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# Minority acquisitions and merger control: a way forward for the EU

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As the European Commission looks to review and potentially revise its rules for reviewing minority share acquisitions under EU competition law, Ropes & Gray antitrust specialists Adam Eckart and Jonathan Cheng explore how the approaches of other antitrust jurisdictions around the world may influence how DG Comp views, and eventually examines, minority deals and their effect on competition.

What could be major changes regarding the antitrust reporting of minority acquisitions are on the horizon in the European Union.

Sparked in part by the continuing six-year saga of competition enforcement efforts in the Ryanair/Aer Lingus case, the European Commission is reviewing, and potentially seeking to revise, its regulatory framework regarding non-controlling shareholdings. Such shareholdings are currently outside the scope of the European Commission's Merger Regulation (ECMR), which applies only to acquisitions of "control". The challenge for the EU centres around what regulations will be most effective in identifying (and therefore providing the opportunity to mitigate any anti-competitive effects of) minority acquisitions. More particularly, looking at the approach of other jurisdictions, the question remains about what combinations of objective and subjective criteria may create the best balance for the EU, capturing the transactions most likely to create competitive harm while not casting too wide of a net.

Many jurisdictions have already crafted their own merger regimes that try to address the potential issues raised by minority acquisitions. The US employs a mandatory pre-merger notification system that combines complex objective reporting criteria with subjectivity when determining the applicability of certain exemptions such as the "passive investor" exemption. Similarly, a number of EU member states (including Germany, Austria, and the UK) already have pre-merger regulations, separate from the ECMR, which address minority acquisitions by focusing on objective standards, such as a percentage shareholding, and subjective determinations, such as whether such shareholding allows one to materially or substantially influence the business decisions of the issuer. Additionally, other nascent regimes, including Brazil and India, have their own variations to address the pre-merger reporting of minority acquisitions and employ a range of objective and subjective reporting criteria when considering such transactions.

Although we recognise that the EU will not simply employ an 'out of the box' approach, the path forward for the EU could be modelled on a particular jurisdiction or the EU may amalgamate the approach of a number of jurisdictions. As such, it is important to understand the existing pre-merger reporting requirements for minority acquisitions in select jurisdictions, including the US, Germany,

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Austria, the UK and others, and identify common themes and possible trajectories the commission may take.

**Background and Rationale for Review**

Minority acquisitions (also known as "structural links" in the EU) are generally acquisitions that fail to amount to "control" of the target company. What constitutes "control" varies by jurisdiction. In the EU, control arises through the possibility of exercising decisive influence, which may occur through:

- ownership of more than half of a company's capital or business assets;
- having the power to exercise more than half the voting rights of the company;
- having the power to appoint more than half the members of the supervisory board, the administrative board or bodies legally representing the company; or, more generally,
- having the right to manage the company's affairs, including through negative control rights such as veto rights over commercial strategic behaviour of the company.

By contrast, in the US, "control" is not possible through negative control rights but, rather, is defined with reference to a bright-line test. With respect to a corporation, control results from a 50 per cent shareholding or having a present contractual right to appoint at least half of the corporation's board of directors. With respect to a non-corporate entity, control results from a right to at least 50 per cent of the profits or, upon dissolution, assets of such entity.

Acquisitions that do no result in control can still create issues from an antitrust perspective. While the potential theories of antitrust harm in acquisitions of control are well documented, the theories of harm in minority acquisitions are a more recent and evolving debate. Other than a general weakening of competition, the potential anti-competitive effects of minority acquisitions may include:

- the potential risk of sharing competitively sensitive information;
- the potential to create the ability to control or influence the target company, such as through board appointment rights or governance rights;
- the possibility of collusion and/or coordinated effects; and, in the case of vertical structural links,
- allowing companies to hamper competitors' access to inputs or customers.

Such effects may be amplified when the parties to the transaction are competitors, or are in protected or specialised industries, such as media, telecoms, banking, finance and insurance.

