Minority shareholdings: New competition law issues?

September 21, 2016

New competition law issues with respect to minority shareholdings?

A topic that recently became prominent in the competition law community and beyond is whether so-called “common ownership” may have a negative effect on competition. “Common ownership” describes the situation where large institutional shareholders (such as investment funds, foreign wealth funds, pension funds, etc.) hold large minority stakes in a number of companies that are active in the same industry and compete with each other.

The negative effects that have been described in two recently published studies may have an impact on how competition authorities assess minority shareholdings by institutional and strategic investors, which is of importance for institutional investors structuring their portfolio, for strategic investors who pursue an investment strategy targeted at a given sector, and also for companies that seek to attract specifically such institutional or strategic investors. The importance attached to this issue is demonstrated by the fact that the German Monopolies Commission (an advisory body to the Federal Government) covered this issue in its latest biennial report released on 20 September 2016. It appears likely that competition authorities around the world will examine closely such shareholdings in the future, either on the basis of currently existing legal provisions, or even on the basis of new, or amended, legislation.

Debate triggered by economic studies

The current debate has been triggered by two recently published economic studies. The studies found that there is empirical evidence that – at least in concentrated markets – competition is weakened, and consumer prices may increase, if there is a significant degree of common ownership. By way of example (the sectors examined in the studies were airlines and banking in the US): Out of United Airlines’ seven largest shareholders, who hold 60% of the voting shares, five were also among the ten largest shareholders of Southwest and Delta Airlines respectively. Airline ticket prices were found to be 3-11% higher due to common ownership, compared to prices to be expected absent common ownership. The interest sparked by the studies has to do with the fact that common ownership has increased over the last decades – investment funds today manage billions of Euros.

Why may common ownership lead to a lessening of competition?

Absent common ownership, firms compete in order to gain market shares at the expense of their competitors. If a shareholder owns stakes of a similar range in several firms active in the same market, the benefit the shareholder gains if one firm increases its market share and its profits is offset by the loss incurred because of the decrease of the market share and the profits of the other firm. Large institutional shareholders invested in several firms of the same industry therefore have an interest in the performance of the industry as a whole (which has repercussions on their overall portfolio), rather than in the performance of and competition between individual firms. According to the studies, common ownership can have an impact of the conduct of the firms active on the market – be it that investors directly contact the management to make their views known, or be it that management, on its own
initiative, pre-emptively align their conduct with what they deem to be in the shareholder’s interest.

**Impact on competition law enforcement...**

**... in the US**

The economic studies described above have attracted quite some attention from competition authorities in the US; the Department of Justice confirmed that it is looking into the issue of common ownership and its effects on competition with respect to several industries.

**... in the EU**

In the EU, competition law is enforced both by the European Commission and the national competition authorities of the EU Member states.

**EU level**

The European Commission does not (yet) have jurisdiction that would allow it to assess the acquisition of minority stakes under merger control rules (while in Germany, Austria and the UK merger control rules apply to such deals). Notably, in the recent past, there has been a debate whether the merger control jurisdiction of the European Commission should be expanded to also cover the acquisition of minority stakes. When these proposals were published for discussion in 2013 and 2014 respectively, there was considerable opposition against the Commission’s proposals. Recent statements by the Commissioner for Competition suggest that the Commission considers amendments to the EU merger control rules that would bring “direct” minority shareholdings between undertakings that are horizontally (i.e., as competitors) or vertically (in up-and downstream markets) related to be disproportionate. The issue of common ownership did not feature prominently in the past debate. The mechanisms that have now been described on the basis of empirical research may however re-ignite the discussion, this time with a focus on the question whether there is a need to pay greater attention to indirect links between undertakings that compete with each other, or that are active on vertically related markets, that are created by institutional or strategic shareholders that hold minority shareholdings in these undertakings. But also absent legislative changes, if it considers such minority shareholdings to give rise to competition concerns, the European Commission might seek to address common ownership on the basis of the general competition law provisions enshrined in Art. 101 and Art. 102 of the Treaty on the Functioning of the European Union.

**Germany**

In Germany, the acquisition of minority shareholdings has long been subject to merger control scrutiny by the Federal Competition Office. Transactions may have to be notified, inter alia, if the acquirer is awarded a position of “competitively significant influence” on the target. Such an influence is deemed to exist where a (small) stake is acquired, and where certain “plus-factors” apply (e.g. board representation, special information rights). The provision was introduced to capture situations where the relationship between companies results in a restriction of competition between them that is so significant that they do not act on the market independently from each other any longer. The concerns underlying these provisions may now have been confirmed by the studies described above, at least with respect to concentrated markets.

In the past, the Federal Cartel Office focused on the acquisition of minority shareholdings in competitors, rather than on the acquisition of minority stakes by institutional or strategic investors. However, the economic studies described above have also been noticed in Germany. The Monopolies Commission (an independent advisory body composed of experts and nominated by the Federal Government and appointed by the Federal President, which publishes regular reports and special opinions on competition law issues) has dealt with the issue of common ownership in its latest biennial report that was released on 20 September 2016. For the time being, the Monopolies Commission refrained
from providing any direct recommendation on economic policy. However, it noted that consideration of this issue in the future development of the EU merger control rules would be welcome. The Monopolies Commission also clarified that the issues described do not only apply with respect to institutional investors, which were so far the focus of the discussion, but also with respect to other diversified investors who hold minority stakes in a number of different undertakings.

Conclusion

Overall, it is to be expected that competition authorities worldwide will monitor closely the effects of common ownership on competition. They may interpret existing rules more strictly and take a more interventionist approach if they come to the conclusion that there might be negative impacts on competition, or a significant potential for such effects. It remains to be seen in how far the debate that has now been triggered even has an impact on future legislative reforms of the EU merger control rules, or in other jurisdictions where the acquisition of minority shareholdings is not within the scope of application of merger control rules today. These developments may become crucial for institutional investors, strategic investors, and also for companies that seek to attract institutional or strategic investors.

Your Key Contacts

Dr. Jörg Karenfort
Partner, Berlin
D +49 30 26 47 33 05
joerg.karenfort@dentons.com