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An Eye On Acquiring Minority Interests

Law360, New York (April 21, 2010) -- A recent report published by the UK's Office of Fair Trading (OFT) could signal a renewed interest by competition authorities in situations where companies obtain minority interests in competitors.

UK competition authorities have typically investigated the acquisition of minority interests under merger control provisions, which apply only where the minority interest in question enables the acquirer to exercise some form of "control" over its competitor (what exactly constitutes "control" can vary from case to case).

However, the report highlights that many forms of minority rights that may not grant the acquirer any form of "control" can still have a detrimental impact on competition.

Background and Findings of the Report

On March 22, 2010, the OFT published a report on the potential effect on competition of companies holding minority interests in competitors. The report was commissioned by the OFT and the research was undertaken by an independent economic consultancy.

The report considered the potential implications to competition of minority interests such as: minority share ownerships, interlocking directorships and loans to competitors.

Importantly, the report focused on situations where the rights extending from such interests did not grant the right holder any form of "control" over the competing undertaking. As a result, the scenarios that were analyzed would not (on their own) typically qualify for review by the OFT pursuant to UK merger control laws.

The report analyzed the possible unilateral and coordinated effects of each form of minority interest and found that, in general, minority interests in imperfectly competitive markets can be used to further soften competition, which can lead to higher prices and lower quantities to the detriment of consumers.

In particular, the report found that minority share ownerships and interlocking directorships both create incentives to compete less vigorously, and interlocking directorships also raise "potentially strong" concerns about companies maintaining a "collusive equilibrium" as a result of increased information flow. In addition, it found that interests such as minority share ownerships do not result in any obvious efficiencies.

Interestingly, aside from considering the more "traditional" forms of minority interest (such as minority share ownerships and interlocking directorships) the report also considered how derivatives — a relatively new, and now extremely common, form of financial instrument — may impact competition. Here the report found that derivatives have broadly similar unilateral effects to those of minority share ownerships.

In particular, where the buyer "goes long" (and thus benefits from an increase in the share price of a competitor), the findings of the report suggest that derivates are "suitable tools for strategically affecting competition" in cases where competition takes place over short, well-defined periods (e.g. where competitors fight for discrete projects through bidding processes).

Interestingly, where the buyer "goes short," the report found that derivatives could be used to share the profits of a cartel and could also support exclusionary behavior.

A Question of Assessment

Merger Control

In the United States, an HSR filing is triggered based upon the value of the acquired interest, not the acquisition of control, and Section 7 of the Clayton Act prohibits the acquisition of "the whole or any part of the stock" of a corporation that may lessen competition, regardless of the acquisition of control. Indeed, the Supreme Court expressly held in Denver & Rio Grande Western R.R. v. United States that "[a] company need not acquire control of another company in order to violate the Clayton Act."

In the EU, UK and many other jurisdictions, however, merger control rules (both substantive and procedural) only apply to situations where the acquisition of a minority interest allows the acquirer some form of control over the target.

But even where merger control regimes apply only to the acquisition of control, companies seeking to make strategic investments face the problem that there is no single standard for determining the level at which the acquisition of a minority interest can be said to result in "control." This often creates uncertainty for companies (and their advisers) when attempting to determine whether the acquisition of a minority interest could trigger a merger filing.

Provided the relevant turnover thresholds are met, the European Community Merger Regulation (ECMR) grants the European Commission (Commission) jurisdiction over transactions that result in a "concentration."

In broad terms, a concentration will arise where an undertaking obtains direct or indirect "control" over another by way of "rights, contract or other means" which "confer the possibility of exercising decisive influence." The Commission's Consolidated Jurisdictional Notice also explains that control can occur on a legal or a de facto basis.

In reality, it is rare for the Commission to assert jurisdiction over the acquisition of a minority shareholding leading to sole control. It is often a combination factors that lead to a finding of control.

For example, in its decision in KLM/UK Air, the Commission found that the “combined effect” of a loan arrangement, a call option, board representation and a 14.9 percent shareholding gave KLM the possibility of exercising decisive influence over UK Air.