**A Key Example – Ryanair/Aer Lingus**

The Ryanair/Aer Lingus saga illustrates several possible theories of harm arising from minority acquisitions. In 2006, 2008 and 2012, Ryanair launched three separate public bids for rival airline Aer Lingus; such bids were notified to DG Comp, which subsequently prohibited the acquisition. Notwithstanding the commission's prohibition, Ryanair increased its shareholding in Aer Lingus from 5 per cent to 29 per cent in between its public bids, which entitled it to certain special governance

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rights. Such rights fell short of "control" in the EU. Accordingly, the commission did not have the authority to review such incremental share increases. However, the UK Competition Commission did have the authority to review the share increases because of the structure of its national pre-merger regime, and the UK authority opened an investigation in June that year.

The Competition Commission considered a number of theories of harm arising from Ryanair's minority acquisition, including the substantial lessening of competition for air transportation services between the UK and Ireland and the weakening of Aer Lingus's effectiveness as a competitor either for offensive or defensive purposes. Ryanair had the power to block special resolutions, which would impede Aer Lingus's commercial policy and strategy. As an offensive measure, the commission found Ryanair could weaken Aer Lingus, making it easier to acquire, while, as a defensive measure, Ryanair could prevent Aer Lingus from striking deals with other airlines, preventing Aer Lingus from becoming a stronger competitor to Ryanair. Ultimately, in August 2013, the commission ordered Ryanair to divest its shareholding to 5 per cent and to commit not to seek or accept board representation or acquire future shares.

**Current EU Landscape and Ryanair**

The drawn-out and complicated interplay between the two airlines and the two different regulatory agencies could have been avoided, or at least reduced, if the EU's definition of "decisive influence" required the reporting of minority acquisitions. Even before the dust settled in the multiple Ryanair/Aer Lingus investigations, the commission openly recognised in 2011 a possible enforcement gap in its merger regulations: certain minority acquisitions could result in a substantial lessening of competition and the current EUMR did not provide a framework for the mandatory review of such acquisitions, prompting DG Comp to revisit and possibly update its regulations.

**A Look Around the World**

While the commission is highly unlikely to adopt the regime of another jurisdiction in a wholesale manner, it is currently reviewing how other jurisdictions have addressed the problem of minority shareholdings. Therefore, a review of several key jurisdictions that have sophisticated regimes and/or regimes with low triggering thresholds may provide some insight into common themes and enforcement techniques. Such themes may be insightful in understanding a path forward for the EU.

*US*

In the US, share acquisitions generally require pre-merger reporting if certain jurisdictional thresholds are satisfied, whether or not control is obtained. Interpreted narrowly, one exemption to the pre-merger reporting obligation may be available for an acquisition that is for "investment purposes only" and would result in the acquiring person holding 10 per cent or less of an issuer's outstanding voting securities. Whether an acquisition qualifies as solely for the purposes of investment depends largely on the subjective intent of the acquiring person, namely whether such person intends to participate in the management of the issuer by doing something more than simply holding and voting its stock. Actions inconsistent with passive investment intent include nominating a candidate for the

board of directors, proposing corporate action requiring shareholder approval, soliciting proxies, and being a competitor of the issuer, among other things. These actions, or a competitive relationship between the parties, make it more likely that a transaction could pose anti-competitive harm and, assuming that the jurisdictional thresholds of the Hart-Scott-Rodino Antitrust Improvements Act 1976 are satisfied, there is no available safe harbour from reporting.

