

Summary

1. On 15 June 2012, the Office of Fair Trading (OFT) referred the completed acquisition by Ryanair Holdings plc (Ryanair) of a minority shareholding in Aer Lingus Group plc (Aer Lingus) to the Competition Commission (CC) for investigation and report. The reference was made under section 22(1) of the Enterprise Act 2002 (the Act). Following an extension to the statutory reference period, we are required to publish our final report by 11 July 2013.
2. Ryanair was founded in 1985 and has been listed on the Dublin, London and New York stock exchanges since 1998. Ryanair pioneered the low-cost/low-fares business model in Europe. In the year ended 31 March 2013, Ryanair carried 79.3 million passengers, serving approximately 1,500 routes in 28 countries across Europe. Ryanair reported turnover of €4,884 million and operating profit before exceptional items of €718.2 million in the year ended 31 March 2013. Ryanair operates flights from Ireland to 12 airports in Great Britain.
3. Aer Lingus was founded by the Irish Government in 1936 to provide air services between Ireland and the UK. It was floated on the London and Irish stock exchanges in 2006, with the Irish Government retaining a 25.1 per cent shareholding. Aer Lingus operates as a 'value carrier' and has a number of agreements with other airlines, including a franchise agreement with Aer Arann under which Aer Arann operates a number of routes to provincial UK airports under the Aer Lingus Regional brand. Aer Lingus's primary markets are the Republic of Ireland, the UK, continental Europe and the USA. In 2012 it carried 9.7 million passengers. In the year ended 31 December 2012 Aer Lingus reported turnover of €1,393 million and operating profit before exceptional items of €69 million. Aer Lingus operates flights from the Republic of Ireland to four airports in Great Britain, as well as having a base at Belfast City.

4. Aer Lingus shares were admitted to the Irish and London stock exchanges on 2 October 2006. By 5 October 2006 Ryanair had acquired a shareholding of 19.1 per cent. Ryanair continued to acquire shares and by 2 July 2008 had increased its shareholding to its current level of 29.82 per cent. The cost to Ryanair of acquiring the 29.82 per cent shareholding in Aer Lingus was €407.2 million. Based on a share price range of €1.10 to €1.40, the value of Ryanair's shareholding in Aer Lingus is between €175–223 million. Ryanair said that it bought shares in Aer Lingus because it wanted to, and still wants to, acquire Aer Lingus. It said that it did not acquire its shareholding in order to influence Aer Lingus. Aer Lingus said that Ryanair used its shareholding to undermine and weaken its principal competitor.

5. Ryanair's first public offer for Aer Lingus was launched on 23 October 2006. The European Commission prohibited the first bid on 27 June 2007. On 10 September 2007 Ryanair appealed the European Commission's prohibition decision to the General Court. On 11 October 2007, following an earlier request by Aer Lingus that Ryanair divest itself of the minority shareholding should the concentration be prohibited, the European Commission ruled that the minority shareholding did not constitute a concentration under the EU Merger Regulation (EUMR) and therefore did not require its divestiture. This decision was appealed by Aer Lingus to the General Court. On 6 July 2010 the General Court upheld the European Commission in both cases. Ryanair launched a second bid in December 2008 but abandoned it in January 2009 after the Irish Government indicated that it would not support the bid. On 24 July 2012 Ryanair notified the European Commission of its third bid for Aer Lingus. The European Commission prohibited the third bid on 27 February 2013. On 8 May 2013 Ryanair appealed the European Commission's prohibition decision to the General Court.

6. We provisionally concluded that Ryanair's 29.82 per cent shareholding in Aer Lingus gave it the ability to exercise material influence over Aer Lingus's commercial policy and strategy. We reached this provisional view having regard to a range of factors and, in particular, Ryanair's ability to block special resolutions and the disposal of Heathrow slots under the Articles of Association which are relevant to Aer Lingus's ability to pursue its commercial policy and strategy. We discussed the relevance of its ability to exercise material influence in our assessment of competitive effects. We provisionally concluded that a relevant merger situation had been created.

7. We provisionally concluded that the relevant product market was the supply of air passenger services. We identified six corridors connecting airports in Great Britain and the Republic of Ireland where services operated by Ryanair and Aer Lingus overlapped and a further five corridors where Ryanair's services overlapped with routes operated by Aer Arann under the Aer Lingus Regional brand. We also identified some overlap between Ryanair and Aer Lingus on routes between London and Northern Ireland and Northern Ireland and Faro.

8. We provisionally concluded that Ryanair and Aer Lingus imposed a strong competitive constraint on each other on overlap routes between Great Britain and Ireland, and were also likely to impose a competitive constraint—albeit less significant—on each other through the threat of entry on routes between Great Britain and Ireland on which the two airlines were not currently both active. We provisionally concluded that on most overlap corridors, Ryanair and Aer Lingus did not face a competitive constraint from any other airlines although there was some competitive constraint from other airlines on the London to Dublin and Bristol to Dublin corridors and, more substantially, on overlap routes between London and Northern Ireland, and Northern Ireland and Faro.

