Minority Power - EU Merger Control and the acquisition of Minority Shareholdings

1. Introduction

Effective and efficient competition policy requires appropriate and well-designed tools to tackle all sources of harm to competition and, ultimately, consumers. Currently, the Merger Regulation only applies to “acquisitions of control” and does not cover acquisitions of non-controlling minority shareholdings. According to economic research, however, the purchase of a non-controlling minority shareholding can also harm competition. This is corroborated by the day-to-day experience of competition authorities within and outside the EU.

In 2013, DG Competition launched a public consultation to uncover a possible “enforcement gap” concerning minority shareholdings, and to find solutions for any problems. In response to the comments received, the Commission has now presented concrete proposals in the Commission White Paper, published in July 2014. This proposal intends to make EU merger control more comprehensive by addressing potential harm to competition resulting from the acquisition of non-controlling minority shareholdings. At the same time, undue burdens for businesses should be avoided. This can be achieved by only targeting transactions that are prima facie problematic from a competition point of view. In addition, the proposed review system will be lighter than currently foreseen under the Merger Regulation for full mergers. The consultation period for submitting comments on the proposal ran until 3 October 2014.

In a nutshell

The acquisition of non-controlling minority shareholdings can harm competition. This is demonstrated both by economic theory and the experience of national competition authorities inside and outside the EU.

The Commission’s White Paper proposes to complement the Merger Regulation with a light system for reviewing the acquisition of minority shareholdings. This will focus on transactions that may be prima facie problematic from a competition point of view, i.e those giving a certain degree of influence over a competitor or a vertically related company.

Such a system will establish a one-stop shop for the control of minority shareholdings, without subjecting all transactions to a burdensome notification system. The proposed reform would make EU merger control more comprehensive by providing a targeted toolkit against all types of harm that company tie-ups may bring to competition and consumers.

This policy brief outlines how the acquisition of a non-controlling minority shareholding can harm competition and explains the White Paper’s proposal for a ‘targeted transparency system’ which will allow the Commission to review acquisitions capable of raising competition problems.

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1 The Merger Regulation only covers acquisitions of control, defined as the possibility for the acquirer to exercise decisive influence over a company. Most minority shareholdings are non-controlling, as the rights attached to them usually do not allow for the exercise of “decisive influence” on strategic commercial behaviour. However, minority shareholdings may exceptionally allow for control on a de facto basis, for example if the minority shareholder is highly likely to achieve a majority at the shareholders’ meeting.

2. **Current Treatment of Minority Shareholdings under EU and national competition law**

**No power under merger control rules on a stand-alone basis**

Minority shareholdings normally do not give rise to “control” over a company, and so are not as such subject to EU merger scrutiny, which is limited to “concentrations”, i.e. full mergers involving an “acquisition of control”). Under current EU competition rules, the Commission can only deal with minority shareholdings if parties notify a concentration that includes a pre-existing minority shareholding of one of the merging parties. This way, minority shareholdings have already come to the Commission’s attention in a number of cases under the Merger Regulation. Because of these cases, the Commission understands the kind of concerns minority shareholdings may raise and knows how to deal with them. However, the Merger Regulation currently does not allow the Commission to review or intervene against the acquisition of the minority stake itself, even if it has the same harmful effects. This is undesirable. The Commission’s authority to investigate a minority stake should not have to depend on the date of the acquisition.

**Can antitrust rules do the trick?**

In the public consultation, some stakeholders argued that competition concerns raised by the acquisition of minority shareholdings could be addressed under Articles 101 or 102 TFEU. Indeed, according to the Court of Justice, the acquisition of a (controlling or minority) stake in, for instance, a competitor can, under certain circumstances, be construed as an anti-competitive agreement or an abuse of a dominant position.

However, in reality, the antitrust rules set out in Article 101 and 102 TFEU do not cover all problematic cases.

