

**RYANAIR/AER LINGUS MERGER INQUIRY**

**Provisional findings report**

30 May 2013

The Competition Commission has excluded from this published version of the provisional findings report information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [X]. Some numbers have been replaced by a range. These are shown in square brackets. Non-sensitive wording is also indicated in square brackets.

## Contents

	<i>Page</i>
Summary .....	3
Provisional findings .....	12
1. The reference.....	12
2. The industry and the companies .....	12
Industry background.....	12
Ryanair.....	13
Aer Lingus.....	14
3. The acquisition .....	16
Ryanair's acquisition of its shareholding in Aer Lingus .....	16
Cost to Ryanair of acquiring its shareholding .....	18
Rationale for the transactions.....	18
4. The relevant merger situation.....	20
Enterprises ceasing to be distinct.....	20
Level of shareholding and patterns of attendance and voting at shareholder meetings.....	23
Ryanair's ability to pass or defeat ordinary resolutions .....	26
Board representation.....	29
Distribution and holders of the remaining shares.....	29
The status and expertise of the acquirer and its corresponding influence with other shareholders.....	30
Any other special provisions in the constitution of the company conferring an ability materially to influence policy.....	30
Constraints on Aer Lingus's Management Time .....	32
Provisional conclusion on material influence.....	33
Turnover and share of supply test .....	34
Timing .....	34
Provisional conclusion on relevant merger situation .....	35
5. Substitutability and competition between the UK operations of Ryanair, Aer Lingus and their rivals.....	35
Airlines operating routes between Great Britain and Ireland .....	36
Market definition.....	37
Product market.....	37
Geographic market.....	39
The competitive constraint between Ryanair and Aer Lingus .....	42
Closeness of service offering.....	42
Direct evidence of competition between the airlines .....	43
Potential competition .....	44
Provisional conclusions on the competitive constraint between Ryanair and Aer Lingus .....	45
The competitive constraint from other rivals .....	46
Provisional conclusions on constraint from other rivals.....	47
The trend in competition between Ryanair and Aer Lingus since 2006.....	47
6. The counterfactual .....	50
The views of parties .....	51
Our assessment .....	53
Aer Lingus would pursue a broadly similar commercial strategy under a range of ownership structures .....	53
Major change of Aer Lingus's strategy .....	53
Aer Lingus withdrawal from the airline industry.....	54
Provisional conclusions on the counterfactual .....	55
7. Assessment of the competitive effects of the acquisition .....	55
Relevance of the European Commission's findings to our assessment.....	56
Effects of the acquisition .....	58

Ryanair's influence over Aer Lingus's effectiveness as a competitor .....	58
Provisional conclusion on the impact of Ryanair's minority shareholding on Aer Lingus's ability to combine with another airline .....	72
Ryanair's incentives.....	87
Provisional conclusion on Ryanair's influence over Aer Lingus's effectiveness as a competitor .....	89
Ryanair's effectiveness as a competitor.....	91
Coordinated effects .....	95
Market entry/expansion .....	98
Provisional conclusions on the SLC test.....	102

*Appendices*

- A: Terms of reference and conduct of the inquiry
- B: Corporate background of Aer Lingus
- C: Aer Lingus corporate governance issues
- D: Substitutability and competition between the UK operations of Ryanair and Aer Lingus,  
and their rivals
- E: Trends in fares, overlap, frequency and service offering since 2006
- F: Combinations involving Aer Lingus
- G: Share issuance by Aer Lingus
- H: Economic benefits accruing to Ryanair from its shareholding in Aer Lingus
- I: Variable margins and pricing pressure
- J: Likelihood of entry and barriers to entry

Glossary

## 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.

## Provisional findings

### 1. The reference

- 1.1 On 15 June 2012, the OFT referred the completed acquisition by Ryanair of a minority shareholding in Aer Lingus to the CC for investigation and report. The reference was made under section 22(1) of the Act.
- 1.2 Our terms of reference, together with information on the conduct of the inquiry, are set out in Appendix A. Following an extension to the statutory reference period, we are required to publish our final report by 11 July 2013.
- 1.3 This document, together with the appendices, constitutes our provisional findings. Further information, including non-commercially sensitive versions of submissions by Ryanair and Aer Lingus and summaries of evidence from third parties, can be found on our website.<sup>1</sup>

### 2. The industry and the companies

- 2.1 In this section, we first provide a brief overview of the European air passenger transport industry (see paragraphs 2.2 to 2.4). We then provide an outline of the two companies involved in this acquisition: Ryanair (see paragraphs 2.5 to 2.9) and Aer Lingus (see paragraphs 2.10 to 2.15). Further details on Aer Lingus are set out in Appendix B.

#### ***Industry background***

- 2.2 There are a variety of different business models for scheduled passenger air services. Differences between carriers relate mainly to the airline's operating model (hub and spoke or 'network' carriers as opposed to point-to-point models) and to the

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<sup>1</sup> [www.competition-commission.org.uk/our-work/directory-of-all-inquiries/ryanair-aer-lingus](http://www.competition-commission.org.uk/our-work/directory-of-all-inquiries/ryanair-aer-lingus).

level of service that is offered to passengers (full service as opposed to low-frills or no-frills model).

- 2.3 Air passenger travel is closely correlated with economic activity. Passenger numbers are also sensitive to unforeseen events such as the volcanic ash incident in 2010. The economic downturn in 2008/09 accentuated the challenges for airlines with high cost structures. There have been a number of exits and withdrawals from the industry, and a number of sub-scale carriers face an uncertain future as independent airlines. Merger activity has seen the consolidation of European airlines into a small number of major groups, with five large airline groups emerging: Air France, IAG, easyJet, Lufthansa and Ryanair.
- 2.4 Gulf-based airlines, such as Etihad and Emirates continue to expand their footprint in Europe to attract long-haul passengers with European origins or destinations via a range of organic and inorganic strategic investments.

### **Ryanair**

- 2.5 Ryanair was founded in 1985 and has been listed on the Dublin, London and New York stock exchanges since 1998.<sup>2</sup>
- 2.6 As of March 2013 Ryanair offered over 1,500 flights daily serving approximately 1,500 routes between some 180 airports in 28 countries across Europe. In the year ended 31 March 2013, Ryanair carried 79.3 million passengers (2011/12: 75.8 million). At 31 March 2013 it had a fleet of 305 Boeing 737-800 aircraft with an average age of less than four years.

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<sup>2</sup> The primary market for Ryanair's ordinary shares is the Irish Stock Exchange. Shares were first listed there on 5 June 1997. Ordinary shares have also traded on the London Stock Exchange since 16 July 1998. In addition, American Depositary Shares, each representing five ordinary shares, are traded on the Nasdaq Stock Market in the USA.

- 2.7 Ryanair operates flights from Ireland to 12 airports in Great Britain, including Stansted, Gatwick, Luton, Manchester, Birmingham, Edinburgh, Prestwick and Bristol. In the year to 31 March 2012, these Great Britain/Ireland routes represented [0–10] per cent of Ryanair’s total scheduled revenue (excluding baggage) and [0–10] per cent of group operating profit.
- 2.8 In the year ended 31 March 2013 Ryanair reported turnover of €4,884 million (2012: €4,325 million) and operating profit before exceptional items of €718.2 million (2012: €617.9 million). At 31 March 2013 Ryanair had cash reserves of €3,559 million (2012: €3,516 million) and debt of €3,498 million (2012: €3,625 million).
- 2.9 Ryanair pioneered the low-cost/low-fares business model in Europe, originally developed in the USA by Southwest Airlines. Ryanair’s strategy is based on low fares, secondary airports, point-to-point flights, short-haul routes and low operating costs. Ryanair is not part of any alliances, partnerships or code shares.

### ***Aer Lingus***

- 2.10 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.
- 2.11 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 (2011: 9.5 million).<sup>3</sup> At 31 December 2012 it had a fleet of 44 Airbus aircraft with an average age of 7.1 years.

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<sup>3</sup> Excludes passengers carried on the Aer Lingus Regional franchise operated by Aer Arann and the United Airlines’ extended code share services.

- 2.12 Aer Lingus operates flights from the Republic of Ireland to four airports in Great Britain: Heathrow, Gatwick, Manchester and Birmingham, as well as having a base at Belfast City. In the year to 31 December 2011, these Great Britain/Ireland routes represented [20–30] per cent of its total revenue and [30–40] per cent of its total passengers.<sup>4</sup>
- 2.13 In the year ended 31 December 2012 Aer Lingus reported turnover of €1,393 million (2011: €1,288 million) and operating profit before exceptional items of €69 million (2011: €49 million). At 31 December 2012 Aer Lingus had cash reserves of €909 million (2011: €895 million) and debt (aircraft asset lease financing) of €532 million (2011: €577 million).
- 2.14 Aer Lingus operated as a traditional full service carrier until 2001. Post 9/11 it introduced a low-fares business model to compete with low-cost carriers. Since 2009 it has repositioned itself as a ‘value carrier’. Aer Lingus’s strategy is based on serving airports at central locations which enhance connectivity for customers at a competitive price and entering into partnerships with other airlines.
- 2.15 Aer Lingus has a number of codeshare and interline agreements with other airlines.<sup>5</sup> In 2010 it first signed a franchise agreement with Aer Arann under which Aer Arann operates a number of routes to provincial UK airports under the Aer Lingus Regional

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<sup>4</sup> Aer Arann, under the Aer Lingus Regional franchise, operates flights to a further ten UK airports—see paragraph 2.15.

<sup>5</sup> A codeshare agreement is an arrangement whereby two airlines can sell seats on the same flight under their respective codes. A seat can be purchased from one airline (a marketing carrier) but the flight is actually operated by a cooperating airline. Aer Lingus has codeshare agreements with Etihad (for flights between Dublin and Abu Dhabi and on connecting flights to destinations across Etihad’s network such as Sydney, Melbourne, Brisbane, Kuala Lumpur, Muscat and Bahrain); United Airlines (under which Aer Lingus can market seats on United Airlines’ services from Ireland to North America and from Chicago’s O’Hare airport); British Airways (under which British Airways can market seats on Aer Lingus’s services from Dublin, Cork, Shannon and Belfast to London Heathrow which connect with British Airways’ onward services); JetBlue Airways (under which Aer Lingus can market seats on JetBlue domestic and Caribbean services connecting with Aer Lingus’s services from Ireland to North America); and KLM (under which KLM can market seats on Aer Lingus services from Dublin and Cork to Amsterdam which connect with KLM’s onwards services). An interline agreement is a more basic form of cooperation which does not involve the marketing carrier placing its code on the operating carrier’s flight and simply allows for a through ticket to be purchased and baggage to be checked through on to a connecting flight with another airline without having first to be reclaimed by the passenger at the connecting airport and then checked in again with the second airline. Aer Lingus has interline agreements with numerous airlines.



brand. In February 2013 Aer Lingus signed wet lease agreements<sup>6</sup> with Virgin Atlantic Airways Limited (Virgin) to fly some of the new domestic routes from Heathrow recently announced by Virgin.<sup>7</sup>

### **3. The acquisition**

3.1 In this section, we set out the key events in Ryanair's acquisition of its shareholding in Aer Lingus (see paragraphs 3.2 to 3.7); the costs of its acquisition (see paragraphs 3.8 and 3.9); and the rationale for its acquisition of the minority shareholding and the full bids (see paragraphs 3.10 to 3.15).

#### ***Ryanair's acquisition of its shareholding in Aer Lingus***

3.2 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 and on that day announced its intention to launch a public bid for Aer Lingus. Ryanair's first public offer for Aer Lingus was launched on 23 October 2006.

3.3 Ryanair continued to acquire shares and by 28 November 2006 had a shareholding of 25.2 per cent. By 20 August 2007 Ryanair had increased its shareholding to 29.4 per cent and by 2 July 2008 Ryanair had further increased its shareholding to its current level of 29.82 per cent (159,231,025 shares).

3.4 The first bid was investigated by the European Commission, which prohibited it 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

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<sup>6</sup> 'Wet leasing' is where aircraft are provided together with crew, maintenance and insurance.

<sup>7</sup> In addition, from late 2013, Aer Lingus will operate an Airbus A330 aircraft for the next two winter seasons on behalf of a major European tour operator.

ruled that the minority shareholding did not constitute a concentration under the EUMR<sup>8</sup> 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.

