Competition Policy Lab: Minority Shareholdings

Bruegel, 18th July 2013

The European Commission has recently opened a public discussion on the treatment of minority shareholding in the context of merger regulation. Currently, the acquisition of minority stakes which do not imply a change in control of the target company is not subject to merger control. Economic theory, however, suggests that absence of control does not necessarily imply absence of harm to consumers. Therefore, a framework to assess potential effects of minority shareholding is deemed necessary by the Commission. These issues were discussed during the Competition Policy Lab held at Bruegel. [1]

The legal framework

Johannes Lübking, head of the Merger Policy Unit of the Commission's DG Competition, opened the seminar introducing the legal framework. Under the EU Merger Regulation the Commission cannot examine minority shareholdings in stand-alone investigations but has taken them into consideration when analyzing the effects of a merger on competition, for example by requiring a divestment of the stake. The situation seems rather unsatisfactory because the Commission cannot intervene in case the stake is acquired after the closing of a merger case, even in case the shareholding had raised competition concerns. Mr Lübking also explained that EU Antitrust Law gives the Commission limited ability to treat anticompetitive minority shareholdings: first, under Article 101 of the Treaty on the Functioning of the European Union (TFEU), it is unclear whether all situations creating competitive harm are covered, in particular whether an "agreement" restricting competition exists if a minority stake is acquired via the stock exchange or if the competitive harm results from a mere change in incentives following an acquisition of a minority stake; second, Art. 102 TFEU requirements that the acquiring undertaking should be dominant and that the acquisition should constitute an abuse would limit the Commission's reach to very narrowly defined cases.

For these reasons, the Commission has initiated a process to reflect on bringing minority shareholdings under its jurisdiction in the context of EU Merger Control. According to Mr Lübking, the major challenge is to design a "system that does not create unnecessary administrative burden whilst ensuring to catch the anticompetitive transactions" (link to presentation). Two principal options are being considered: a notification system, parallel to the one in place for merger control for which also stakes must be notified ex-ante to the EC; a selective system, more similar to an antitrust system for which the Commission investigates transactions most likely to raise competition concerns. The selective system can then be designed as a self-assessment system in which the parties do not have any filing obligation and a transparency system for which the parties have to publish a short information notice. The higher burden that companies would incur in complying with a notification system and the limited number of cases expected may be points in favour of a selective system.

Minority shareholding in the economic literature

Giulio Federico from DG Competition's Chief Economist Team explained how harm can materialize, through horizontal or vertical effects. Unilateral horizontal effects arise because the acquiring company internalizes part of the profits of the target and therefore has less incentive to compete. Also, in specific cases where the acquisition of stakes confers the company special corporate rights, the target company's strategic decisions could be influenced by a competing firm. "Material influence" of this type represents a

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[1] This synthesis has been prepared by Bruegel. Views expressed in this note cannot be regarded as stating an official position of the European Commission.

serious concern as a price increase fully benefits the acquiring firm whilst the loss of sales for the acquired firm is shared with other shareholders. Likelihood of collusion is also affected by minority shareholding.

In terms of vertical effects, due to relationships between competitors active in different markets, we can distinguish between backward shareholdings, i.e. a downstream firm's partial stake in an upstream firm, and forward shareholdings, i.e. an upstream firm's partial stake in a downstream firm. In presence of backward shareholdings the greatest concern is that the downstream shareholder could induce its target supplier to foreclose its downstream rivals: the controlling downstream player fully benefits from weaker competitors while suffering only a fraction of the losses made by its upstream supplier. This effect depends on the supplier's ability to discriminate among buyers and on the influence exerted by the downstream shareholder on the upstream player, i.e. the presence of material influence. The case of forward shareholding is potentially worrying as the upstream shareholder may have the ability to induce the downstream player not to buy from competing suppliers: the shareholder internalizes only part of the losses made by the downstream buyer but obtains the full advantages of increased upstream sales.

Mr Federico stressed that the relevance of these effects is not just theoretical as the Commission and national competition authorities have dealt with them in several cases. A recent resounding example is the Ryanair – Aer Lingus case: since 2006 Ryanair has made attempts to acquire Aer Lingus, airline competitor in the Irish market, but the Commission has deemed the merger as anticompetitive and prohibited it in 2007 and 2013. At the same time Ryanair has acquired a 30% stake in Aer Lingus: the stake does not grant Ryanair a decisive influence over Aer Lingus but guarantees de fact a veto power in several strategic decisions. As recently as May 2013, after an investigation of the case the UK Competition Commission has issued Provisional Findings in which it asserts that because of the non-controlling stake, Aer Lingus has reduced ability to merge with other airlines, reduced ability to raise capital, and reduced powers to manage its slots in London Heathrow airport. According to the UK CC, these effects may lead to significantly less competition.

The discussion

Professor Spiegel from Tel Aviv University discussed two economic points that should definitely be considered by the EC. The first one relates to the amplified effect of a minority stake acquisition when other cross-shareholdings are already present: generally speaking, when a firm or controller acquires a stake in a target firm, the effective stake depends on its shareholdings in companies that hold themselves shares of the target firm and on cross-shareholdings between the target and other firms. According to Prof. Spiegel, the pre-existing net of cross-shareholdings can substantially alter the incentives at play: for example, even small passive stakes can represent a relevant effective stake and lead to substantial price increases when unilateral horizontal effects materialize. As a consequence, the identification of "safe harbors", situations believed not to have anticompetitive effects, can be difficult.

The second point relates to coordinated effects: Professor Spiegel pointed out that in some circumstances collusion fostered by minority shareholdings can be worse than full-scale mergers. When competitors are heterogeneous in efficiency, the cartelists would set a price that somehow satisfies the least efficient cartelist, a price arguably higher than the one imposed by a monopoly that can operate only the most efficient plants.

Event summary by Marco Antonielli and Mario Mariniello