**Article 101** only applies to agreements that have the object or effect of restricting competition, such as cartels. When it comes to the purchase of minority shareholdings, it is difficult if not impossible to identify a relevant “agreement” in the first place, for instance in the case of purchases via the stock exchange or from multiple sellers. Even where a share purchase agreement exists, these transactions are on the face of it competition-neutral, which makes it in most cases legally difficult to prove an anti-competitive object or effect. Alternatively, one would have to demonstrate that the articles of association or by-laws of a company were anti-competitive. This is far-fetched, as their purpose is to organise the corporate governance of a legal person. Also, it would affect parties to the agreement who have not pursued any anti-competitive objectives, such as the seller of a shareholding or the other shareholders of the target company.

**Article 102** does not offer a straightforward way of tackling minority shareholdings either. First of all, in order for an acquisition of a minority shareholding to constitute an abuse of a dominant position, the buyer would have to hold a pre-existing dominant position in the relevant market. Second, the acquisition of the shareholding would have to be qualified as an “abuse”, i.e. as an attempt to foreclose competitors or exploit customers.

So, the acquisition of a minority stake will not fall under Article 101 or 102 TFEU. Even when it does, antitrust rules are arguably not the best means of addressing the purchase of minority stakes. First, antitrust rules focus on stopping and punishing past anti-competitive conduct. The competition issues (or “theories of harm”) arising from minority shareholdings are similar to those in merger cases, and merger control is based on preventing market structures leading to possible distortions of competition rather than curing them.

On top of all this, the procedural rules laid down in Regulation 1/20036 for the implementation of Articles 101 and 102 TFEU do not provide legal certainty to the parties of the transaction, and take much longer to finalise than merger procedures. Regulation 1/2003 does not provide for voluntary notifications of agreements. Respondents to the 2013 consultation almost unanimously requested the possibility of voluntary notification of acquisitions of non-controlling minority stakes. This would allow them to know where they stand, sooner rather than later.

So, in short, there is indeed an enforcement gap at European level.

**How does national merger control protect consumers across the EU?**

The national competition authorities (NCAs) of Austria, Germany and the United Kingdom have the authority to review acquisitions of minority shareholdings, and have indeed done so in the past. In many jurisdictions outside the EU, such as Canada, the United States and Japan, merger control rules also allow for the review of similar structural links.

However, control of minority shareholdings at national level is no substitution for control at European level. For example, in the Ryanair/Aer Lingus case, UK competition authorities had no jurisdiction to assess the effects of the transaction outside the United Kingdom. The European Commission could have assessed those if the Merger Regulation had covered acquisitions of non-controlling minority stakes. There are cases with dimensions beyond national borders for which the Commission is better placed to investigate the impact on competition.

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The White Paper proposes to establish a one-stop shop for the control of minority shareholdings that threaten to cause anti-competitive harm, which will allow for one review at EU level rather than multiple national filings. For cases reaching the turnover thresholds of the Merger Regulation, such a system would bring all related procedures under one roof and could replace national procedures in Austria, Germany and the United Kingdom.

3. What types of anti-competitive harm can result from minority shareholdings?

According to economic research, minority shareholdings can have anti-competitive effects similar to those caused by mergers. The economic effects of minority shareholdings on competition depend first on the financial interests involved, i.e. the acquiring firm’s entitlement to a share of the profits of the target firm. Second, economic effects are influenced by corporate rights, the acquiring firm’s ability to influence the target firm’s strategic decisions. In certain scenarios, where the legal definition of control and ‘decisive influence’ under the EU Merger Regulation are not met, the holder of a non-controlling minority shareholding may still be able to exert material influence over the target company. This is influence relevant for competitive behaviour but short of control over the target firm. Potentially, this can have significant anti-competitive effects.

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<th>Theory of Harm</th>
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The above table gives an overview of anti-competitive concerns that can result from purchase of minority shareholdings, depending on whether the acquiring firm keeps a ‘silent stake’ in the target firm, or whether it acquires corporate rights that confer ‘material influence.’