- 3.5 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.
- 3.6 After the period for appealing against the General Court's findings expired on 17 September 2010, the OFT initiated an investigation of Ryanair's minority shareholding in Aer Lingus. After unsuccessful appeals by Ryanair to the CAT and the Court of Appeal (which claimed that the OFT was out of time), the OFT referred the investigation to the CC on 15 June 2012.
- 3.7 On 19 June 2012 Ryanair announced its intention to make a third bid for the entire share capital of Aer Lingus. It published its offer document on 17 July 2012 and notified it to the European Commission on 24 July 2012. The final date for shareholder acceptances of the offer was 13 September 2012. The European Commission opened a Phase II investigation on 29 August 2012, on which date the public offer lapsed automatically, in accordance with Rule 12 of the Irish Takeover Rules. The European Commission announced on 27 February 2013 that it had decided to prohibit the third bid on competition grounds.<sup>9</sup> On 8 May 2013 Ryanair filed an appeal to the General Court seeking the annulment of the European Commission's prohibition decision.

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<sup>8</sup> Council regulation on the control of concentrations between undertakings (139/2004/EC).

<sup>9</sup> See [http://europa.eu/rapid/press-release\\_IP-13-167\\_en.htm](http://europa.eu/rapid/press-release_IP-13-167_en.htm).

### ***Cost to Ryanair of acquiring its shareholding***

- 3.8 The cost to Ryanair of acquiring the 29.82 per cent shareholding in Aer Lingus was €407.2 million. In Ryanair's results for the year ended 31 March 2013, the carrying value of its investment in Aer Lingus was €221.2 million (based on €1.389 per share). This represents a gain of €71.5 million over the prior year value of €149.7 million (€0.94 per share). The gain was recognized as other comprehensive income.<sup>10</sup>
- 3.9 Based on a share price range of €1.10 to €1.40,<sup>11</sup> the value of Ryanair's shareholding in Aer Lingus is between €175–223 million.

### ***Rationale for the transactions***

- 3.10 In the following paragraphs we set out Ryanair's stated rationale for holding its minority shareholding in Aer Lingus, as well as Ryanair's and Aer Lingus's views on the full bids for Aer Lingus.
- 3.11 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.
- 3.12 We also considered Ryanair's rationale for launching the bids for the entire share capital of Aer Lingus. In 2012, as in 2006 and 2008, Ryanair stated that Aer Lingus shareholders should accept Ryanair's offer.<sup>12</sup> It said that as the air transport market in Europe inexorably consolidated into five large airlines/groups led by Air France, British Airways, easyJet, Lufthansa and Ryanair, the long-term future of Aer Lingus, its brand and its growth prospects could best be secured within one strong Irish

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<sup>10</sup> The accounts disclose that the investment had been written down to €0.50 per share in prior periods but, as the asset is classified as available for sale, gains and losses are recorded periodically based on the market price of the asset.

<sup>11</sup> Range of share prices: December 2012 to start May 2013.

<sup>12</sup> Ryanair offer document 2012, [www.ryanair.com/doc/news/2012/aerlingus\\_20120619.pdf](http://www.ryanair.com/doc/news/2012/aerlingus_20120619.pdf).

airline group, led by Ryanair, under which Aer Lingus's fares and unit costs could be reduced and its traffic decline could be reversed. If the offer were successful, Ryanair would seek to enable Aer Lingus to provide more competition and consumer choice on short-haul flights to a number of Europe's primary airports where currently Aer Lingus flies but where Ryanair does not and also to grow Aer Lingus's long-haul transatlantic business by additional investment.

- 3.13 Aer Lingus stated in its circular to shareholders<sup>13</sup> that its shareholders should reject Ryanair's offer; its first offer in 2006 was prohibited on competition grounds and the reasons for prohibition were now stronger than before given the increase in route overlap. The number of overlap routes between Aer Lingus and Ryanair had increased from 35 in 2007 to 50 in 2012. In 2007, Aer Lingus and Ryanair were the only operators on 22 of these overlapping routes and this number has doubled to 44 routes in 2012.<sup>14</sup>
- 3.14 Aer Lingus said that the company's strategy was working and that Aer Lingus was a strong and profitable business. Since 2009, Aer Lingus has repositioned itself as a demand-led value carrier and had, to date, delivered €95.8 million in cost savings. In 2011, the company was profitable in a tough economic environment and delivered operating profit (before net exceptional items) of €49.1 million.
- 3.15 Aer Lingus said that Ryanair's offer of €1.30 per share fundamentally undervalued the company.<sup>15</sup>

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<sup>13</sup> [http://corporate.aerlingus.com/media/corporateaerlinguscom/content/pdfs/Day\\_14\\_Documentx.pdf](http://corporate.aerlingus.com/media/corporateaerlinguscom/content/pdfs/Day_14_Documentx.pdf).

<sup>14</sup> See Appendix D for a description of the overlap routes between Great Britain and Ireland.

<sup>15</sup> Aer Lingus referred to the company's gross cash per share of €1.96, net asset value per share of €1.48 (which did not attribute any value to the slot portfolio or brand), and a 2011 adjusted EV/EBITDAR multiple of 4.2x, representing a 30 per cent discount to the average trading multiple of Aer Lingus's traded peers of 6.0x.

#### **4. The relevant merger situation**

4.1 In this section, we discuss the relevant merger situation. Further details in relation to material influence (Aer Lingus shareholder participation and voting) are set out in Appendix C.

4.2 Under the Act and our terms of reference (see Appendix A), we are first required to decide whether a relevant merger situation has been created.<sup>16</sup> A relevant merger situation will have been created where:

- (a) two or more enterprises have ceased to be distinct;<sup>17</sup>
- (b) the UK turnover test or share of supply test has been met;<sup>18</sup> and
- (c) the enterprises have ceased to be distinct no more than four months before the OFT made its reference to the CC.<sup>19</sup>

#### ***Enterprises ceasing to be distinct***

4.3 The Act defines an 'enterprise' as 'the activities or part of the activities of a business' with a 'business' defined as 'including a professional practice and includes any other undertaking which is carried on for gain or reward or which is an undertaking in the course of which goods or services are supplied otherwise than free of charge'.<sup>20</sup>

4.4 Ryanair and Aer Lingus are both publicly listed companies active in the supply of air transport services. We are therefore satisfied that Ryanair and Aer Lingus are 'enterprises' for the purposes of the Act.

4.5 Section 26(1) of the Act states that two enterprises cease to be distinct if they are brought under common ownership or common control. As explained in the joint

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<sup>16</sup> Section 35 of the Act.

<sup>17</sup> Section 23(1)(a) and section 23(2)(a).

<sup>18</sup> Section 23(1)(b) and section 23(2)(b).

<sup>19</sup> Section 24(1)(a).

<sup>20</sup> Section 129(1) and (3) of the Act.

[CC/OFT Merger Assessment Guidelines](#) (CC2),<sup>21</sup> there are three levels of interest referred to as 'control', set out in ascending order:

- (a) Company A, the acquirer, may acquire the ability materially to influence the policy of Company B, the target (known as 'material influence');
- (b) Company A may acquire the ability to control the policy of Company B (known as 'de facto' control); and
- (c) Company A may acquire a controlling (ie over 50 per cent) interest in Company B (known as 'de jure', or 'legal' control).

4.6 Section 26(3) provides the CC with discretion to treat material influence and de facto control as equivalent to legal control.

4.7 As set out in paragraphs 3.2 and 3.3, Ryanair has acquired its current shareholding in Aer Lingus in stages, over a period of two years. The OFT treated all of the transactions within those stages as having occurred simultaneously on the date on which the last of them occurred pursuant to section 29 of the Act. Our terms of reference therefore refer to Ryanair's acquisition of the entire 29.82 per cent shareholding in Aer Lingus as at 2 July 2008.

4.8 As Ryanair holds 29.82 per cent of Aer Lingus it has not acquired legal control. In the current circumstances, we find that Ryanair has not acquired de facto control, which would arise if an entity were to have effective control of a company, notwithstanding that it holds less than the majority of voting rights (for example, where the acquirer has in practice and on a stable basis control of over more than half of the votes actually cast at a shareholder meeting).<sup>22</sup>

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<sup>21</sup> [CC2](#), paragraph 3.2.5 et seq.

<sup>22</sup> 'De facto' control is similar in nature to the concept of 'decisive influence' under the EU Merger Regulation (see paragraph 3.29 OFT Guidelines). It was confirmed by the European Commission in a decision dated 11 October 2007 that Ryanair's

4.9 Whether a party has acquired material influence is a question of fact and degree to be assessed on a case-by-case basis having regard to all relevant circumstances. As far as the jurisdictional test is concerned, our Guidelines indicate that this analysis will focus on the overall relationship between the acquirer and the target and on the acquirer's ability materially to influence policy relevant to the behaviour of the target entity in the marketplace (including its strategic direction and its ability to define and achieve its commercial objectives).<sup>23</sup>

4.10 In making our assessment in the present case, we are able to take into account the extent to which Ryanair has in fact exercised material influence over Aer Lingus in the six and a half years since Ryanair acquired its first shareholding in Aer Lingus.

4.11 However, the jurisdictional question we must decide is not whether Ryanair has in fact exercised material influence; we have to consider whether, on all the evidence available, Ryanair has the ability to exercise material influence.<sup>24</sup>

4.12 In paragraphs 4.13 to 4.42, we discuss a number of factors which may suggest that an acquisition of a minority shareholding confers material influence on the holder, before reaching our provisional conclusion on material influence in paragraphs 4.43 to 4.45.<sup>25</sup>

(a) level of shareholding and patterns of attendance and voting at shareholder meetings—this will be of particular significance where the acquirer holds over

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minority shareholding (then standing at 25.17 per cent) was insufficient to confer control over Aer Lingus on Ryanair under the EUMR (see in particular paragraph 11:

[http://ec.europa.eu/competition/mergers/cases/decisions/m4439\\_20071011\\_1500\\_1937375\\_EN.pdf](http://ec.europa.eu/competition/mergers/cases/decisions/m4439_20071011_1500_1937375_EN.pdf)).

<sup>23</sup> See CC2, paragraph 3.2.8.

<sup>24</sup> See for example BSKyB/ITV final report, paragraph 3.65. Whether influence has been or may in the future be exercised is also an important consideration in the CC's assessment of whether or not the relevant merger situation has given rise, or may be expected to give rise, to an SLC.

<sup>25</sup> See CC2, paragraphs 3.2.10 & 3.2.11.

- 25 per cent of the target, allowing it to block special resolutions (see paragraphs 4.13 to 4.28);<sup>26</sup>
- (b) board representation (see paragraph 4.29);
  - (c) the distribution and holders of the remaining shares, in particular whether the acquiring entity's shareholding makes it the largest shareholder (see paragraphs 4.30 and 4.31);
  - (d) the status and expertise of the acquirer and its corresponding influence with other shareholders (see paragraph 4.32);
  - (e) any other special provisions in the constitution of the company conferring an ability materially to influence policy (see paragraphs 4.33 to 4.39); and
  - (f) constraints on management time (see paragraphs 4.40 to 4.42).

#### *Level of shareholding and patterns of attendance and voting at shareholder meetings*

- 4.13 The rights of Aer Lingus's shareholders are set out in Irish company law, Aer Lingus's Articles of Association and Irish and London stock exchange listing rules.
- 4.14 Under Irish company law and the Articles of Association, the board of directors has a fiduciary duty to act in the best interests of the company. The board of directors runs the company on a day-to-day basis, and takes the majority of decisions concerning the company's commercial strategy. Some issues, however, must be put to a shareholders' vote in a general meeting. Many resolutions passed in general meetings are ordinary resolutions and require a simple majority of those present or a majority of the votes cast in a ballot. These cover certain matters relating to the day-to-day business of the company, including, for example, the appointment of directors;

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<sup>26</sup> The OFT's Jurisdictional and Procedural Guidance states that the OFT will presume a shareholding of more than 25 per cent confers material influence, because it generally enables the holder to block special resolutions. As noted by the CC in its final report on BSKyB/ITV (paragraph 3.40) 'in previous decisions of the CC (and MMC) and OFT, the ability to block special resolutions has been regarded as a very strong indicator of material influence'. In [Southern Water plc/Mid-Sussex Water Company](#) the existence of a 25.1 per cent shareholding, giving the ability to block special resolutions, was held, of itself, to be sufficient to determine the existence of influence. At paragraph 3.55 of its final report into the BSKyB/ITV merger, the CC noted that the ability to block a special resolution creates the ability materially to influence policy when that policy requires a special resolution, indicating that for the jurisdictional test to be satisfied, it is not required that all of the target's policy be subject to material influence.



the appointment of auditors; and approval of a dividend. In addition, under the Irish stock exchange listing rules, certain transactions which are material relative to the size of the company must be passed by ordinary resolution (see Appendix C for a description of what constitutes a material transaction).

