Ryanair - Aer Lingus
The completed acquisition by Ryanair of a minority shareholding in Aer Lingus

Toulouse School of Economics
Workshop on Competition and Law

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November 22, 2013
Outline

1. Introduction
2. Market Definition
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Introduction
Introduction: Industry Background

- **Ryanair**
  - Founded in 1985 as a Private firm
  - Admitted to the Irish and London Stock Exchanges in 1998
  - Low-cost carrier

- **Aer Lingus**
  - Founded in 1936 by the Irish Government
  - Admitted to the Irish and London Stock Exchanges on the 2\textsuperscript{nd} October 2006
  - Operates in agreement with Aer Arann

- Just after the admission of Aer Lingus in the stock exchanges, Ryanair started to buy shares
Introduction: Shareholdings

- 25.1% to Aer Lingus
- 45.08% to Ryanair
- 29.82%
Introduction: Shareholdings

- In order to pass a special motion, you need at least 75% of the voting shares
- Examples of special motions:
  - Changing the articles of associations
  - Issuing new shares for cash
  - Merger with another company

- The first level of investment by Ryanair was a signal for the market about its willingness to acquire Aer Lingus
Introduction: Bids for acquisition of Aer Lingus

- **First Bid**
  - Launched on 23\textsuperscript{rd} October 2006, rejected by the European Commission

- **Second Bid**
  - Launched on December 2008 but was abandoned in January 2009 by Ryanair because the Irish government would not sell its shareholding

- **Third Bid**
  - Launched on 17\textsuperscript{th} July 2012, again rejected by the European Commission
Introduction: Minority Shareholding Inquiry

- Supervision and control of mergers within the EU and its member states operate at two levels

- Different merger control tests: “decisive” or “material” influence

- Ryanair has a non-controlling minority shareholding

- On 15th June 2012, the Office of Fair Trading (OFT) referred the completed acquisition by Ryanair of a minority shareholding in Aer Lingus to the UK Competition Commission

- The reference was made under section 26(1) of the Enterprise Act 2002 (the Act)
  - Potential for Ryanair to exercise material influence
Introduction: Theory on minority shareholding

- Minority shareholding
  - Increased likelihood of collusion. If a member is sitting on the board of directors then it is easier to coordinate pricing and marketing strategies
  - Even if the shareholder has no say in the business policies of the firm, incentives to compete might be reduced
Introduction: Model of minority shareholding on a collusive outcome

- Two firms 1 and 2
- Homogenous goods
- Choose price in each period for an infinite number of periods
- Firm 1 owns a share $\sigma$ of its rival (small enough for firm 2 to keep full control) and receives profit accordingly

*Is the likelihood of collusion affected by the minority shareholding?*
Introduction: Model of minority shareholding on a collusive outcome

Incentive constraint for firm 1:

\[
\frac{1}{2} \sum_{i=0}^{\infty} \delta^i \pi (1 + \sigma) \geq \pi \iff \delta \geq \frac{1 - \sigma}{2}
\]

So \( \sigma = 0 \) makes collusion less likely to hold

Incentive constraint for firm 2:

\[
\frac{1}{2} \sum_{i=0}^{\infty} \delta^i \pi (1 - \sigma) \geq \pi (1 - \sigma) \iff \delta \geq \frac{1}{2}
\]

Overall the minority shareholding \( \sigma > 0 \) has made collusion more likely
Introduction: Cross Ownership literature

*Reynolds and Snapp (1986)*

- Cournot Model
- In markets where entry is difficult, partial ownership could result in less output and higher prices
- Reduced incentives to compete are structural
  - positive correlation in profits
- Internalize free rider problems to enhance cartel stability and profitability
  - Reduction in cheating allows a reduction in policing expenditure
  - Greater investment in deterring entry

*Reitman (1994)*

- Partial ownership to commit to less aggressive competition
Introduction: Cross Ownership literature

*Malueg (1991)*

- Standard model in which firms employ trigger strategy
- The impact of cross ownership on collusion depends on the nature of demand

\[ p = (1 - Q)^x \]

- Increasing cross ownership has two main contrasting effects
  - reduced gains from cheating on a collusive agreement
  - the punishment that would follow cheating is softened
Introduction: Malueg (1991)

Fig. 2. Critical discount factors $\delta^c$ for different values of $x$. 
Introduction: Malueg (1991)

Fig. 1. Profit functions: $x = 2$. 

profit

$\pi^d$

$\pi^m$

$\pi^n$
Introduction: Theory on Horizontal Mergers

Likely to increase market power which can lead to a decrease in both consumer surplus and total welfare. However if the merger increases efficiency in the merging firms then the effect on welfare is ambiguous.