Acquiring a minority shareholding in a competitor can lead to anti-competitive horizontal unilateral effects, because it makes it more likely that the buyers will be able, and find it profitable, to unilaterally raise prices and restrict output. Firms with financial stakes in the profits of a direct competitor can benefit from reducing their own output and/or increasing their own prices. If a significant part of their customers then move to the competitor they have a minority stake in, they will still earn a profit. This may occur even with a silent stake in the target firm.

These so-called unilateral effects are normally less pronounced when purchasing a minority shareholding than in a full merger. The difference is, that compared to a full merger, the buyer can only benefit from a smaller share of the competitors’ profits.

A financial interest in a competing firm provides incentives for the buyer to raise prices. The acquisition of corporate rights makes it possible for the buyer to raise its competitor’s prices and influence its commercial strategy. This can happen when the buyer gains material influence over the outcome of decisions in shareholders’ meetings on the approval of, for instance, significant investments, product lines, geographical scope, and engaging in mergers and acquisitions. The anti-competitive effect may be very significant in these cases, since the buyer benefits fully from the positive effect of the competitor’s price increase but bears only part of the costs, in terms of sales lost to competitors as a result of the price increase. The full effect depends on the level of the buyer’s financial ownership rights. If the buyer ultimately forces the target company to stop competing, the situation has all the disadvantages of a full merger, but without any of the advantages a merger can generate in the form of cost-saving efficiencies.

Ryanair/Aer Lingus: minority shareholding influencing commercial strategy of a main competitor

The Ryanair/Aer Lingus case is an example of a minority shareholding case leading to horizontal competition concerns. Ryanair had already acquired a significant minority shareholding in its competitor, Aer Lingus, when it notified the Commission of its intention to acquire control in 2006. The Commission twice prohibited Ryanair’s acquisition of control because of serious concerns that it would hurt competition by creating and strengthening dominant positions on a large number of flight connections from and to Ireland, but the Merger Regulation did not allow the Commission to order Ryanair to divest the shareholding it already held in Aer Lingus.

The United Kingdom’s Competition Commission (CC) examined Ryanair’s minority shareholding on the basis of UK merger control rules, which do allow for a review of minority interests. In its findings, the CC stated that the shareholding gives Ryanair the ability to influence the commercial policy and strategy of Aer Lingus, its main competitor, by allowing Ryanair to block special resolutions, by restricting Aer Lingus’s ability to issue shares and raise capital, and by limiting Aer Lingus’s ability effectively to manage its portfolio of Heathrow slots. Ryanair was required to reduce its 29.8% stake in Aer Lingus down to 5% and was banned from seeking or accepting board representation and acquiring further shares.

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7 COMP/M.4439 Ryanair/Aer Lingus, and COMP/M.6663 Ryanair/Aer Lingus Ill.
8 See the General Court’s judgment in Case T-411/07 Aer Lingus v Commission [2010] ECR II-3691
9 Competition Commission report issued on 28 August 2013, Ryanair Holdings plc/Aer Lingus Group plc, under appeal.
The acquisition of a minority share may also lead to anti-competitive *coordinated effects* as they can make it easier and more attractive for competitors to coordinate their conduct. First of all, the acquisition of a minority share is likely to increase the incentives to coordinate because the acquiring firm will internalise part of the benefits from coordination of the acquired firm. The acquisition of a minority share can also enhance transparency if it offers the acquiring firm information rights giving a privileged insight into the commercial activities of the firm in which it holds a share. In particular, reciprocal ownership links, i.e. cross shareholdings between competitors, may lead to or strengthen information exchange. This makes it easier for colluding companies to detect whether the behaviour of their partners is in line with expectations. Depending on the circumstances, increased information flow and higher transparency can therefore increase the ability of firms to coordinate.