- 4.15 Certain matters, however, can only be passed by special resolution. Special resolutions require the support of at least 75 per cent of the members who vote at a general meeting. A shareholder with a shareholding of more than 25 per cent would therefore always have the ability to block such a resolution, provided they exercised their votes. Actions that require a special resolution include: changing the Articles of Association; disapplying pre-emption rights when issuing new shares for cash; approving a scheme of arrangement, for example in relation to a merger with another company; variation of rights attached to special classes of shares; changing the form of a company; and allowing winding up of the company. (See Appendix C for a list of matters requiring a special resolution under Irish company law.)
- 4.16 In addition to the standard use of special resolutions under Irish company law, Aer Lingus's Articles of Association contain provisions requiring an EGM to be held and a resolution with particular majority requirements to be passed in certain circumstances if the company proposes to enter into a Disposal Transaction (as defined in the Articles of Association) in respect of its slots at Heathrow Airport (see paragraphs 4.35 to 4.39).

*Ryanair's ability to block special resolutions*

- 4.17 Ryanair's 29.82 per cent shareholding is sufficient to block the passing of special resolutions.

- 4.18 During the period 2007 to 2013, Aer Lingus's shareholders have considered 33 special resolutions. Ryanair opposed 13 of the 33 special resolutions, including in relation to disapplying pre-emption rights in each of the years 2007 to 2013; and special resolutions aimed at changing the Articles of Association, particularly relating to the rights of shareholders in proposing resolutions at an EGM. In all instances, Ryanair has been successful in preventing the adoption of the special resolution. In ten of these the special resolutions were blocked in the ballot (due to Ryanair's vote) while the remaining three resolutions were withdrawn by the board after Ryanair's declaration of its intention to oppose.
- 4.19 Ryanair said<sup>27</sup> that it had blocked all special resolutions concerning the disapplication of pre-emption rights in order to prevent its investment in Aer Lingus being diluted by the issuance of new shares. It noted, however, that it would be willing to subscribe for shares if there was a rights issue. It also said<sup>28</sup> that Aer Lingus, in its view, had no need to raise additional capital quickly and, if it did need to raise capital, could do so without waiving pre-emption rights.
- 4.20 Aer Lingus said that, if normal pre-emption rights were not waived, it would be impossible to offer a rights issue to its shareholders who were resident in certain jurisdictions (eg the USA, Canada, Japan, South Africa and Australia) except at great expense and delay (see Appendix G). Aer Lingus also said that to the best of its knowledge, all listed Irish companies, including Ryanair, regularly passed similar resolutions waiving pre-emption rights on up to 5 per cent of issued shares and in respect of rights issues, up to 33 per cent of the issued shares.

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<sup>27</sup> Ryanair Submission to the OFT on Material Influence dated 31 August 2011, paragraph 47. See [www.competition-commission.org.uk/our-work-/directory-of-all-inquiries/ryanair-aer-lingus/evidence](http://www.competition-commission.org.uk/our-work-/directory-of-all-inquiries/ryanair-aer-lingus/evidence).

<sup>28</sup> Ibid, paragraph 49 et seq.

- 4.21 We discuss further the ways in which Ryanair might use its ability to block a special resolution in our discussion of competitive effects. But we note here that Ryanair's ability to block a special resolution gives it the ability in particular to influence possible combinations of Aer Lingus with other airlines through, for example, its ability to prevent a merger with another airline via a scheme of arrangement or under the Cross Border Merger Regulations.<sup>29</sup> This may be relevant not only in the case of an acquisition of the entire share capital of Aer Lingus by another airline, but could also prevent Aer Lingus from acquiring or merging with an airline of similar or smaller size.
- 4.22 Given its ability to block a special resolution in relation to disapplying pre-emption rights, Ryanair can also prevent Aer Lingus from issuing new shares to a strategic partner via a private placement (for example, in relation to a minority investment in the region of 3 to 5 per cent of Aer Lingus). This also prevents a transaction structure in which a minority shareholder could acquire an equity stake of up to 33 per cent in Aer Lingus via the issuance of new shares.<sup>30</sup>

#### *Ryanair's ability to pass or defeat ordinary resolutions*

- 4.23 This section considers whether Ryanair would be likely to have the ability to achieve a simple majority in Aer Lingus shareholder meetings, taking into account information provided by Aer Lingus on voter turnout and voting patterns for all general meetings since 2007.
- 4.24 Aer Lingus's shareholders are summarized in paragraph 4.30. During the period 2007 to 2013, Aer Lingus's shareholders have considered 76 ordinary resolutions.

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<sup>29</sup> European Communities (Cross-Border) Merger Regulations 2008 giving effect to Council Directive No 2005/56/EC of 26 October 2005.

<sup>30</sup> Aer Lingus's directors currently have authorization from shareholders to issue new shares for cash equivalent to approximately 33 per cent of its issued share capital. Based on a share price range of €1.10 to €1.40 per share, this could raise in the region of €195–250 million for Aer Lingus.

Ryanair opposed four of these, but was not successful in any of these challenges. However, the ballot came within 4.2 percentage points of a majority in 2012 and 5.5 percentage points in 2013, both of which concerned the appointment of Board member David Begg. Ryanair also opposed two ordinary resolutions at an EGM in 2008 and proposed two ordinary resolutions at the 2009 AGM and attempted to give a proxy to the Minister for Transport, which was not accepted.

4.25 Whether Ryanair's shareholding in Aer Lingus is sufficient to achieve a majority at a general meeting will depend in large part on the future of the Irish Government shareholding. We looked at three scenarios in relation to this shareholding:

- (a) the Irish Government retains its 25.1 per cent shareholding in Aer Lingus and votes at all general meetings;
- (b) the Irish Government retains its shareholding but abstains from voting on a particular issue; and
- (c) the Irish Government sells its shareholding (in full or part).

Our detailed assessment of each of these scenarios is set out in Appendix C and in our section on competitive effects.

4.26 In considering these scenarios, we take into account the evidence from the Irish Government. We note that the Irish Government intends to sell its shares as part of its commitment to sell state assets following the 2010 fiscal support package from the Troika.<sup>31</sup> The Irish Government said that it was willing to sell its shares in Aer Lingus at the right time and at the right price but that it was unlikely to do so while Ryanair continued to be a significant minority shareholder. It also said that it was unlikely to sell its shareholding to multiple buyers, preferring to sell to a group that would drive effective competition on routes between the UK and Ireland. We note that the

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<sup>31</sup>Troika: European Stability Fund/International Monetary Fund/European Central Bank.

incentives of Governments are likely to change over time as they react to current events.

4.27 In light of this assessment, we provisionally conclude that:

- (a) If the Irish Government retains and votes its shares, it is unlikely that Ryanair *alone* will be able to secure a majority (ie pass or defeat an ordinary resolution) in opposition to the Irish Government, even if turnout by other shareholders falls below current levels.
- (b) Ryanair has historically lacked the support of other shareholders on resolutions at shareholder meetings. If other shareholders were to vote in the same way as Ryanair, it may be possible for Ryanair to achieve a majority in opposition to the Irish Government.
- (c) If the Irish Government were to abstain and turnout was at the average level, Ryanair would secure a majority.
- (d) If, despite the Irish Government's stated preference for selling its stake to a group, it were to sell its shareholding to multiple buyers, Ryanair would most likely be the largest shareholder in Aer Lingus by a considerable margin and could carry a majority in matters requiring an ordinary resolution if turnout of other shareholders was low.

4.28 We provisionally found that the situations in which Ryanair could achieve a majority (if sufficient other shareholders vote in the same way as Ryanair, the Irish Government were to abstain from voting, or the Irish Government were to sell its shareholding to multiple buyers) were relatively unlikely to occur. However, we could not dismiss these scenarios altogether. If Ryanair were to achieve a majority at a general meeting there would be major implications for Aer Lingus's commercial policy

and strategy because Ryanair would then have control over a company decision put to shareholders by way of an ordinary resolution.<sup>32</sup>

### *Board representation*

4.29 Aer Lingus's board structure and membership is set out in Table 1 of Appendix B.

Ryanair does not appoint any directors to the board of Aer Lingus and has no power to do so unless it is able to achieve a simple majority at a general meeting. To date, Ryanair told us that it had not sought, and would not seek to, appoint any directors but it has unsuccessfully opposed the election of one of the non-executive directors, David Begg.

### *Distribution and holders of the remaining shares*

4.30 The shareholders of Aer Lingus as at 28 March 2013 are set out in Appendix B. In summary, we have identified the following subsets of investors:<sup>33</sup>

- (a) Ryanair owns 29.82 per cent;
  - (b) the Irish Government owns 25.1 per cent;
  - (c) four 'strategic investors' own between 1.2 per cent and 3.8 per cent each, and 10.3 per cent in total;
  - (d) 14 'financial investors' whose ownership has been disclosed as a result of stock exchange disclosure rules own between 0.4 per cent and 2.1 per cent, amounting to 12.1 per cent in total; and
  - (e) the balance of 21.7 per cent of Aer Lingus's shares is held by other investors.
- Some of these shareholders can be identified individually (eg via Bloomberg), but their holdings are generally below 0.5 per cent each and are not subject to disclosure obligations.

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<sup>32</sup> We note that if the exit of the Irish Government led Ryanair to achieve a majority at shareholder meetings on a regular basis, this may confer de facto sole control of Aer Lingus on Ryanair (see paragraph 4.8).

<sup>33</sup> Note, however, that these subsets do not represent concert parties or coalitions.

4.31 Given that Aer Lingus's shares are freely traded on the stock market, the pattern of ownership could evolve in the future. We noted, however, that given the large blocks of shares held by Ryanair and the Irish Government, there was a relatively low proportion of shares available for trading and that the volume of trading has declined to low levels (see Appendix C).

*The status and expertise of the acquirer and its corresponding influence with other shareholders*

4.32 We considered whether Ryanair's industry expertise may influence other shareholders to adopt Ryanair's voting position. We received no evidence to suggest that other shareholders would be particularly influenced in their voting patterns by Ryanair's industry expertise.

*Any other special provisions in the constitution of the company conferring an ability materially to influence policy*

*Ryanair's attempts to call EGMs and place items on the agenda of AGMs*

4.33 Ryanair, in common with any other shareholder holding at least 5 per cent, can requisition Aer Lingus's management to hold an EGM and, in common with any other shareholder holding at least 3 per cent, can place, or seek to place, matters on the agenda of an AGM.<sup>34</sup> Ryanair has sought to do this itself on four occasions and requested the Irish Government to do so on one occasion (see Appendix C).

4.34 The management of Aer Lingus can refuse to hold an EGM or reject proposed resolutions for an AGM following such a request if the subject matter of the proposed resolution(s) is unlawful or is one which, under Irish company law and/or the Articles of Association, is reserved to management rather than shareholders.

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<sup>34</sup> Irish Companies Act 1963, as amended by Shareholders' Rights (Directive 2007/36/EC) Regulations 2009.

### *Disposal of Aer Lingus's Heathrow slots*

- 4.35 Aer Lingus's slots at Heathrow Airport are valuable, both in themselves and because of the ability they afford to Aer Lingus to fly its customers to a global hub airport where they can board long-haul aircraft to their ultimate destination. The Irish Government's desire to protect this connectivity at Heathrow led to special provisions being included in Aer Lingus's Articles of Association at the time of its IPO.
- 4.36 The Irish Government considers that Heathrow slots provide a benefit to the Irish economy. In a statement issued on 2 October 2006, the Minister for Transport said that: 'Heathrow Airport, London serves a unique role in ensuring connectivity to/from Ireland. This connectivity is fundamental both to provide connections to and from Dublin as well as to and from the regions.'<sup>35</sup>
- 4.37 Aer Lingus's Articles of Association provide that (with certain exceptions) no slots at Heathrow Airport may be subject to a 'Disposal Transaction'<sup>36</sup> without prior notification to shareholders holding in excess of 10 per cent of the issued share capital. While a short-term lease of a maximum of 36 months in duration is excluded from the definition of a 'Disposal Transaction', the Articles provide that only one such short-term lease may be in place at any one time. If shareholders amounting to at least 20 per cent of Aer Lingus's share capital so require, the company must call an EGM to vote on the transaction. To proceed, the vote in favour of the sale must be greater than: 100 per cent minus the Minister of Finance's (Irish Government's) holding in per cent, minus 5 per cent, subject to a maximum of 75 per cent. Today, that would mean that more than 69.9 per cent of votes must be in favour of the motion.

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<sup>35</sup> [http://corporate.aerlingus.com/investorrelations/regulatorynews/2006pressreleases/minister\\_lhr.pdf](http://corporate.aerlingus.com/investorrelations/regulatorynews/2006pressreleases/minister_lhr.pdf).

<sup>36</sup> A Disposal Transaction is defined as: 'A transaction pursuant to which any member of the Group proposes to sell, transfer or otherwise dispose of, lease, surrender, mortgage or otherwise alienate or encumber any Existing Slot(s) held by it or any of its subsidiaries.'



