing coordination

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JV – Remedies

Remedies: if an SLC is found, then various options available:

- Reduced shareholding
- Restrict voting rights
- Other behavioural restrictions on buyer or target (eg to accept an offer for its shares under certain pre-defined conditions)

Key challenge: determining what shareholding/voting level is low enough

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Case study: *Ryanair/Aer Lingus (1)*

- **Aer Lingus:** Irish flag carrier, 'mid-frills' offer.
- **Ryanair:** low-cost airline model in Europe.
- Two main airlines operating between GB and Ireland, and close competitors on these routes, with lots of evidence of direct price competition.
- **The transaction:**
 - **2006:** Ryanair makes public offer for Aer Lingus, starts acquiring shares
 - **2007:** EU prohibits transaction, but Ryanair retains 30% stake
 - **2010:** OFT launches investigation into minority shareholding
 - **2013:** CC orders Ryanair to divest shareholding to 5%
 - **2015:** IAG bid for Aer Lingus accepted

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Case study: *Ryanair/Aer Lingus* (2)



TOH1 (a):

- Despite closeness of competition, the incentive for Ryanair to compete less vigorously post-merger would be limited, as any increase in Aer Lingus' profits would only flow back to Ryanair indirectly and uncertainly.

TOH2(b)

- AER Lingus would be unlikely to act in Ryanair's interests, given:
 - Acrimonious nature of relationship between the parties
 - Ryanair did not have board representation
 - The fiduciary duty of the management to act in the interests of the company as a whole

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Case study: *Ryanair/Aer Lingus* (3)



TOH2:

- Ryanair's shareholding would influence Aer Lingus' ability to participate in a combination (ie an acquisition, merger or JV).
- Ryanair's shareholding would allow it to impede or prevent any deals which it considered would make Aer Lingus stronger, and agree or facilitate any deals which it considered would make Aer Lingus weaker. This was a particular concern in the airline industry, given the significance of economies of scale and importance of consolidation.
- Risk that Aer Lingus would not survive in the longer term absent some kind of combination. Aer Lingus' exit would result in an SLC on routes between GB and Ireland where the two airlines currently competed.

TOH3

- Coordination unlikely, given asymmetry in costs and offering, complexity of fares, and the strong competition observed between the two companies pre- and post-merger

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Additional reading

CC/MMC cases:

Ryanair/Aer Lingus: [final report](#) (2013)

BSkyB/ITV: [report sent to secretary of state](#) (2007)

Policy papers:

[DG Comp white paper on minority shareholdings](#) (2014)

[Annex to DG Comp consultation: Economic literature on non-controlling minority shareholdings](#) (2013)

[OECD Policy roundtable on minority shareholdings](#) (2008 - includes references to some OFT cases)

Selected academic papers

[The competitive effects of partial equity interests and joint ventures](#); Reynolds and Snapp, IJIO; 1986

[Competitive effects of partial ownership: financial interest and corporate control](#), O'Brien and Salop, Antitrust law journal, 2000

[Challenging the economic incentives analysis of competitive effects in acquisitions of passive minority equity interests](#), Dubrow, Antitrust law journal, 2001

[The competitive effects of passive minority equity interests: reply, O'Brien and Salop](#), Antitrust law journal, 2001

[Partial cross ownership and tacit collusion](#); Gilo, Moshe, Spiegel; RJE 2006