Finally, acquisitions of stakes in a firm active in an upstream or downstream market may lead to competition concerns by *input or customer foreclosure*. By acquiring a minority stake in a firm active in an upstream or downstream market, the buyer will also acquire the incentive to foreclose competitors in these markets. Now, depending on the degree of influence on the target company’s decisions, the minority stake buyer can attempt to block competitors from the target company’s inputs or access to customers.

Also, the fear that commercially sensitive information may end up in the hands of a competitor may deter companies from dealing with firms in which their competitors have minority stakes that provide extensive information rights.

### IPIC/MAN Ferrostaal: input foreclosure via minority shareholding

An example of a vertical competition concern caused by a minority shareholding is the IPIC/MAN Ferrostaal case (COMP/M.5406). In 2009, the Commission approved the acquisition of MAN Ferrostaal (a subsidiary of MAN) by International Petroleum Investment Company (IPIC), subject to conditions. The Commission found that the transaction would give rise to a foreclosure risk regarding the only existing non-proprietary technology for melamine production in the world.

MAN Ferrostaal had a 30% minority shareholding in Eurotecnica, the supplier of the input technology of melamine. This participation gave them important veto rights – albeit short of control – over Eurotecnica’s melamine licensing and engineering businesses. The Commission expected that the merger might lead to a foreclosure strategy towards IPIC’s major competitors producing melamine or potential new entrants. To remedy the situation, MAN Ferrostaal committed to divest its entire minority shareholding in Eurotecnica.

Material influence by minority sharoldings over decisions provoke a higher risk of foreclosure than in a complete merger. Input foreclosure is more likely because the buyer fully benefits from increased profits on the downstream market caused by foreclosing its rivals, but only suffers a part of the upstream losses caused by the foreclosure strategy (‘free rider effect’).

In ‘silent stake’ minority shareholdings, by contrast, input foreclosure poses less of a problem than in a full merger, because of the smaller financial incentives to foreclose.

### 4. The practice of the NCAs

In Austria, Germany and the United Kingdom, the NCAs have intervened in a number of cases where minority stakes raised competition concerns. Acquisitions of non-controlling minority shareholdings account for approximately 10-12% of all mergers notified in Germany and 5% in the United Kingdom.

#### A-Tec/Norddeutsche Affinerie – a national case where minority shareholdings led to coordinated behaviour

The German Bundeskartellamt prohibited the acquisition of a 13.75% participation by A-Tec Industries AG (A-Tec) in Norddeutsche Affinerie, a copper producer, which would have granted A-Tec a ‘competitively significant’ influence over Norddeutsche Affinerie, and ordered the dissolution of the already implemented transaction. Because of the consistently low participation in Norddeutsche Affinerie’s shareholders meetings, A-Tec’s 13.75% share gave it a de facto blocking minority for certain shareholders’ resolutions under corporate law, comparable to the legal position granted by acquisition of a 25% stake. A-Tec was the only shareholder possessing know-how of the copper industry sector, and the only one with any strategic long-term objectives directed at the competitive behaviour of Norddeutsche Affinerie.

The Bundeskartellamt concluded that the transaction would have led to the creation of a (collective) dominant position on the market for oxygen-free copper billets. Pre-acquisition, buyers of oxygen-free copper billets could choose between two equal, independent suppliers. Post-acquisition, the Bundeskartellamt expected the two parties to coordinate their behaviour in the market place as a result of the transaction, with customers having no real alternatives to switch to another supplier.

### 5. The proposed system: a ‘targeted’ transparency system

Minority shareholdings can have harmful effects, but there are currently only limited possibilities for reviewing them at EU level. How could EU merger control, using the ‘significant impediment to effective competition’ test defined by the EU Merger Regulation, best cover these potentially harmful acquisitions? Though the competitive harm can be considerable, the number of potentially problematic cases will likely be limited. This means that the design of the review system should not go beyond what is required to ensure an adequate level of protection.