*Germany and Austria*

The competition laws of Austria and Germany capture minority investments above certain thresholds. An acquisition of voting securities of an issuer in the amount of 25 per cent or more is generally reportable in Germany and Austria provided their respective jurisdictional thresholds are satisfied. Acquisitions of less than 25 per cent of the voting securities of an issuer, which otherwise meet the respective jurisdictional thresholds, may also be reportable where a combination of "plus factors" are satisfied. "Plus factors," which provide indicia of the exercise of a competitively significant influence, may include qualitative considerations such as sector-specific knowledge of an acquiring person and practical applications of voting rights. When taken into consideration, such "plus factors" could be competitively relevant and render a minority acquisition reportable. The combinations of the plus factors that result in a determination of a competitively significant influence are evaluated on a case-by-case basis.

*UK*

As mentioned above, the UK competition regulations capture minority shareholdings. In the UK, acquisitions of 25 per cent or more are subject to the UK's voluntary notification regime if they also meet either a turnover or share of supply test. Under UK competition law, the acquisition of minority interests can result in an acquirer obtaining either "de facto control" or "material influence". Under the "de facto control" standard, the determination of control is made on a case-by-case basis and may be conferred by shareholdings of as little as 25 per cent to 30 per cent. Under the "material influence" standard, there is a "presumption of material influence" above a 25 per cent shareholding but a possibility of "material influence" conveyed by shareholdings of 15 per cent or less. In certain circumstances, including in the case of stake-building in the context of a public bid, the decision of whether to investigate a transaction "will depend on all the circumstances of the case [...] and in particular its belief as to the extent of the competition concerns that could potentially result".

*Brazil*

Brazil's competition law requires that parties pre-notify minority acquisitions where the acquiring person would hold, directly or indirectly, a share of 20 per cent or more of an issuer and the parties satisfy certain jurisdictional thresholds. Additionally, notification is mandatory if the acquisition is of 5 per cent or more and involves an interest in a competitor or vertically related party. This element of the law is relatively new, and it remains to be seen how closely the Brazilian competition authorities will review and enforce acquisitions of as little as 5 per cent, even where there is an overlap between the acquiring and the target companies.

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*India*

In India, transactions where a party is able to exercise 25 per cent or more of the voting rights of another company are notifiable, assuming jurisdictional thresholds are met. The Competition Commission of India (CCI) requires notification of minority acquisitions conferring less than 25 per cent where the acquisition will lead to an "appreciable adverse effect" on competition. Interestingly, the CCI's regulations detail certain types of acquisitions it views as unlikely to have a substantial effect on competition including acquisition of voting rights in the ordinary course or for investment below 25 per cent, an acquisition in which the acquirer already holds 50 per cent of the issuer, and an acquisition of assets not related to the business activity of the acquiring person, among others. Additionally, the CCI has issued new rules to require the notification of "creeping" acquisitions where an acquiring person, who already holds 25 per cent or more (but less than 50 per cent) of the shares of an issuer acquires an additional 5 per cent or more of voting stock or rights in any given financial year. Such regulations allow the CCI to keep track of an acquiring person's gradual share increase in an issuer and may allow the regulators to ask questions as such a person approaches a "controlling" interest.

**Identified Themes**

Across jurisdictions, certain common themes and approaches to identifying problematic minority acquisitions may influence the EU. The most common themes include the use of objective standards (prescribed turnover, percentage, and "deal size" thresholds), "plus factor" type analysis (the possible competitive impact of an acquisition, and the relative market positions of the parties), and subjective considerations, including an acquiring person's intention in acquiring a minority stake.

*Objective standards contrasted with plus factors and subjective standards*

One generally unifying theme is that many jurisdictions have specific and identified jurisdictional objective standards that determine reporting obligations for minority acquisitions. For instance, the thresholds in Germany, Austria, the UK and India adopt some form of a 25 per cent threshold, while Brazil has a 20 per cent threshold. Brazil further adds bright line factors, such as competitor status and vertical relationships, where notification is mandatory.

Many jurisdictions, however, supplement their objective standards with their own tailored "plus factors," used to augment the rigid jurisdictional thresholds. In Austria and Germany, the "plus factor" analysis assists in determining whether a party can obtain significant influence to require a merger notification.