- 4.38 Given that Ryanair's shareholding is 29.82 per cent, and a 30.1 per cent vote is needed to block the relevant resolution, Ryanair would be in a position to call an EGM and, based on historical shareholder turnout, would be able to block the resolution on its own unless there was extremely high turnout (nearly 100 per cent). Based on historical turnout at Aer Lingus meetings, it is highly likely that Ryanair would have the ability to block the relevant resolution.
- 4.39 Until recently, no attempt to sell Heathrow slots had been made by Aer Lingus since Ryanair acquired its shareholding, although Aer Lingus submitted evidence that, on one occasion, a particular transaction with another airline to exchange Heathrow slots [§] was not progressed when the other airline realized that it would be subject to the approval mechanism set out above and Ryanair would have an effective veto. In addition, Aer Lingus has recently notified the Irish Government and Ryanair under its Articles of Association about a proposed slot transaction with British Airways (see paragraph 7.77(b)).<sup>37</sup>

### *Constraints on Aer Lingus's Management Time*

- 4.40 Aer Lingus told us that Ryanair had sought to use its position as a shareholder to challenge Aer Lingus's management in various ways, including making complaints to regulators, making public statements on the pensions issue, initiating judicial review proceedings and seeking undertakings or commercially sensitive information (see Appendix C).
- 4.41 We note that none of the complaints to regulators or judicial review proceedings was upheld, and none of the attempts to seek undertakings was successful and no commercial information was supplied to Ryanair.

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<sup>37</sup> [www.ise.ie/app/announcementDetails.aspx?ID=11560115](http://www.ise.ie/app/announcementDetails.aspx?ID=11560115).

4.42 Aer Lingus also put it to us that Ryanair's minority shareholding, combined with its repeated attempts to acquire the whole company, has generated a significant constraint on Aer Lingus's management time. Ryanair said that its activities had been completely consistent with its role of minority shareholder and none of the incidents described above has had any effect on Aer Lingus's behaviour in the marketplace.

*Provisional conclusion on material influence*

4.43 We provisionally concluded that Ryanair's 29.82 per cent shareholding in Aer Lingus gives it the ability to exercise material influence over Aer Lingus. We reach this provisional view having regard to all the factors discussed in paragraphs 4.13 to 4.42 and, in particular, Ryanair's ability to block special resolutions and the sale of Heathrow slots under the Articles of Association which are relevant to Aer Lingus's ability to pursue its commercial policy and strategy. We discuss the relevance of its ability to do so further in our assessment of competitive effects in Section 7.

4.44 As set out in paragraph 4.11, we do not consider it necessary to have concluded whether or not Ryanair has to date exercised material influence over Aer Lingus's commercial policy and strategy. Rather, this is one factor in the CC's assessment of whether or not the acquisition has given rise to, or may be expected to give rise to a an SLC as dicussed further in the competitive effects section.

4.45 In light of the above, we provisionally conclude that Ryanair has acquired the ability materially to influence the commercial policy and strategy of Aer Lingus and that, in exercising our discretion under section 26(3) of the Act, this material influence gives rise to legal control for the purposes of the Act.

### ***Turnover and share of supply test***

- 4.46 The second limb of the jurisdictional test as to whether a relevant merger situation has been created is whether the turnover or share of supply test is met.
- 4.47 The turnover test is satisfied where the value of the turnover in the UK of the enterprise being taken over exceeds £70 million.<sup>38</sup> In this instance we have not sought to assess the applicable turnover for each of the years in which Ryanair held a shareholding in Aer Lingus as instead we have been able to rely on the share of supply test.
- 4.48 We find that Ryanair's completed acquisition of Aer Lingus meets the share of supply test set out in section 23(4)(b) of the Act, since Ryanair and Aer Lingus together account for more than 25 per cent of passengers flown between Great Britain and the Republic of Ireland. As set out in paragraph 5.3, the two airlines together carried 82 per cent of all outbound passengers travelling between Great Britain and the Republic of Ireland in 2012 (Ryanair with a share of 49.9 per cent of passengers, Aer Lingus with a share of 31.7 per cent of all passengers).

### ***Timing***

- 4.49 The period of four months (see paragraph 4.2(c)) was suspended under section 122(4) of the Act while the potential application of the EUMR to the minority shareholding was being considered. It was then further extended by both the Competition Appeal Tribunal and the Court of Appeal during the course of an appeal brought by Ryanair in the UK courts against the OFT's decision to investigate the acquisition of the minority shareholding. The Court of Appeal made an order on 24 November 2011 that the four-month time limit be suspended until the

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<sup>38</sup> Section 23 of the Act.

determination of Ryanair's appeal.<sup>39</sup> Ryanair's appeal was dismissed by the Court of Appeal on 22 May 2012 and Ryanair and the OFT agreed a further extension for the OFT to consider whether to refer the acquisition to the CC. The reference was made by the OFT on 15 June 2012. We therefore decide that the reference was made within the necessary time period.

### ***Provisional conclusion on relevant merger situation***

4.50 We provisionally conclude that a relevant merger situation has been created.

## **5. Substitutability and competition between the UK operations of Ryanair, Aer Lingus and their rivals**

5.1 In this section we:

- (a) describe the airlines active on routes between Great Britain and Ireland, the principal area of overlap between the UK operations of Ryanair and Aer Lingus;
- (b) consider the markets within which the merger may give rise to an SLC (the relevant markets);
- (c) assess the strength of the competitive constraint that Aer Lingus imposes on the UK operations of Ryanair, and vice versa;
- (d) assess the strength of the competitive constraint imposed by other airlines; and
- (e) consider whether the intensity of competition between Ryanair and Aer Lingus has changed since 2006.

5.2 In carrying out our assessment of substitutability and competition on routes between Great Britain and Ireland, we draw in particular on the evidence and findings from the

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<sup>39</sup> For the Court of Appeal's reasons for making the Order of 24 November 2011, see judgment dated 21 December 2011 in *Ryanair Holdings PLC v Office of Fair Trading* [2011] EWCA Civ 1579.

European Commission's decision on Ryanair's third bid for the entire share capital of Aer Lingus, announced on 27 February 2013 (see paragraph 3.7).<sup>40</sup>

### ***Airlines operating routes between Great Britain and Ireland***

5.3 The primary area of overlap between the UK operations of Ryanair and Aer Lingus is on services between Great Britain and the Republic of Ireland. As we set out in Appendix D, Ryanair and Aer Lingus together carried around 82 per cent of all passengers travelling between Great Britain and the Republic of Ireland in 2012.

There is also some limited overlap between the carrier's services between Northern Ireland and London, and between Northern Ireland and Portugal.

5.4 In addition to Ryanair and Aer Lingus, we identified a number of other airlines that were active in these areas:

(a) *Aer Arann* was the third largest operator between Great Britain and the Republic of Ireland in 2012. As described in Appendix B, Aer Arann operates a number of services under the 'Aer Lingus Regional' brand. Given the scope of the franchise agreement between Aer Lingus and Aer Arann, we also consider overlap between routes operated by Aer Arann and Ryanair in this section.

(b) *Flybe* is a regional airline, operating scheduled, short-haul services from a number of UK bases. It said that it had a hybrid business model; it had adopted many of the features of the low-frills sector while retaining some features of full-service carriers such as pre-assigned seating. It has been active on the Exeter to Dublin route for around 15 years, and also operates between Southampton and Dublin, Manchester and Knock, Manchester and Waterford, Birmingham and Waterford, Edinburgh and Knock, Glasgow and Shannon and London Gatwick and Belfast.

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<sup>40</sup> As at 30 May 2013, the European Commission's findings were not yet publicly available. However, the European Commission provided us with a copy of its decision as sent to the parties.

- (c) *British Airways* forms part of the IAG group, together with Iberia. It is the former British flag carrier, with a large network of short- and long-haul services, centred around its London bases at Heathrow and Gatwick. It previously operated a service to Dublin from London Gatwick (withdrawn in 2009), and re-entered the London to Dublin corridor following the acquisition of bmi in 2012. It also operates between London and Belfast.
- (d) *CityJet* is a subsidiary of the Air France KLM group. It has a fleet of 33 aircraft, with a network centred on its bases at London City and Paris Charles De Gaulle airports. It has been active on the London to Dublin corridor since 2003.
- (e) *easyJet* is a point-to-point low-fares carrier with a large network of short-haul flights across Europe. It runs services between Belfast City airport and Stansted, Luton and Gatwick, and Belfast International and Faro airport.

### ***Market definition***

5.5 In this section, we consider the market definition that we should adopt as a framework for our analysis of competitive effects, and identify the markets within which the transaction may give rise to an SLC (the relevant markets).<sup>41</sup> We first discuss substitutability between air travel and other transport modes, and identify the relevant product market. We then consider substitutability between the airlines' services in terms of the airports served, and identify the relevant geographic markets.

### ***Product market***

5.6 Both Ryanair and Aer Lingus supply air passenger services. In taking this as our starting point, however, we recognized that airlines differentiate in terms of the services offered to passengers and the customer base targeted. We discuss the substitutability of the service offering of Ryanair and Aer Lingus—and the resulting closeness of competition between them—in paragraphs 5.18 to 5.21.

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<sup>41</sup> CC2, section 5.2.

- 5.7 We considered whether to include any additional forms of transport in our product market. For passengers travelling between Great Britain and the Republic of Ireland, this would most likely be by ferry (with crossings operated between NW England, Wales and Scotland in Great Britain, and Dublin, Belfast and Rosslare in Ireland), in combination with overland transportation from the passenger's origin/destination to the relevant ports.
- 5.8 We noted that travelling using an alternative mode of transport would generally involve substantially longer journey times. For example, the total travel time from central London to central Dublin would be around six and a half hours by train and ferry,<sup>42</sup> compared with around two and a half hours by air.<sup>43</sup> Central Manchester to central Dublin would involve a travel time of approximately two and a half hours by air,<sup>44</sup> compared with five and a quarter hours by train and ferry.<sup>45</sup> Aer Lingus told us that the total travel time by alternative modes of transport remained significantly longer than that by air when taking into account realistic check-in/waiting times. In addition, we saw no evidence of the airlines altering their behaviour in response to the actions of ferry or rail operators, or of the airlines monitoring the activities of ferry or rail operators.
- 5.9 In its investigation, the European Commission concluded that intermodal substitution was not relevant for any of the overlap routes. In line with this conclusion, we found that while an alternative form of transport might present a reasonable alternative for some non-time-sensitive passengers, the degree of substitutability between flying and these other transport modes was limited, and so the strength of any competitive constraint was likely to be weak.

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<sup>42</sup> Assuming 4 hours by train to Holyhead, 2-hour ferry to Dublin, 35-minute bus to Dublin city centre.

<sup>43</sup> Assuming 45-minute train to London Stansted, 1-hour-20-minute flight, 40-minute bus to Dublin city centre.

<sup>44</sup> Assuming 45-minute bus to Manchester Airport, 1-hour-5-minute flight, 40-minute bus to Dublin city centre.

<sup>45</sup> Assuming 2 hours 45 minutes by train to Holyhead, 2-hour ferry to Dublin, 35-minute bus to Dublin city centre.

5.10 On this basis, we provisionally conclude that the relevant product market is the supply of air passenger services.

### *Geographic market*

5.11 A key dimension in which airlines' services are differentiated is in terms of the airports served. We would expect many passengers to be willing to consider using a rival airline's service to/from the same city (whether or not it is the same airport). However, passengers are likely to be less willing to substitute to a route connecting two different cities that are a long way from their intended origin and destination.

5.12 In order to identify relevant geographic markets, we use a version of the origin and destination approach, similar to that employed by the European Commission in a number of previous investigations into airline mergers.<sup>46</sup> More specifically, we identify a set of overlap corridors encompassing routes between groups of nearby origin and destination airports, close enough to one another that a significant number of passengers would be likely to consider them substitutable. Following the European Commission, we use as our starting point a 100km/1-hour distance threshold to identify potentially substitutable airports.<sup>47</sup> The full details of our overlap analysis are set out in Appendix D.

5.13 The overlap corridors that we have identified are listed in Table 1. There are six corridors connecting airports in Great Britain and the Republic of Ireland where services operated by Ryanair and Aer Lingus overlap (encompassing 14 Ryanair routes and eight Aer Lingus routes). Aer Lingus carried a total of 1.47 million outbound passengers on routes on these six corridors in 2012 (around three-quarters of all passengers carried by Aer Lingus from UK airports in the year); Ryanair

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<sup>46</sup> Including the European Commission's two investigations, in 2007 and 2013, into Ryanair's bids for Aer Lingus.