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The White Paper proposes a balanced system which:

- catches the (relatively small) number of potentially anti-competitive transactions;
- avoids unnecessary administrative burden;
- fits seamlessly with the existing system of merger control on the European and national levels.

The result is a targeted transparency system which will only apply to transactions that are likely to raise potential competition issues, namely acquisitions creating a ‘competitively significant link’ between the buyer and the target. It will also impose less of an administrative burden on the parties and the Commission than the elaborate notification system that currently applies to ‘full’ mergers under the Merger Regulation.

In order to provide parties with legal certainty, only transactions meeting both of the following criteria will fall within the definition of a ‘competitively significant link’:

- acquisitions of a minority shareholding in a competitor or vertically related company (i.e. there needs to be a prima facie competitive relationship between buyer and target); and
- the competitive link will be considered significant if the level of acquired shareholding is (1) around 20%11 or (2) above 5%, but accompanied by additional elements such as rights which give the acquirer a ‘de facto’ blocking minority for certain shareholders’ resolutions, a seat on the board of directors, or access to commercially sensitive information of the target.

By limiting jurisdiction to competitively relevant transactions, the system will mainly target strategic acquisitions made by industrial investors. Thus, it will normally not affect investments made by private equity investors or banks, whose business is generally not related to that of the firms in which they invest, and should not hamper the liquidity of equity markets.

Any firm wishing to acquire a minority stake creating a ‘competitively significant link’ as defined above will have to submit a short ‘information notice’ informing the Commission of the transaction. Based on the information notice, the Commission can decide whether to investigate the transaction or not. Member States can ask the Commission for a referral to do so.

Whether or not a transaction is warranted, Member States will consider whether the proposed transaction is referred to Member States are not yet implemented and can be partially) implemented, it should have the power to issue interim measures in order to ensure the effectiveness of its final decision.

The Proposed Procedure in a nutshell – how will minority shareholdings be reported and investigated?

(1) Short information notice to the Commission required when undertakings propose to acquire a minority shareholding they believe is a ‘competitively significant link’. The information notice contains information relating to the parties, turnover, a description of the transaction, the level of shareholding before and after the transaction, any rights attached and some limited market information.

(2) Only some cases picked up: On the basis of this information notice, the Commission will decide whether further investigation of the transaction is warranted. Member States will consider requesting a referral.

(3) Full notification required only if the Commission initiates an investigation. Similarly, the Commission will only issue a final decision if it initiates an investigation in the first place.

(4) Voluntary submissions of full notification are allowed in order to provide parties with legal certainty.

(5) Waiting periods for implementation of the acquisition following the submission of an information notice could be introduced. If the Commission does not initiate an investigation and Member States do not request a referral within the waiting period, the parties could implement the transaction (but the Commission could still investigate the case afterwards, see point 6). Suggested length of the waiting period could be 15 working days12.

(6) Time limits for initiating investigations: Whether or not a transaction has already been implemented, the Commission can investigate it only within a limited period following the information notice. A 4- to 6-month period gives the business community enough time to come forward with complaints, and reduces the risk of the Commission initiating an investigation merely on a precautionary basis during the waiting period.

(7) Interim measures: In the event that the Commission initiates an investigation of a transaction which was already (fully or partially) implemented, it should have the power to issue interim measures in order to ensure the effectiveness of its final decision. Such power could take the form of a hold separate order, for example.

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11 For instance, the UK Office of Fair Trading (OFT) has set a threshold at 15% above which it may examine any case (see OFT, ‘Mergers-Jurisdictional and procedural guidance’, para. 3.20). This might also serve as a clear-cut threshold above which a shareholding could be considered a ‘competitively significant link’.

12 The 15-day period would be aligned with the current deadline under Article 9 for a Member State referral request following a full notification. Such a system would ensure that transactions that are referred to Member States are not yet implemented and can be handled by the Member States under their normal procedure, as they might foresee a stand-still obligation and not be equipped to deal with consummated transactions.