- Factors affecting unilateral market power
  - Concentration
  - Entry
  - Falling firm defense
Market Definition
Market Definition: Product Market

- Substitutability between other forms of transport?
- Combination of train and ferry is the most efficient alternative

<table>
<thead>
<tr>
<th>Route</th>
<th>Air (Hours)</th>
<th>Train and Ferry (Hours)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central London - Central Dublin</td>
<td>2.5</td>
<td>6.5</td>
</tr>
<tr>
<td>Central Manchester - Central Dublin</td>
<td>2.5</td>
<td>5.25</td>
</tr>
</tbody>
</table>

- The competitive constraint of intermodal substitution is weak and the relevant product market is supply of air passenger services
Market Definition: Geographical Market

1. London-Dublin

Overlap corridors

- Ryanair
- Aer Lingus
- Aer Arann
- BA
- Cityjet
- Flybe
Market Definition: Geographical Market

- The commission considered 11 corridors on which Ryanair and Aer Lingus were competing
  - 6 where Ryanair and Aer Lingus were competing directly
  - 5 where Ryanair and Aer Arann were competing
## Market Definition: Geographical Market

**TABLE 2** Summary of corridors on which the services of Ryanair and Aer Lingus/Aer Arann overlap

<table>
<thead>
<tr>
<th>Route</th>
<th>Total number of passengers carried by Ryanair, Aer Lingus and Aer Arann</th>
<th>Share of all passengers travelling on the corridor %</th>
<th>Airport pair?</th>
<th>Other airlines present?</th>
</tr>
</thead>
<tbody>
<tr>
<td>(GB/Republic of Ireland—Ryanair and Aer Lingus)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>London–Dublin</td>
<td>1,562,819</td>
<td>38.2 43.7 0.9</td>
<td>Yes</td>
<td>BA (10%), CityJet (4%), Flybe (3%)</td>
</tr>
<tr>
<td>London–Cork</td>
<td>389,843</td>
<td>44.4 55.6</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>London–Shannon</td>
<td>280,767</td>
<td>53.3 46.7</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>London–Knock</td>
<td>133,134</td>
<td>70.1 29.9</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>NW England–Dublin</td>
<td>532,763</td>
<td>72.5 25.8 1.6</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Birmingham/East Midlands–Dublin</td>
<td>350,057</td>
<td>64.8 34.7 0.4</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>(GB/Republic of Ireland—Ryanair and Aer Arann)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Glasgow/Edinburgh/Prestwick–Dublin</td>
<td>330,786</td>
<td>56.2 8.2 37.4</td>
<td>Yes</td>
<td>Flybe (8%)</td>
</tr>
<tr>
<td>Bristol/Cardiff/Exeter–Dublin</td>
<td>182,040</td>
<td>61.7 29.9</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>NW England–Cork</td>
<td>72,941</td>
<td>47.0 53.0</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>NW England–Shannon</td>
<td>43,888</td>
<td>36.0 63.9</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>Birmingham/East Midlands–Knock</td>
<td>36,229</td>
<td>59.5 19.6</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>(Northern Ireland—Ryanair and Aer Lingus)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>London–Northern Ireland</td>
<td>197,580</td>
<td>6.0 11.8</td>
<td>No</td>
<td>easyJet (45%), BA (20%), Flybe (15%)</td>
</tr>
<tr>
<td>Northern Ireland–Faro</td>
<td>37,991</td>
<td>11.0 31.3</td>
<td>No</td>
<td>easyJet (49%)</td>
</tr>
</tbody>
</table>

Source: CC analysis of CAA data.

Note: Total passenger numbers and shares of all passengers are given for 2012, and refer to outbound passengers (i.e. passengers departing UK airports) only.
Competition
Competition: Observations

- Competition between 2006 and 2012

- Has there been a significant lessening of competition (SLC)?

- Observation of the commission:
  - Strong competition between the firms
  - Substantial evidence of a positive correlation between the prices set by one carrier and the prices set by the other, resulting in lower fares
  - Competitive constraints on each other on routes where only one is present
Competition: Influence of Ryanair on the strategic decisions of Aer Lingus

- Ryanair’s influence on Aer Lingus’ strategy
  - Aer Lingus’s ability to participate in a combination with another airline
  - Aer Lingus’s ability to issue shares in order to raise capital
  - Aer Lingus’s ability to manage effectively its portfolio of Heathrow slots
  - Aer Lingus’s ability to pass an ordinary resolution
  - Aer Lingus’s management resources

- Other impacts
  - Ryanair’s effectiveness as a competitor
  - Coordination effect (Collusion)
Counterfactuals
Counterfactuals: Views of the Parties

▶ Aer Lingus
  ▶ The counterfactual is a competitive situation where Aer Lingus operates independently. Although absent of Ryanair's shareholding it would have been better placed for M&A activity it couldn’t be certain this would have occurred before 2006.

▶ Ryanair
  ▶ Aer Lingus's cost base could not sustain long term competition with R. AL had no future as an independent airline because of its small scale and peripheral location.
  ▶ If Aer Lingus was acquired by another airline or investor, they would break it up and sell off its valuable Heathrow slots and transatlantic routes, closing loss-making routes in the UK and Europe. Most major European flag carriers indicated they had no intention of acquiring Aer Lingus.