More recently, in Ryan Air/Air Lingus, the Commission concluded that the acquisition of a 29.4 percent shareholding by Ryan Air in Air Lingus did not amount to an acquisition of control by Ryan Air (Air Lingus is currently appealing this decision).

In contrast with the position under the ECMR where the test is one of “decisive influence,” UK merger control rules (under the Enterprise Act) are centred around the concept of “material influence.”

As a result, there is the possibility that the OFT could exert jurisdiction over the acquisition of a minority interest that might not meet the test of decisive influence under the ECMR but that is sufficient to meet the test of material influence in the UK. This may well give the OFT an advantage over the Commission should it wish to investigate "less significant" acquisitions such as the situations described in the recent report.

The OFT’s guidelines on substantive assessment in merger cases, explain that the authority may examine an acquisition of a shareholding as low as 15 percent. This occurred in the First Milk/Wiseman merger where the OFT investigated the acquisition of a 15 percent shareholding by First Milk in Robert Wiseman Dairies.

More recently, in its decision in BSkyB/ITV, the OFT concluded that BSkyB’s 17.9 percent shareholding in ITV was sufficient to give it material influence over the policies of ITV. However, it is obvious that each situation will be assessed on a case by case basis — for example, contrast these examples with the OFT’s finding in Moet Hennessy/S.N.C. Glenmorangie plc where a shareholding of 34 percent was found not to amount to material influence.

Situations Falling Outside Merger Control

The acquisition of minority rights below the requisite level of control needed to trigger a merger notification to authorities such as the Commission or the OFT will be assessed under general competition law principles, such as prohibition against anticompetitive agreements (in the EU — Article 101 of the Treaty on the Functioning of the European Union, and in the UK — Chapter I of the Competition Act). However, in practice, this has only occurred on a limited number of occasions.

In BAT Reynolds v Commission (a case decided before a system of merger control had been introduced by the Commission) the European Court of Justice recognised that the acquisition of a minority shareholding in a competitor may fall to be assessed under the prohibition of against anticompetitive agreements.

It is also clear that the Commission is entitled to consider the competitive effects of a minority interest falling below the level of control where such an interest is held by one of the parties to a merger that has been notified to the Commission under the ECMR (i.e. where one of the notifying parties has such an interest in a third party). This was confirmed by the Court of First Instance (now the General Court) in Kesko Oy/Commission.

Lessons from the U.S.?

The U.S. Department of Justice’s Antitrust Division and the Federal Trade Commission have challenged a number of transactions involving the acquisition of small minority interests.

In Zeneca/Astra, the Commission required Zeneca to divest a small 3 percent investment interest in Chiroscience (to which Zeneca was divesting rights in a drug).

In Time Warner/Turner, the FTC required TCI to divest its interest in Time Warner or to cap its interest at a 9.4 percent nonvoting interest, and in Medtronic/Physio-Control the FTC required Medtronic to make its 10 percent interest in SurVivaLink, a competing firm, entirely passive by delegating its voting rights and agreeing not to nominate members to the board of directors, participate in business decisions, or obtain confidential information.

In April 2009, comments to the Federal Energy Regulatory Commission regarding the FERC's policies on partial acquisitions, the FTC noted that even partial acquisitions that do not lead to any form of control can raise competitive concerns by (1) altering incentives of one or both firms to compete, (2) creation of influence over acquired firms, or (3) facilitation of the exchange of competitively sensitive information.

Future Implications of the Report

The findings of the report raise the question of how competition authorities should tackle minority interests, particularly in light of the development of new financial instruments such as derivatives.

While merger control rules are still the most widely used tool to assess minority interests, it is clear from the report that interests falling below the requisite level of control for merger notification purposes are still capable of harming competition.

While it is doubtful that the publication of the report will spark a rush on the part of competition authorities to investigate minority interests, it should serve as a reminder to companies (and their advisers) that such minority interests are very much on the radar — whether or not they constitute a controlling interest.

More generally, the report perhaps also opens the door for a wider debate on the merit of introducing legislation similar to that of the Clayton Act that would enable authorities to more easily exert jurisdiction over noncontrolling minority interests.

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