<sup>47</sup> Road distances and drive-times are calculated using the google maps API.



1.75 million outbound passengers (12.9 per cent of all passengers carried by Ryanair from UK airports in the year). Total calendar year 2011 revenue for Ryanair on these routes was around €[redacted] million.<sup>48</sup> Aer Lingus total passenger revenue on these routes for calendar year 2011 was around €[redacted] million.<sup>49</sup>

5.14 We identify a further five corridors between Great Britain and the Republic of Ireland where Ryanair's services overlap with routes operated by Aer Arann under the Aer Lingus Regional brand. Ryanair carried a total of 0.39 million outbound passengers on these routes in 2012; Aer Arann carried a total of 0.26 million. Finally—looking outside the routes between Great Britain and the Republic of Ireland—we find that both Ryanair and Aer Lingus also operate services between London and Northern Ireland and Northern Ireland and Faro. The extent of overlap here is weaker, given the distance between City of Derry airport (from which Ryanair operates) and Belfast City airport (from which Aer Lingus operates). The airlines carried a combined total of 0.33 million outbound passengers on these two corridors in 2012.

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<sup>48</sup> Total calculated as *totalgrossrev* + *totaladminexcessbag* + *totalotherrev*.

<sup>49</sup> Total calculated as *purepaxrev* + *recoverablerev* + *retailrev*.

TABLE 1 Summary of corridors on which the services of Ryanair and Aer Lingus/Aer Arann overlap

Route	Total number of passengers carried by Ryanair, Aer Lingus and Aer Arann	Share of <i>all</i> passengers travelling on the corridor %			Airport pair?	Other airlines present?
		Ryanair	Aer Lingus	Aer Arann		
<i>Republic of Ireland—Ryanair/Aer Lingus</i> London–Dublin	1,562,819	38.2	43.7	0.9	Yes	BA (10%), CityJet (4%), Flybe (3%)
London–Cork	389,843	44.4	55.6		Yes	
London–Shannon	280,767	53.3	46.7		No	
London–Knock	133,134	70.1	29.9		No	
NW England–Dublin	532,763	72.5	25.8	1.6	Yes	
Birmingham/ East Midlands–Dublin	350,057	64.8	34.7	0.4	Yes	
<i>Republic of Ireland—Ryanair/Aer Arann</i> Glasgow/Edinburgh/Prestwick–Dublin	330,786	56.2	6.2	37.4	Yes	
Bristol/Cardiff/Exeter–Dublin	182,040	61.7		29.9	Yes	Flybe (8%)
NW England–Cork	72,941	47.0		53.0	No	
NW England–Shannon	43,988	36.0		63.9	No	
Birmingham/East Midlands–Knock	36,229	58.5		19.6	No	
<i>Northern Ireland—Ryanair/Aer Lingus</i> London–Northern Ireland	197,580	6.0	11.8		No	easyJet (45%), BA (20%), Flybe (15%)
Northern Ireland–Faro	37,991	11.0	31.3		No	easyJet (49%)

Source: CC analysis of CAA data.

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

5.15 Although in most instances we thought that a significant number of passengers would consider the airports within these origin and destination groupings to be substitutable, in some instances the groupings included airports located a significant distance from each other.<sup>50</sup> We did not, however, need to conclude on whether passengers would consider these more distant airports to be substitutable, as this did not affect our conclusions on the competitive effects of the transaction.<sup>51</sup>

<sup>50</sup> This applies in particular to City of Derry and Belfast airports, Southampton and the London airports, and Exeter and Bristol airports.

<sup>51</sup> Indeed, even looking only at instances where Ryanair and Aer Lingus operate to and from the same airports, we found that Ryanair and Aer Lingus overlap on three routes on which they were both still active in May 2013, between London Gatwick and Dublin, Manchester and Dublin and Birmingham and Dublin. The airlines are the only two operators on each of these routes, and carried a combined total of 1 million outbound passengers in 2012.

## ***The competitive constraint between Ryanair and Aer Lingus***

- 5.16 In this section, we examine the extent of the competitive constraint that Ryanair imposes on Aer Lingus (and Aer Arann), and vice versa. We begin by considering the closeness of the service offerings of the airlines, then review direct evidence of competition between them, and finally assess whether the airlines would be likely to impose a competitive constraint on each other through potential competition and the threat of entry.
- 5.17 In our assessment we have regard to the analysis of the European Commission, which found that Ryanair and Aer Lingus are by far the most important carriers operating out of Ireland. It concluded that the two companies are close competitors and exert an important competitive constraint upon each other, referring in particular to the similar business models of the two airlines, as well as the fact that they both enjoy high brand recognition in Ireland and are both particularly well established in Irish airports.

### ***Closeness of service offering***

- 5.18 A primary factor in determining the extent of competition between the parties on overlapping corridors will be the extent to which passengers consider the services of the two airlines to be substitutable—ie the extent to which passengers of one company would be willing to switch to the services of the other.
- 5.19 A key dimension in which one airline's offering will differ from another's is in terms of the level of services provided to passengers and the extent to which these services are included in ticket prices.
- 5.20 We provide a comparison of the service offering of the two airlines in Appendix D. We also compare the average prices paid and the journey purpose of the passengers

carried by the two airlines. We found that Aer Lingus (which describes itself as a 'value carrier') generally offers more services, charges higher prices, and carries more business passengers than Ryanair (a low-cost carrier).

5.21 However, despite these differences, the service offerings of the two airlines are similar in many important respects, and we would expect a significant proportion of passengers to consider the airlines' services to be substitutable. We find that on all corridors both airlines carry significant numbers of business passengers, passengers on holiday and passengers visiting friends and relatives. We therefore find it unlikely that any of these categories of passengers would only consider flying with one of the airlines when travelling between Great Britain and the Republic of Ireland.

#### *Direct evidence of competition between the airlines*

5.22 We also considered direct evidence of competition between the airlines. This evidence is set out in more detail in Appendix D.

5.23 Both Ryanair and Aer Lingus take the behaviour of each other into account in determining their prices. There is strong evidence illustrating that the prices set by one carrier have a direct impact on the prices set by the other. In our view, this demonstrates the competitive constraint that exists between the airlines. We also saw various internal documents prepared by the parties in the course of business which confirmed to us that Ryanair and Aer Lingus monitor each other's behaviour more generally.

5.24 In addition, the European Commission in its latest investigation used regression analysis to investigate whether the presence of one of the parties on a corridor has an impact on the fares of the other, and to estimate the magnitude of any such effect. It found that Ryanair's presence on a corridor was associated with a decrease in Aer

Lingus's fares, and vice versa, and that these effects were economically and statistically significant, and highly robust to the use of alternative specifications.

5.25 We also noted a number of Ryanair promotional campaigns directly targeting Aer Lingus's customers, which also suggested a level of competition between the two airlines.

5.26 To summarize, there is a considerable body of direct evidence showing the airlines competing for passengers, and illustrating that their actions have an impact on each other's behaviour.

### *Potential competition*

5.27 We considered the extent to which Ryanair and Aer Lingus might impose a competitive constraint on each other via the threat of entry.

5.28 The European Commission found in its decision announced on 27 February 2013 prohibiting the proposed acquisition that both Aer Lingus and Ryanair exert a significant constraint on each other on a number of routes on which they are not currently both active, including two routes involving a UK airport. Specifically, it found that Ryanair would be the most credible potential entrant on Aer Lingus's route between Cork and Birmingham, and that Aer Lingus would be the most credible potential entrant on Ryanair's route between Newcastle and Dublin.

5.29 Our assessment of potential competition is set out in Appendix D. We note that the two airlines have entered or expanded on routes between Great Britain and the Republic of Ireland in competition with each other on various occasions in previous years. Because of their established position in the Irish and UK markets, many of the barriers to entry identified in our section on market entry would be less of a deterrent

to new entry by Ryanair and Aer Lingus than to other airlines.<sup>52</sup> We identified a number of routes between Great Britain and the Republic of Ireland on which Ryanair was currently active, but Aer Lingus was not, and a number of routes on which Aer Lingus Regional services operated but on which Ryanair was not currently active. We provisionally conclude that Ryanair and Aer Lingus may impose a competitive constraint on routes between Great Britain and the Republic of Ireland on which both airlines are not already active through the threat of entry.

5.30 We considered whether Aer Lingus could impose a competitive constraint on Ryanair's other UK services. We noted that Aer Lingus had previously operated from Gatwick and Belfast to various seasonal destinations, and had applied to the European Commission for slots for services between Edinburgh and London which were divested following the BA/bmi transaction. However, given the large number of other airlines active in the UK market, we considered that any competitive constraint exerted by Aer Lingus through the threat of entry on UK routes would be likely to be weak.

#### *Provisional conclusions on the competitive constraint between Ryanair and Aer Lingus*

5.31 We provisionally conclude that Ryanair and Aer Lingus impose a strong competitive constraint on each other on overlap routes between Great Britain and Ireland, and are 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 are not currently both active.

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<sup>52</sup> Although we note that airport capacity constraints and the weak economic environment could still deter entry.

### ***The competitive constraint from other rivals***

- 5.32 In this section, we assess the extent to which other airlines impose a competitive constraint on those routes where Ryanair and Aer Lingus compete for passengers.
- 5.33 The European Commission concluded in its decision that the competitive constraint from other airlines on any of the UK overlap routes would not be strong enough to constrain a merged Ryanair/Aer Lingus.
- 5.34 In general, we would not expect the competitive constraint imposed by other airlines on routes between Great Britain and the Republic of Ireland to be strong. As set out in paragraph 5.3, together Aer Lingus and Ryanair accounted for 82 per cent of all passengers travelling between Great Britain and the Republic of Ireland in 2012, with Aer Arann carrying a further 10 per cent of passengers under the Aer Lingus Regional brand. The only other airlines present are British Airways (carrying 4 per cent of all passengers), Flybe (carrying 2 per cent of all passengers) and CityJet (carrying under 2 per cent of all passengers), none of which has a base at Dublin airport. On 9 out of the 13 overlap corridors identified in Table 1, Ryanair and Aer Lingus are the only airlines present and therefore there will not be any competitive constraint from rival airlines on routes on these corridors.
- 5.35 We looked at the remaining four overlap corridors in more detail (see Appendix D). We found that on the London to Dublin corridor, there was likely to be some constraint from British Airways and CityJet. On the Bristol to Dublin corridor, the competitive constraint from Flybe was likely to be weak. We expected the competitive constraint from other airlines—and in particular easyJet—on overlap routes between London and Northern Ireland, and Northern Ireland and Faro to be strong.

### *Provisional conclusions on constraint from other rivals*

5.36 We provisionally conclude that on most overlap corridors, Ryanair and Aer Lingus do not face a competitive constraint from any other airlines. On the London to Dublin and—to a lesser extent—the Bristol to Dublin corridors, there is likely to be some competitive constraint from other airlines. We provisionally conclude that there is likely to be a strong competitive constraint from other airlines—and in particular easyJet—on overlap routes between London and Northern Ireland, and Northern Ireland and Faro.

### *The trend in competition between Ryanair and Aer Lingus since 2006*

5.37 In this section we look at whether the intensity of competition between Ryanair and Aer Lingus has changed compared with the level which existed in 2006. We begin by setting out the findings of the European Commission on developments in competition between the airlines since 2006,<sup>53</sup> before discussing the trend in four dimensions of the competitive offering of Ryanair and Aer Lingus over the period: fares, overlap, frequency and the level of services offered by the airlines. The full details of our assessment are set out in Appendix E.

#### *The European Commission's findings*

5.38 As discussed in paragraph 5.17, the European Commission found that Ryanair and Aer Lingus are close competitors and exert an important competitive constraint upon each other. It identified 46 routes—including 12 involving a UK airport—on which the airlines competed vigorously.

5.39 It said that its market investigation had not provided material indications that market circumstances had changed since 2007. If anything competition may have increased between the parties. Specifically, in relation to the extent of overlap between the

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<sup>53</sup> The relevance of the European Commission's findings and our duty of sincere cooperation are discussed in Section 7.



parties' operations, it found that the number of routes on which Ryanair and Aer Lingus overlapped increased from 35 in 2007 to 46 in 2012. On almost 85 per cent of these routes (65 per cent in 2007) there were no other scheduled airlines active.<sup>54</sup>

### *Fares*

5.40 We were not aware of any evidence suggesting that there had been changes in the way that Ryanair and Aer Lingus monitor and react to each other's fares into account since 2006.

5.41 We calculated average fares (using ticket revenue only, excluding revenue from, for example, excess baggage and administration charges) for each month from January 2005 to December 2011 on the routes of Ryanair and Aer Lingus on the six primary overlap corridors. In line with the assessment of the European Commission, we found that [redacted] average ticket revenues per passenger [redacted].