▶ The competition commission conclude that there were three potential counterfactual scenarios
Counterfactual 1: Aer Lingus withdrawal from competition with Ryanair on routes between Great Britain and Ireland

- A takeover of Aer Lingus by a large network carrier might lead to a withdrawal from routes between Great Britain and Ireland because of pressure to reallocate the Heathrow slots to long-haul operations.

- Outcome unlikely because if the Irish Government were to sell its stake to another airline, it would be likely to seek to maintain connectivity with London Heathrow in line with its established policy.
Counterfactual 2: Aer Lingus withdrawal from the airline industry

- With the exception of 2008 and 2009, when the Irish economy was in difficulty, Aer Lingus generated profit before tax and positive operating cash flow each year since 2006.

- Aer Lingus had unrestricted cash of 313 million euros on its balance sheet at 31 December 2012, and total cash and deposits of 745 million euros.

- Ryanair has not provided any substantive analysis of its claim that the break-up value of Aer Lingus exceeds its value.
Counterfactual 3: Aer Lingus continues to compete with Ryanair

- Aer Lingus’s network, branding and goodwill is intrinsically connected with its operations in Ireland and Great Britain.

- Aer Lingus would have continued or would continue to compete with Ryanair on routes across the Irish Sea, whether as an independent airline or in combination with another airline.
Competition: Conclusion on the SLC

"Ryanair’s acquisition in a 29.28% shareholding in Aer Lingus has led to an SLC in the markets for air passengers services between Great Britain and Ireland”
Remedies
Remedies: Analytical framework for assessment

The idea is to identify the remedies that are effective in addressing the SLC and then to choose the least costly and intrusive option. There are three main remedy options:

- full divestiture (Ryanair sells whole shareholding in Aer Lingus)
- partial divestiture (Ryanair sells part of holding in Aer Lingus)
- behavioural remedies accompany partial divestiture

In the Remedy Guidelines the CC states it prefers structural remedies (divestitures) to behavioural remedies. They argue behavioural remedies may result in distortions compared with a competitive market outcome.
Remedies: Ryanair proposed remedies

► An order preventing it from voting against an acquisition of Aer Lingus by another EU airline
► An order preventing it from voting against an acquisition by Aer Lingus
► An order preventing it from voting against Aer Lingus issuing new shares
► An order preventing it from voting against Aer Lingus board on disposal of Heathrow slots
► Offer it’s shares if an airline achieved acceptance for more than 50% of Aer Lingus shares

All of the above to hold true for non-EU airlines if it became legal in the future for them to hold over 50% in Aer Lingus
Remedies: Aer Lingus proposed remedies

- Behavioural remedies not sufficient as the ability to call EGM’s could indirectly cause an offer or scheme of arrangement to fail.

- Anything short of full divestiture would be perceived as an invitation for Ryanair to continue impeding Aer Lingus’s management and present further bids for Aer Lingus in the future.
Remedies: Commission’s conclusions

- Airlines still deterred from purchasing shares as Ryanair’s shareholding was still intimidating

- It is difficult to predict all matters that may come before AL shareholders in AGMs or EGMs. This makes it inherently difficult to cater for all eventualities (hold-out problem)

- Even putting Ryanair’s shareholding in a voting trust would likely result in a significant distortion of Aer Lingus’ governance due to a large non-participating shareholder
Remedies: Partial Divestiture

### TABLE 3  Ryanair shareholding corresponding to 25 per cent effective voting power based on turnout of other shareholders

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Historical low</td>
<td>23.4</td>
<td>13.2</td>
<td>9.5</td>
<td>7.2</td>
<td>3.5</td>
<td>5.4</td>
</tr>
<tr>
<td>Historical average</td>
<td>37.2</td>
<td>15.7</td>
<td>12.2</td>
<td>11.0</td>
<td>7.5</td>
<td>8.3</td>
</tr>
<tr>
<td>Historical high</td>
<td>41.4</td>
<td>16.4</td>
<td>12.9</td>
<td>12.1</td>
<td>8.6</td>
<td>9.1</td>
</tr>
<tr>
<td>Above average assumption</td>
<td>60</td>
<td>19.5</td>
<td>16.1</td>
<td>16.7</td>
<td>13.3</td>
<td>12.5</td>
</tr>
<tr>
<td>Full participation</td>
<td>100</td>
<td>25.0</td>
<td>22.0</td>
<td>25.0</td>
<td>22.0</td>
<td>18.7</td>
</tr>
<tr>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Source: CC calculation.</td>
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</tr>
</tbody>
</table>

* Assumes 3 per cent of total shares vote the same way as Ryanair (16,021,203 shares).

Note: See Appendix L for formulae used to derive the Ryanair shareholding that corresponds to 25 per cent effective voting power.

\[
\text{Effective voting power} = \frac{\text{Votes cast by Ryanair plus \text{"allies\"}}}{{\text{Total votes cast}}} = 25\%
\]
Conclusion

- Ryanair required to reduce its shareholding in Aer Lingus to 5 per cent of Aer Lingus’s issued ordinary shares
- Ryanair should not to seek or accept board representation or acquire further shares in Aer Lingus (unless clearance is given under the EUMR for a concentration between Ryanair and Aer Lingus)
Thank you for your time