By contrast, the US is somewhat of an outlier, by employing an objective jurisdictional test with respect to minority interests in corporations and adding a subjective intent prong to its 10 per cent passive investor exemption. Notably, however, the US does not require the reporting of non-controlling minority position acquisitions in non-corporate entities.

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*Competitive impact and treatment of competing firms*

Similar to the above, one "plus factor" that seems to be particularly relevant to a number of jurisdictions is the importance and competitive impact of competing firms. A competitive relationship between the parties to a transaction is specifically of concern in the US and Brazil. In the US, competitors are a class of entities that are not eligible for the 10 per cent "investment only" exemption. Similarly, in Brazil, transactions involving competitors can be reportable where as little as a 5 per cent equity stake is acquired. Of course, with competitors in the mix, regulators become more concerned with the possible anti-competitive aspects of a transaction, warranting additional review and analysis.

**Next Steps for the EU**

The commission has several regulatory and enforcement options regarding regulating structural links. Three examples include:

*Ex Ante Mandatory Notification*

Essentially, the ex ante mandatory notification would mirror the current EU pre-merger notification regime by extending the scope to include structural links. The commission appears to be contemplating inserting either a shareholding "safe harbour" or a substantive safe harbour (eg, the UK's material influence standard). There is also the possibility of adopting one or a combination of both (similar to the US's "investment only" exemption, as set out above). Additionally, the commission has mentioned several possible permutations for structural links, including using a variation of the short-form notification for typical structural links, a long-form notification if certain competitive issues are present (eg, competitors in concentrated markets), a shorter waiting period, and/or not imposing a standstill obligation, among others.

Voluntary Notification

While voluntary systems are not, statistically-speaking, common among those jurisdictions that have reporting regimes, a voluntary regime could be established as either an ex ante or ex post notification. In principle, the voluntary notice for minority acquisitions is a sensible choice. Generally speaking, it is unlikely to be necessary for the merging entities in a minority acquisition to be required to unwind any integrated operations and facilities as divesting a level of shareholding should be a relatively easy remedy for the acquiring person to comply with as evidenced by Ryanair/Aer Lingus. However, it is always possible that competitive harm could occur, such as with the exchange of commercially sensitive information or maximisation of profits, in the interim. An obvious issue, though, is whether parties would take the time and expense to notify in a non-compulsory situation or whether they would be willing to take the risk of non-notification. Further, a bifurcated system (requiring mandatory notification of control acquisitions and voluntary notification of structural links) could create confusion to potential filers.

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No Notification with Ex Post Investigative Authority

Providing the least amount of burden on businesses and placing the investigatory obligation solely on the regulators, the commission could explicitly expand its authority to investigate structural links under the ECMR while not implementing a notification obligation. Under this option, the burden would be on the commission, based on its own market intelligence gathering, to seek out and determine whether any given particular structural link is anti-competitive.

**Conclusion**

Since the commission's last comprehensive review of its competition framework almost a decade ago, the competition world has changed drastically. In 2004, many of the countries discussed above had either rudimentary pre-merger regimes or no dedicated pre-merger regime; the wave of mergers and acquisitions in the airline industry had just begun; and large inter-competition agency conferences promoting cooperation amongst competition agencies had just started. While the Ryanair/Aer Lingus case undoubtedly brought the structural links issue to the forefront of discussion in the EU, the adoption and adaptation of regulations regarding the pre-merger reporting of non-controlling minority acquisitions, including in nascent regimes, are a sign of an emerging trend: enforcers are interested in these transactions. For legal practitioners, the measures DG Comp will take to address structural links, including the form of regulation, the cost to current and prospective clients, and the possible transactional delay (as would be caused by a mandatory waiting period) will continue to be closely watched. Regardless of the commission's path forward, major changes to the regulatory landscape of the EU could potentially affect clients, transaction costs, and deal timeframes going forward.

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