5.42 Ryanair argued that the European Commission's econometric analysis showed that Ryanair exerted a stronger competitive constraint on Aer Lingus in 2013 than it did in 2007. In our view, the results of the two analyses showed that Ryanair exerted a strong competitive constraint on Aer Lingus fares in both periods. It was not clear to us, however, that the analysis showed that fare competition between the two airlines had increased since 2006.

### *Overlap*

5.43 We also looked at the trend in the extent of overlap between the two airlines' routes over the period. We agreed with the European Commission's findings that the extent of overlap between the operations of the two airlines has increased since 2006. Although the overlap corridors accounting for the great majority of passengers—

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<sup>54</sup> These figures refer to all Ryanair and Aer Lingus routes, not just to routes between Great Britain and Ireland.

London, NW England, Birmingham/East Midlands and Edinburgh/Glasgow to Dublin, and London to Cork and Shannon—were active in both periods, the franchise agreement between Aer Lingus and Aer Arann entered into in 2010 had added three additional overlap corridors compared with the situation prior to 2006.<sup>55</sup> In addition, Aer Lingus itself had entered another corridor in competition with Ryanair (between London and Knock), and withdrawn from an overlap corridor (between Newcastle and Dublin) over the period. The total number of passengers carried on overlap corridors declined between 2007 and 2013.

### *Frequency*

- 5.44 We compared the total frequency operated by Ryanair and Aer Lingus on overlap routes in 2006 and 2012. We found that Aer Lingus's frequency on the London–Dublin, London–Cork and London–Knock corridors had increased over the period as a result of its introduction of new services from London Gatwick. There was a slight decrease in Aer Lingus's frequency on other overlap routes. Ryanair's frequency on all of the overlap corridors decreased over the period, most significantly on the London to Dublin and NW England to Dublin corridors. Ryanair attributed this reduction in frequency to a significant reduction in demand for air travel. It said that Ryanair would have been expected to cut capacity between the UK and Republic of Ireland, regardless of its shareholding in Aer Lingus because of the major recessions in the period, and increases in aviation taxes and airport charges. It said that other airlines had also cut capacity between the UK and Republic of Ireland since 2007.

### *Service offering*

- 5.45 We considered whether there had been any change in the service offerings of the two airlines since 2006. As set out in paragraph 2.14, Aer Lingus was operating a low-fares business model in 2006 but repositioned itself as a 'value carrier' from

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<sup>55</sup> Between Bristol and Dublin, NW England and Shannon and Birmingham/East Midlands and Knock.

2009. Nevertheless, we considered that in many important respects the service offering of the two airlines remains very similar and that the two airlines will impose a strong competitive constraint on each other (see paragraph 5.21). Aer Lingus told us that this repositioning was a reaction to the global economic and financial crisis, and that the repositioning had enabled it to compete more effectively with Ryanair.

#### *Other evidence*

5.46 In its submission to the OFT,<sup>56</sup> Ryanair also referred to:

- (a) Ryanair internal documents, [redacted];
- (b) Ryanair press releases and print advertising, showing Ryanair targeting Aer Lingus customers in the period since the transaction.

5.47 This evidence also suggested to us that there had been a continuation of competition between Ryanair and Aer Lingus since 2006.

#### *Provisional conclusion on competition between Ryanair and Aer Lingus since 2006*

5.48 We provisionally conclude that, in line with the European Commission's findings, competition between Ryanair and Aer Lingus has remained intense since 2006. The extent of overlap between the operations of the two airlines has increased, largely as a result of Aer Lingus's Regional franchise agreement with Aer Arann. We discuss the relevance of these findings to our assessment in our discussion of competitive effects.

## **6. The counterfactual**

6.1 In carrying out our competitive assessment, we compare the prospects for competition with the acquisition against the competitive situation in the absence of the acquisition. The latter is called the 'counterfactual'.<sup>57</sup>

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<sup>56</sup> Ryanair submission to the OFT on SLC, paragraph 5.19. See [www.competition-commission.org.uk/our-work/directory-of-all-inquiries/ryanair-aer-lingus/evidence](http://www.competition-commission.org.uk/our-work/directory-of-all-inquiries/ryanair-aer-lingus/evidence).

- 6.2 The counterfactual is necessarily uncertain since it is not an observable event. As set out in our Guidelines, the CC typically incorporates into the counterfactual ‘only those aspects of scenarios that appear likely on the basis of the facts available to it and the extent of its ability to foresee future developments’.
- 6.3 In this case, unusually, we have an observable history of more than six and a half years of Ryanair’s ownership of shares in Aer Lingus. We also take into account our expectations of future developments, drawing as appropriate on that history and the inferences that may reasonably be drawn from it.
- 6.4 Ryanair’s public bids for Aer Lingus are also relevant to this counterfactual assessment. As set out in paragraphs 3.2 to 3.7, Ryanair has launched three unsuccessful public offers for the entire share capital of Aer Lingus in 2006, 2008 and 2012. Ryanair may not launch another bid for Aer Lingus for 12 months after its most recent bid lapsed (29 August 2012), due to Irish Takeover Rules.<sup>58</sup>
- 6.5 On 8 May 2013 Ryanair appealed against the European Commission’s decision to prohibit its third bid. We note that Ryanair may, in due course, launch a fourth bid for the entire share capital of Aer Lingus.

### ***The views of parties***

- 6.6 Aer Lingus said that the appropriate benchmark for assessing the effects of Ryanair’s shareholding was a competitive situation in which Ryanair holds no shares in Aer Lingus. While Aer Lingus believed that in the absence of Ryanair’s shareholding it would have been better placed to participate in M&A activity, it could not be certain that such a possibility would have materialized since 2006. In its view, the relevant

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<sup>57</sup> CC2, paragraph 4.3.1.

<sup>58</sup> Ryanair said that, should the General Court overturn the European Commission’s prohibition before that date, this would not be correct.

counterfactual therefore remained a situation in which Ryanair did not own any shares in Aer Lingus, and where Aer Lingus operates independently of any other airline.

- 6.7 Ryanair told us initially that, if it were unable to acquire full ownership of Aer Lingus, ‘the appropriate counterfactual is either the breakup of Aer Lingus or its ultimate failure and closure’. Ryanair said that Aer Lingus’s cost base could not sustain long-term competition with Ryanair’s much lower cost base to/from Ireland. In Ryanair’s view, Aer Lingus had no future as an independent airline because of its small scale, its peripheral location and its repeated failure to expand outside Ireland. If Ryanair’s offer for Aer Lingus was unsuccessful, Aer Lingus was likely to be acquired by another airline or financial investor that would break up Aer Lingus, sell off its valuable Heathrow slots and transatlantic routes and close its loss-making short-haul routes to the UK and Europe.
- 6.8 Ryanair told us that Aer Lingus would be a potential acquisition target for a financial institution rather than an airline, and most major European flag-carrier airlines including British Airways, Air France and Lufthansa had indicated that they had no interest in acquiring Aer Lingus.
- 6.9 Ryanair also told us that the break-up of Aer Lingus would result in higher value to its shareholders because of ‘the continuing concerns about the company’s failure to address its pension fund deficit, and the continuing trend of smaller peripheral flag carriers exiting the market over the medium to long term’.
- 6.10 Subsequently, Ryanair told us that it agreed with the first of our counterfactual scenarios (see paragraph 6.11), namely that Aer Lingus would continue with its current broad commercial strategy.

## ***Our assessment***

6.11 We considered three possible counterfactual scenarios.<sup>59</sup>

- (a) Aer Lingus would pursue a commercial strategy on routes between Great Britain and Ireland broadly similar to its current strategy, either under independent ownership or as part of another airline;
- (b) Aer Lingus would combine with another airline and change its strategy significantly; and
- (c) Aer Lingus would withdraw from the airline industry.

### ***Aer Lingus would pursue a broadly similar commercial strategy under a range of ownership structures***

6.12 Under this counterfactual, absent Ryanair's shareholding, Aer Lingus would continue to operate without major changes to its current commercial strategy on routes between Great Britain and Ireland for the foreseeable future.

6.13 We recognize that there is a range of possible ownership structures for Aer Lingus, including its continuation as an independent airline or its combination with another airline. However, even if Aer Lingus were no longer an independent airline, we think it likely that an acquirer would retain Aer Lingus's air passenger services between Great Britain and Ireland because the value of Aer Lingus's network, branding and goodwill is intrinsically connected with its operations in Ireland.

### ***Major change of Aer Lingus's strategy***

6.14 The second counterfactual is the possibility of a major change of Aer Lingus's strategy as a result of a merger between Aer Lingus and another airline, absent Ryanair's shareholding.

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<sup>59</sup> Ryanair told us that the counterfactual scenarios that we have set out were not counterfactual scenarios as envisaged in the CC's Guidelines because none of them was precluded by, or inconsistent with, Ryanair's minority shareholding. We discuss the likely impact of Ryanair's shareholding in our section on competitive effects.

- 6.15 If another airline were to acquire Aer Lingus, there may be a review of Aer Lingus's commercial strategy, with a variety of outcomes such as a major change of strategy with respect to the Great Britain–Ireland air passenger services (for example, the redeployment of the Heathrow slots for flights to destinations other than Ireland).
- 6.16 However, for the reasons set out in paragraph 6.13, we think it unlikely that an acquirer would acquire Aer Lingus with an intention of substantially changing its current strategy with respect to air passenger services between Great Britain and Ireland. On this basis we do not think that this is the most likely counterfactual.

### ***Aer Lingus withdrawal from the airline industry***

- 6.17 Under the third counterfactual scenario, we considered whether Aer Lingus would be likely to withdraw from the industry, absent Ryanair's shareholding.
- 6.18 Aer Lingus is the former Irish national flag-carrier airline and has been a listed public company since 2006 with a clear and consistent strategy of continuing to operate as an airline. Ryanair's initial views on the counterfactual was that Aer Lingus would eventually fail or that it would be 'broken up' to realize a higher value for its shareholders (see paragraphs 6.7 and 6.8), resulting, necessarily, in reduced competition between Ryanair and Aer Lingus.
- 6.19 We reviewed Aer Lingus's recent financial performance, and noted that:
- (a) With the exception of 2008 and 2009, when the Irish economy was in difficulty, Aer Lingus has generated profit before tax and positive operating cash flow each year since 2006.
  - (b) Aer Lingus's results for the calendar year 2012 showed an increase in passenger numbers (by 1.5 per cent to 9.7 million), average yield per passenger (by 7 per

cent to €120) and revenue (by 8 per cent to €1.4 billion). Operating profit before exceptional items increased by 41 per cent to €69 million in 2012.

(c) Aer Lingus had unrestricted cash of €313 million on its balance sheet at 31 December 2012, and total cash and deposits of €745 million.

6.20 Ryanair has not provided any substantive analysis of its claim that the break-up value of Aer Lingus exceeds its value as a going concern. We note that Aer Lingus's management are operating the business on a continuing basis in the interests of all its shareholders. We did not think that this counterfactual scenario was sufficiently likely to warrant further consideration.

### ***Provisional conclusions on the counterfactual***

6.21 We provisionally conclude that the appropriate counterfactual is 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.

## **7. Assessment of the competitive effects of the acquisition**

7.1 In this section we assess the competitive effects of Ryanair's acquisition of a minority shareholding in Aer Lingus. We consider whether the acquisition has resulted, or may be expected to result, in a reduction in Aer Lingus's, Ryanair's or both companies' effectiveness as actual competitors (on overlap routes) or potential competitors (on routes where the companies do not currently overlap).

7.2 We start by discussing the relevance of the European Commission's findings to our own assessment and our duty of sincere cooperation pursuant to Article 4(3) of the Treaty on European Union (TEU). We then discuss three possible competitive effects arising from the acquisition of Ryanair's minority shareholding:



- (d) 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;
- (e) 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
- (f) 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.

### ***Relevance of the European Commission's findings to our assessment***

7.3 Ryanair said that the evidence of competition between Ryanair and Aer Lingus on the routes between Great Britain and Ireland since the transaction (approximately six and a half years) demonstrated comprehensively that Ryanair had not used its minority shareholding to create a lessening of competition. It said that the evidence set out in the European Commission's decision on Ryanair's third bid for Aer Lingus, confirmed that competition between Ryanair and Aer Lingus was intense and had in fact increased since Ryanair obtained its minority shareholding. Ryanair said that, as no relevant factual circumstances had changed since this finding was made, the CC was legally obliged, pursuant to the duty of sincere cooperation, to reach a decision that was consistent with the European Commission's findings. Ryanair stated that it would be inconceivable for the CC to find that the same fact pattern evidenced an SLC between Ryanair and Aer Lingus.