9. We looked at whether the intensity of competition between Ryanair and Aer Lingus had changed compared with the level which existed in 2006. We provisionally concluded that, in line with the European Commission's findings, competition between Ryanair and Aer Lingus had remained intense since 2006, and that the extent of overlap between the operations of the two airlines had increased, largely as a result of Aer Lingus's Regional franchise agreement with Aer Arann.
10. We did not agree with Ryanair's submission that we were bound to conclude, on the basis of the European Commission's assessment of the competition between Ryanair and Aer Lingus, that the acquisition of the minority shareholding had not and would not result in a substantial lessening of competition (SLC). We took into account that, absent Ryanair's shareholding, competition during the period since 2006 or in the future may have developed differently and may have been stronger, and we were required to consider not only whether the transaction has, to date, led to an SLC, but also whether an SLC might be expected in the future.
11. We provisionally concluded that the appropriate counterfactual was that Aer Lingus, absent Ryanair's shareholding, would pursue a broadly similar commercial strategy on routes between Great Britain and Ireland, either as an independent company or in combination with another airline.
12. We assessed the competitive effects of Ryanair's acquisition of a minority shareholding in Aer Lingus. We discussed three possible competitive effects arising from the acquisition of Ryanair's minority shareholding that may have resulted, or may be expected to result, in a reduction in Aer Lingus's, Ryanair's or both companies' effectiveness as competitors on routes between Great Britain and Ireland:

- (a) that the shareholding has or may be expected to reduce Aer Lingus's effectiveness as a competitor because of the influence that it gives Ryanair over its rival, or by affecting the commercial strategies that are available to Aer Lingus;
- (b) that the change in financial incentives associated with the shareholding has or may be expected to reduce Ryanair's effectiveness as a competitor by giving it the incentive to compete less fiercely with Aer Lingus; and
- (c) that Ryanair's minority shareholding has or may be expected to increase the effectiveness of any existing coordination between Ryanair and Aer Lingus, or increase the likelihood of coordination between them in the future.

13. Having considered a number of mechanisms by which Ryanair, given its minority shareholding, might exert its influence over Aer Lingus's effectiveness as a competitor (see paragraph 12(a)), we reached the following provisional conclusions in relation to each mechanism:

- (a) Ryanair's shareholding would be likely to be a significant impediment to Aer Lingus's ability to be acquired by, merge with or acquire another airline and could make it more difficult for Aer Lingus to attract a strategic minority shareholding. We provisionally found it likely that, absent Ryanair's shareholding, either in the period since 2006 or in the foreseeable future, Aer Lingus would have been involved or would be involved in an acquisition, merger or joint venture. Such combinations would be likely to lead to synergies, over and above those which could arise from looser forms of cooperation between Aer Lingus and other airlines, making Aer Lingus a more effective competitor with Ryanair than it would otherwise have been.
- (b) Ryanair's ability to block a special resolution gives it influence over Aer Lingus's ability to issue shares and might hamper Aer Lingus's ability to raise capital. Given Aer Lingus's existing balance sheet strength and forecast financial performance, under circumstances of stable trading, no new debt issuance or

acquisition activity by Aer Lingus, we found it unlikely that Aer Lingus would need to raise equity in the medium to long term. However, if Aer Lingus needed to issue shares for cash in future for a corporate transaction or to optimize its capital structure, Ryanair's ability to restrict it from doing so could cause Aer Lingus to become a less effective competitor than it would otherwise have been.

(c) Ryanair would be able to influence Aer Lingus's ability to dispose of some of its Heathrow slots in order to optimize its slot portfolio. We found it likely that, absent Ryanair's minority shareholding, either in the period since 2006 or in the foreseeable future, Aer Lingus would have wanted to manage its portfolio of Heathrow slots in the context of optimizing its network and that this would have involved the sale or lease of slots. Ryanair's ability to prevent Aer Lingus from disposing of its slots could reduce its effectiveness as a competitor by limiting its strategic options. Although the scale of any impact would depend on the specific transaction being considered, this could increase Aer Lingus's costs and restrict its flexibility with regard to its network, causing it to be a less effective competitor than it would otherwise have been.

(d) Ryanair could influence Aer Lingus's commercial strategy by exercising the deciding vote in the context of an ordinary resolution. Given the stated position of the Irish Government, we found it relatively unlikely that Ryanair alone would be able to achieve a majority in a shareholder vote. However, this could occur if other shareholders were to vote in the same way as Ryanair, the Irish Government were to abstain, or the Irish Government were to sell its shareholding to multiple buyers. If Ryanair were to achieve a majority there could be very significant implications for Aer Lingus because of the importance of company decisions put to a shareholder vote.