7.4 Aer Lingus said that there could be no conflict between the European Commission's and our findings unless the national authority and the EU institution were applying the same law to the same facts. It said that this was not the case here as the European

Commission were considering the application of the EUMR to the public bid and the CC was considering the application of the Act to the minority holding.

- 7.5 It is clear that under the EUMR the European Commission does not have jurisdiction to conduct a review of the competitive effects of Ryanair's acquisition of a minority shareholding in Aer Lingus;<sup>60</sup> as a result we have a duty under the Act to carry out our own assessment.
- 7.6 The Court of Appeal has recently confirmed that what is required by a Member State to comply with the duty of sincere cooperation under article 4(3) of the TEU is highly fact sensitive and it is for the Member State to choose the most appropriate course of action to take in order to fulfill it.<sup>61</sup>
- 7.7 In the present case, we consider that the appropriate course of action is to take into account the European Commission's assessment of competition between Ryanair and Aer Lingus in making our assessment of competitive effects in this particular case. It has been helpful to us in understanding the intensity of competition between Ryanair and Aer Lingus and their rivals (and how this has changed over time) (see Section 5) and the likelihood of entry into the Irish market by other airlines. We have not reached any provisional findings that are in conflict with those of the European Commission on these points.
- 7.8 However, we do not agree with Ryanair's submission that we are bound to conclude, on the basis of the European Commission's assessment of that competition, that the acquisition of the minority shareholding has not and will not result in an SLC.

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<sup>60</sup> See the judgments of the General Court, Case T-411/07 dated 6 July 2010, paragraphs 64 & 78, and the recent decision of the Court of Appeal, [2012] EWCA Civ 1632 at paragraph 60.

<sup>61</sup> *Supra*, paragraph 55.

- 7.9 We looked carefully at the evidence of the period since 2006 as presented by the European Commission and gathered by the CC during the course of its inquiry. In particular, we refer extensively to events in the period since 2006 in our assessment of the different mechanisms by which Ryanair's shareholding in Aer Lingus may affect competition.
- 7.10 It is our provisional view that, in principle, the European Commission's finding that Ryanair and Aer Lingus compete intensely neither precludes, nor is in conflict with our findings that, absent Ryanair's shareholding, competition during the period since 2006 or in the future may have developed differently and may have been stronger. This is relevant as many of the potential competitive effects of the transaction that we analysed would manifest themselves in terms of an action not being taken by Ryanair or Aer Lingus (for example, Aer Lingus being prevented from combining with another airline or from managing its portfolio of Heathrow slots).
- 7.11 In addition, we need 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. The evidence presented in the European Commission's decision, whilst informative of the level of observable competition between the parties, is a factor among others that we have taken into account when assessing the likelihood of an SLC in the future.

### ***Effects of the acquisition***

#### ***Ryanair's influence over Aer Lingus's effectiveness as a competitor***

- 7.12 We considered whether Ryanair's minority shareholding could serve to reduce Aer Lingus's effectiveness as a competitor.

- 7.13 We identified a number of examples of different ways in which Ryanair's minority shareholding might result in Aer Lingus becoming a weaker competitor. It might, for example, allow Ryanair to:
- (a) affect Aer Lingus's ability to participate in a combination with another airline (see paragraphs 7.15 to 7.64);
  - (b) hamper Aer Lingus's ability to issue shares to raise capital (see paragraphs 7.65 to 7.72);
  - (c) influence Aer Lingus's ability to manage its portfolio of slots at London Heathrow (see paragraphs 7.73 to 7.84);
  - (d) influence Aer Lingus's commercial strategy by exercising the deciding vote in an ordinary resolution (see paragraphs 7.85 to 7.91);
  - (e) use its position as a minority shareholder to take actions to raise Aer Lingus's management costs or impede its management from concentrating on Aer Lingus's commercial strategy (see paragraphs 7.93 to 7.100); and
  - (f) incentivize the management of Aer Lingus to take into account the interests of Ryanair in setting its commercial policy (see paragraphs 7.103 to 7.107).
- 7.14 We discuss the likelihood and scale of any possible competitive effects associated with each of these different mechanisms in turn below, before commenting more generally on the extent to which Ryanair would be likely to have an incentive to exert its influence in order to make Aer Lingus a less effective competitor (see paragraphs 7.108 to 7.111).

*Aer Lingus's ability to participate in a combination with another airline*

- 7.15 One way in which Ryanair's shareholding might weaken the effectiveness of Aer Lingus as a competitor is if it restricts Aer Lingus's ability to manage its costs at a competitive level or expand or improve its offering via a combination with another airline. In what follows, we begin by setting out how Ryanair's minority shareholding

might influence Aer Lingus's ability to combine with another airline. We then consider evidence related to the likelihood of Aer Lingus being involved in a combination absent Ryanair's minority shareholding, discussing the general trend in consolidation in the airline industry, the views of airlines, internal documents of Aer Lingus and discussions between Aer Lingus and other airlines since 2006. Finally, we discuss the potential impact of a combination on Aer Lingus's effectiveness as a competitor, before drawing some provisional conclusions.

*The influence of Ryanair's minority shareholding*

- 7.16 We considered how Ryanair's minority shareholding might influence Aer Lingus's ability to combine with another airline.
- 7.17 We identified a spectrum of ways in which Aer Lingus and another airline could combine. These ranged from a full merger involving the integration of business activities and assets (including an acquisition of Aer Lingus by another airline, an acquisition by Aer Lingus of another airline, and other combinations based on the relative contribution of Aer Lingus and its merger partner to the enlarged business), through a joint venture (with close cooperation but less extensive business integration than a full merger), acquisition of a strategic investment in Aer Lingus via a minority shareholding by another airline, to franchises, codeshares and bilateral alliances with no integration. We set out different possible forms of combination in more detail in Table 1 in Appendix F.
- 7.18 Aer Lingus said that Ryanair's shareholding allowed it to control the destiny of Aer Lingus, making it 'kingmaker'. It told us that because of the minority shareholding, Aer Lingus was known as a target for a Ryanair takeover rather than a successful and profitable airline, and that this was an impediment to partnership negotiations. It

said that Ryanair's presence on its share register was considered by potential investors to be a poison pill.

- 7.19 Ryanair told us that it would be open to offers for its shareholding on their merits, and had repeatedly said so in public. It also told us that it would support Aer Lingus if it sought to raise capital by taking up its quota of shares in the events of a rights issue.
- 7.20 Third parties told us that any acquirer of Aer Lingus would be likely to be concerned by Ryanair's minority shareholding. IAG told us that [REDACTED]. Air France said that Ryanair's presence as an existing shareholder in Aer Lingus was not considered a deterrent to another airline acquiring an interest in the airline. However, there would be concerns over the illiquid share block between the shares held by the Irish Government, Ryanair and employees. Overall, Air France said that it would be difficult, but not impossible, for another airline to take a stake in Aer Lingus given its current share register. Lufthansa said that [REDACTED]. Aer Arann told us that a potential suitor would have concerns about acquiring an airline in which the largest shareholder was also a competitor.
- 7.21 We considered the influence of Ryanair's minority shareholding on Aer Lingus's ability to combine with another airline across the spectrum of different forms of cooperation (see paragraph 7.17).
- 7.22 We found that Ryanair's minority shareholding gives it the ability to influence possible acquisitions of Aer Lingus by another airline. Ryanair could prevent a bidder from acquiring 100 per cent of Aer Lingus by choosing to retain its shares.<sup>62</sup> If Ryanair decides not to sell, an acquirer would need to accept Ryanair remaining as a

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<sup>62</sup> The 'squeeze out' provision is only effective with a shareholding of less than 10 per cent. So, even with a 10 per cent shareholding in Aer Lingus, Ryanair would have the ability to prevent an offeror achieving the squeeze out of minority shareholdings, so an offeror would only be able to secure 90 per cent of the shares.

significant minority shareholder, with different incentives to its own, and with, for example, the ability to block special resolutions and a proportionate share of the dividends and profits of Aer Lingus.

7.23 We also considered that the shareholding would affect Aer Lingus's ability to merge with, enter into a joint venture with, or acquire another airline. First, as set out in paragraphs 4.21 and 4.22, Ryanair's ability to block a special resolution means that it could prevent a merger between Aer Lingus and another airline via a scheme of arrangement<sup>63</sup> or under the Cross Border Merger Regulations.<sup>64</sup> Ryanair can also prevent Aer Lingus from issuing new shares to a strategic partner via a private placement, which restricts Aer Lingus's ability to secure a strategic investor other than through a market purchase of shares. Second, Ryanair could hamper Aer Lingus's ability to issue shares for cash in order to raise the capital needed to acquire or merge with another airline, by defeating the special resolution required to disapply pre-emption rights. This is discussed in more detail in paragraphs 7.65 to 7.72. Third, if Ryanair were able to command a majority in an Aer Lingus general meeting (see paragraphs 7.85 to 7.91) it would be able to block a class 1 transaction (see Appendix C). This would be relevant in a joint venture (for example, a new company is created in which Aer Lingus and a partner own shares) or acquisition discussions where the value of the assets to be acquired by Aer Lingus exceeded the relevant thresholds.<sup>65</sup>

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<sup>63</sup> A takeover or merger involving an Irish public company may be implemented using the scheme of arrangement procedure under section 201 of the Irish Companies Act 1963. This mechanism allows the buyer to save 1 per cent stamp duty on the offer price, and also provides greater certainty on the timing of the change of control to the extent that the buyer will know that 100 per cent control can be obtained within two days of the court approval. However, this type of scheme of arrangement requires 75 per cent approval of shareholders in a general meeting and thus could be blocked by Ryanair acting alone.

<sup>64</sup> The cross-border merger mechanism in the European Communities (Cross-Border Mergers) Regulations 2008 can also be used for mergers between companies which are incorporated in the EC. For instance, Iberia and British Airways used the equivalent regulations in Spain and the UK to merge. As with schemes of arrangement, merging via this route allows the buyer to save 1 per cent stamp duty on the offer price as well as achieve 100 per cent control within two days of the court approval. However, this merger mechanism also requires approval by special resolution of the shareholders and thus, in the case of Aer Lingus, could be blocked by Ryanair.

<sup>65</sup> For example (assuming a share price range of €1.10 to €1.40 per share), any transaction valued at €150–190 million or greater would be a class 1 transaction under the Consideration Test.

7.24 We did not consider that Ryanair's shareholding would influence Aer Lingus's ability to enter into less significant forms of cooperation such as codeshares, franchise agreements and alliances. We noted that Aer Lingus has been able to enter into a number of such agreements in the period since the transaction took place (see paragraph 2.15).

*Consolidation in the airline industry*

7.25 We considered whether there was a trend of consolidation among airlines.

7.26 Ryanair highlighted the trend in consolidation in the airline sector in its offer for the outstanding shares in Aer Lingus in June 2012, saying that Europe's flag carriers were inexorably consolidating into five large scheduled airline groups led by Air France, British Airways, easyJet, Lufthansa and Ryanair.<sup>66</sup> Aer Lingus told us that in the near to medium term there was likely to be a continuing pattern of significant consolidation in the airline industry.

7.27 The general trend of consolidation in the industry was also recognized in our discussions with other airlines, with the desire for revenue and cost synergies, as well as the financial pressures on certain airlines identified among the potential drivers of this trend. We were told by several airlines that consolidation in the European airline sector was part of a worldwide trend of consolidation that would continue in the future, with the US airline industry in particular exhibiting a significant amount of merger and acquisition activity over the previous decade.

7.28 We identified a number of examples of European airline M&A in recent years, including the following:

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<sup>66</sup> [www.ryanair.com/doc/news/2012/aerlingus\\_20120619.pdf](http://www.ryanair.com/doc/news/2012/aerlingus_20120619.pdf).



- (a) mergers of large flag-carrier airlines with global networks in Europe, including BA/Iberia in 2009 and KLM/Air France in 2004. Potential cost savings and revenue synergies from expanded global networks were a key element of the rationale for both;
- (b) regional consolidation due to financial pressures on the target company, including Lufthansa/Swiss in 2005, and bmi which was acquired by Lufthansa in 2008 and subsequently by IAG in 2012. Cost synergies represented a central plank of the IAG/bmi merger rationale;
- (c) regional consolidation driven by the target company's access to attractive routes, passenger flows or capacity-constrained airports, including Lufthansa/Austrian airlines in 2008, Vueling/Clickair in 2008, and the joint venture between Delta and Virgin Atlantic in 2012; and
- (d) minority shareholding investments by Middle-East airlines: for example, Etihad purchase of 29 per cent of Air Berlin via a capital increase, and Etihad's acquisition of nearly 3 per cent of Aer Lingus via stock market share purchases.