(e) Ryanair's minority shareholding was not required for it to lobby against Aer Lingus's decisions. We did not expect Ryanair's requesting of information as a minority shareholder to affect Aer Lingus's effectiveness as a competitor. Nor did

we expect its ability to call EGMs or propose resolutions at an AGM materially to affect Aer Lingus's effectiveness. Ryanair's minority shareholding increased the likelihood of it mounting a full bid for Aer Lingus. Any such bid could significantly disrupt Aer Lingus's commercial policy and strategy.

(f) It was unlikely that Aer Lingus would compete less fiercely with Ryanair in order to avoid antagonizing its largest shareholder either now or in the future.

14. Ryanair told us that when it had opposed Aer Lingus's management, it had done so only to protect the value of its shareholding, and that it would, for example, support Aer Lingus in raising capital and would be willing to sell its shareholding to another airline (albeit for a significant premium over market price). However, given the closeness of competition between Ryanair and Aer Lingus, we provisionally found that Ryanair would have an incentive to use its influence to weaken Aer Lingus's effectiveness. This incentive would not exist for a shareholder which was not in competition with Aer Lingus.

15. Although the transaction links Ryanair's financial success with Aer Lingus's, we provisionally found it unlikely that Ryanair would compete less strongly with Aer Lingus because of its financial interest in Aer Lingus. In reaching this conclusion, we took into account that the acquisition of its minority shareholding in Aer Lingus was part of Ryanair's overall strategy of acquiring the entirety of Aer Lingus. We provisionally found it unlikely that Ryanair's minority shareholding in Aer Lingus would lead to coordinated effects.

16. We provisionally concluded that substantial entry on routes between Great Britain and the Republic of Ireland was unlikely due to several factors. These included early morning capacity constraints at Dublin Airport and some UK airports, the need to establish a well-known brand and base in Ireland, the relative unattractiveness of the

Irish market, the potential for an aggressive response by existing operators and the level of taxes and airport charges. We therefore concluded that entry or expansion by other airlines would be unlikely to offset any SLC that we might otherwise have found.

17. In reaching our overall conclusion, we attached particular weight to the influence that Ryanair is able to exercise over Aer Lingus's commercial policy and strategy by limiting its ability to be acquired by, merge with or acquire another airline. In addition, we took into account Ryanair's ability to restrict Aer Lingus in issuing shares for cash for a corporate transaction or optimizing its capital structure, and limiting its ability to optimize its portfolio of Heathrow slots, as well as the increased likelihood of Ryanair mounting further bids for Aer Lingus given its minority shareholding. We also noted Ryanair's ability to pass or defeat an ordinary resolution at an Aer Lingus general meeting which would arise in the relatively unlikely event that other shareholders voted in the same way as Ryanair, the Irish Government abstained from voting, or the Irish Government sold its shareholding to multiple buyers.
18. We considered that, in exercising influence over Aer Lingus's commercial policy and strategy, Ryanair's minority shareholding would affect Aer Lingus's overall effectiveness as a competitor, albeit without giving Ryanair direct influence over the company's competitive offering on a day-to-day basis. Given the closeness of competition between Ryanair and Aer Lingus, we provisionally found that Ryanair would have an incentive to use its influence to weaken Aer Lingus's effectiveness that would not exist for a shareholder which was not in competition with Aer Lingus.
19. We provisionally found that Ryanair's minority shareholding was likely to have a significant impact on Aer Lingus's effectiveness as a competitor. The importance of scale to airlines was clear from our discussions, with Ryanair itself highlighting Aer

Lingus's small scale as an impediment to its survival. We identified a number of significant synergies that would be likely to arise from a combination between Aer Lingus and another airline, over and above those that might arise via looser forms of cooperation. Given wider trends in the airline industry, we would expect the pressure on Aer Lingus's cost base—and the need for additional scale to remain competitive—to become stronger over time. In addition, given the value and strategic importance of Aer Lingus's Heathrow slots, there could be a significant impact on Aer Lingus arising from its reduced ability to optimize its slot portfolio. Additional bids by Ryanair for the outstanding shares in Aer Lingus could significantly disrupt Aer Lingus's commercial strategy. Although relatively unlikely, if Ryanair were to achieve a majority at a general meeting, the implications for Aer Lingus's competitive capability could be very significant because of the importance of issues put to a shareholder vote.

20. We provisionally concluded that these constraints on Aer Lingus's ability to implement its own commercial policy and strategy were likely to make Aer Lingus a less effective competitor than it would otherwise have been across its network generally, and specifically as a rival to Ryanair on routes between Great Britain and Ireland. We provisionally found that entry on routes between Great Britain and Ireland was unlikely to offset these adverse effects.
21. We provisionally concluded that Ryanair's acquisition of a 29.82 per cent shareholding in Aer Lingus had led or may be expected to lead to an SLC in the markets for air passenger services between Great Britain and the Republic of Ireland.