7.29 We found that there was a pattern of consolidation in the airline industry, for which a primary driving force was the need to exploit economies of scale and contain or reduce the costs per passenger (see paragraphs 7.50 to 7.61). We formed the view that this trend of consolidation of European airlines was likely to continue in the future.

*Views of airlines on the likelihood of a combination involving Aer Lingus*

7.30 We considered the views of Aer Lingus, Ryanair and other airlines on the likelihood of Aer Lingus being involved in a combination absent Ryanair's minority shareholding. Further details of their views are provided in Appendix F.

- 7.31 Aer Lingus said that it had been and remained interested in attracting investment, and that its management had identified a need for growth and was actively considering both inorganic and organic options for expansion. Aer Lingus told us that it was constrained by the size of its home market; however, it needed to grow in order to achieve greater scale to avoid the company's cost competitiveness eroding over time. It also said that the financial markets held the view that Aer Lingus's consolidation was necessary.
- 7.32 Aer Lingus also said that it did not have a weak balance sheet and so was not in the situation of many European carriers looking to consolidate, and that its financial strength could guarantee its independence for a long period of time. It said that rather than being acquired, it might look to acquire another airline.
- 7.33 Ryanair told us that Aer Lingus had no future as an independent airline because of its small scale, its peripheral location and its repeated failure to expand outside of Ireland. It said that Aer Lingus would not be around as an independent airline in five years' time because its cash pile would continue to dwindle, although the time period could be shorter or longer, depending on how the airline dealt with issues such as the pensions deficit and its high overheads. It told us that nobody believed that there was a bright future for peripheral sub-scale carriers in Europe.
- 7.34 Ryanair said that the only long-term future for Aer Lingus was as part of a bigger, stronger Irish airline together with Ryanair. It said that although Aer Lingus had shopped itself around, it had been unsuccessful in finding a partner because no other airlines were interested in Aer Lingus. It told us that easyJet, Air France, British Airways and Lufthansa had all said in the last five years that they were not interested in acquiring Aer Lingus. Although five years ago they were engaged in pan-European consolidation, they now had much greater global issues to deal with and would not

be concerned with a small peripheral Irish airline. Any potential bidder would be more concerned by Aer Lingus's heavy focus on Ireland, limited growth prospects and the deficit in Aer Lingus's pensions fund than by Ryanair's presence on the share register. Ryanair also pointed out that it had received no offers for its shareholding from any airline.

7.35 Third parties identified a number of features which could make Aer Lingus an attractive partner for a combination, including its strong financial position, its brand, its portfolio of Heathrow slots and its position in the Irish market. Like Ryanair, however, third parties also identified a number of factors that could limit Aer Lingus's attractiveness, including the pension deficit, the relatively limited scale of Aer Lingus's long-haul operations and the size of the Irish market. However, we took the view that these would be likely to be factors affecting the price which an acquirer would be willing to pay for Aer Lingus, rather than presenting an absolute deterrent to choosing Aer Lingus as a partner. We also noted that these factors had not dissuaded Ryanair from seeking to acquire the company.

7.36 Several parties told us that, in the short term, a transaction involving Aer Lingus and one of the three large European carriers (IAG, Air France/KLM and Lufthansa) was relatively unlikely, as they were occupied with recent acquisitions. [REDACTED]

7.37 Nevertheless, we considered that while the large European carriers were currently occupied with recent acquisitions and may not be interested in an acquisition at present, this may not have always been the case since 2006 and would not always be the case in the future. Although, as far as we are aware, [REDACTED], one potential reason for this was the existence of Ryanair's minority shareholding.

*Aer Lingus internal documents discussing combinations*

7.38 We considered Aer Lingus internal documents discussing combinations with other airlines.

7.39 We saw a number of Aer Lingus strategy presentations [REDACTED].

7.40 In 2010 [REDACTED] presented an M&A Opportunity Assessment to Aer Lingus. This report identified a total universe of 116 merger partners for Aer Lingus and presented the results of a systematic screening exercise. It identified a shortlist of [REDACTED] potential partners and identified [REDACTED] best-fit merger partners for Aer Lingus. We note that since this report was prepared the trend of airline mergers has continued, and specific options available to Aer Lingus at the time of the report are no longer possible. [REDACTED]

7.41 [REDACTED]

*Discussions between Aer Lingus and other airlines in the period since 2006*

7.42 We considered evidence of discussions between Aer Lingus and other airlines that had taken place since 2006. Further details of these discussions are provided in Appendix F.

7.43 Aer Lingus told us that it had had informal, exploratory contacts with a number of unnamed potential investors or partners in the period since 2006, and that it had emerged clearly in these contacts that Ryanair was seen as a major deterrent to investment in Aer Lingus.

7.44 Aer Lingus described a possible combination between Aer Lingus and [REDACTED] that had been considered in early 2012. The transaction was ultimately abandoned as a result of Ryanair's third bid for the outstanding shares in Aer Lingus. [REDACTED] told us that the

shareholding of Ryanair in Aer Lingus was a [redacted] consideration when considering what could be achieved as a result of these discussions with Aer Lingus: it was clear that any proposal that Aer Lingus and [redacted] developed would need to be acceptable to Ryanair.

- 7.45 Aer Lingus also told us that it had had discussions with [redacted] about the possibility of Aer Lingus acquiring [redacted] with [redacted] about the possibility of [redacted] and with [redacted] about the possibility of acquiring its [redacted].

*Other factors affecting the likelihood of Aer Lingus being involved in a combination*

- 7.46 We also considered whether there were any other factors which might affect the likelihood of Aer Lingus being involved in a combination absent Ryanair's minority shareholding.
- 7.47 The Irish Government has announced its intention to sell its shares in Aer Lingus, although it said that the disposal of its shares would only take place at the right time, under the right conditions and at the right price (see Appendix C). We considered that the sale of the Irish Government's shareholding would increase the likelihood of Aer Lingus being involved in a combination with another airline absent Ryanair's minority shareholding, given the possibility that the shareholding could be acquired by another airline.
- 7.48 We also identified two external restrictions which could affect the likelihood of Aer Lingus being involved in a combination with another airline. First, EU ownership rules prevent non-EU airlines from taking a controlling shareholding in EU airlines, and so may narrow the range of combinations that could be possible between Aer Lingus

and a non-EU airline to a merger or joint venture, rather than a full acquisition.<sup>67</sup> In addition, any combination would be subject to standard merger control considerations.<sup>68</sup>

*Impact of a combination on Aer Lingus's effectiveness as a competitor*

7.49 We considered whether a combination between Aer Lingus and another airline would be expected to make Aer Lingus a more effective competitor to Ryanair on routes between Great Britain and Ireland.

7.50 Both Ryanair and Aer Lingus referred to the importance of scale to airlines in order to keep costs down. Aer Lingus told us that in the absence of an ability to build scale, it will face an inevitable 'cost creep' over time, eroding its competitiveness. In particular, it said that even if its factor costs (for example, wages) remained constant, it would expect its unit costs to increase over time as a result, for example, of increases in airport charges. This created a need for growth (eg by sharing overheads over larger volumes), in order to reduce costs and remain competitive. An internal presentation prepared for Aer Lingus's board on the company's five-year plan identified [REDACTED].

7.51 We recognized that combinations between airlines could lead to both revenue and cost synergies.

7.52 On the revenue side, synergies would be primarily in terms of the benefits associated with larger complementary networks. We were told that some of the revenue

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<sup>67</sup> Under European Law (Article 4(f), Regulation (EC) No 1008/2008 of 24 September 2008), non-European shareholders are currently not permitted to own more than 49 per cent of a European airline. We do not expect this to change in the foreseeable future. The European Commission has agreed bilateral arrangements with countries outside the European Union, which apply to all EU-listed airlines.

<sup>68</sup> Since 2004, the European Commission has examined 15 mergers and several alliances in the air transport sector. The recent prohibition of Ryanair's bid for the outstanding shares in Aer Lingus is the third prohibition decision (the previous prohibition decisions being the prohibition of Ryanair's first bid for Aer Lingus in 2007, and the prohibition of the acquisition by Olympic Air of Aegean Airlines in 2011). All the prohibition decisions were related to transactions involving two airlines having large bases at the same 'home' airport.

synergies associated with combinations between airlines could be achieved via lighter forms of cooperation such as code-shares or bilateral alliances, with the extent of the synergies depending on the depth of cooperation.

- 7.53 Aer Lingus told us that greater revenue synergies would be associated with a full combination rather than looser types of cooperation. Synergies of this type could increase its effectiveness as a competitor by potentially enabling it to sell more connecting itineraries, which would in turn increase traffic, enabling it to offer an enhanced frequency and/or the operation of larger aircraft (with associated lower costs per seat).
- 7.54 In our discussions with airlines we identified a number of possible cost synergies associated with combinations between airlines, including:
- (a) increased bargaining power in procurement, for example with regards to aircraft, ground handling, airport charges, fuel and catering contracts;
  - (b) elimination of duplication in both back office functions (eg finance, legal, HR, IT, sales and marketing) and at airports (eg check-in staff, ground handlers);
  - (c) consolidation of maintenance and training programmes and IT systems; and
  - (d) diversification of operations, and sharing of successful models/expertise within a single organization.
- 7.55 Several airlines gave us examples of cost synergies that had arisen in the context of transactions that they had previously been involved in. For example, IAG gave some examples of the economies of scale associated with the merger between BA and Iberia, and said that the acquisition of bmi had allowed very material cost savings. Flybe referred to its acquisition of BA Connect, which had allowed it to reduce staff costs and duplication of maintenance, repair and overhaul facilities. Lufthansa said

that it had experienced [REDACTED] in recent acquisitions in which it had been involved (see Appendix F).

7.56 [REDACTED] Aer Lingus told us that the [REDACTED] transaction could have led to considerable cost savings (in addition to synergies in the areas of [REDACTED]) in a short timeframe. [REDACTED] It told us that the synergies associated with the [REDACTED] transaction would have enabled the combined entity to compete more effectively in existing markets, as well as potentially providing a platform for entrance into new markets and routes.

7.57 The 2010 M&A Opportunity Assessment prepared for Aer Lingus by [REDACTED] evaluated the potential synergies associated with potential merger partners. It estimated indicative revenue and cost synergies in the context of a merger with full integration and a merger in which two brands were retained. Based on the two-brand scenario, the range of annual cost synergies was €[tens of millions] for the various merger scenarios. These cost synergy estimates assumed savings would be achieved in relation to overheads, sales and marketing, maintenance, sourcing, station expenses and fleet optimization. In addition, estimated annual revenue synergies were €[tens of millions].

7.58 In its submission to the European Commission on the possible customer benefits of its bid for the outstanding shares in Aer Lingus, Ryanair argued that the acquisition of Aer Lingus would generate substantial cost savings, a significant proportion of which would be derived from economies of scale. Ryanair expected to generate synergies and savings in most cost categories, in particular staff costs, turnaround times, aircraft costs, fuel costs, maintenance costs, airport and handling costs, and distribution and other costs. Overall, Ryanair would reduce Aer Lingus's annual cost base (excluding fuel) by at least [REDACTED] per cent or approximately €[tens of millions].



- 7.59 Ryanair told us that the discount it received in its most recent aircraft order would be a multiple of anything that Aer Lingus would have negotiated. However, Ryanair said that no other party would be able to reduce Aer Lingus's costs per passenger from its current €[REDACTED] to anywhere close to its own costs per passenger of €[REDACTED].<sup>69,70</sup>
- 7.60 Ryanair told us that the bulk of the cost savings and flexibility advantages of combinations could be achieved through partnerships such as minority investments, franchises, codeshares and bilateral alliances. It gave the example of Aer Lingus's direct involvement in the acquisition of aircraft for Aer Arann, which it said was intended to allow access to lower-cost aircraft and financing. However, most of the airlines that we talked to told us that cost synergies would primarily be restricted to fuller combinations such as mergers, because they generally required a greater level of integration between the parties' operations.
- 7.61 We reviewed Aer Lingus's cost structure (see Appendix F). We thought that, given its cost structure, there seemed to be scope for cost synergies to arise from a combination with another airline. We considered an illustrative range of potential cost synergies that might be associated with a combination, [REDACTED] and found these to be significant.

*Provisional conclusion on the impact of Ryanair's minority shareholding on Aer Lingus's ability to combine with another airline*

- 7.62 We provisionally found that Ryanair would be able to impede another airline from acquiring full control of Aer Lingus, and its shareholding would be likely to be a significant impediment to Aer Lingus's ability to merge with or acquire another airline.

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<sup>69</sup> We note, however, the difference in business model between Aer Lingus and Ryanair.

<sup>70</sup> We note that the European Commission concluded in its decision on Ryanair's third bid that Ryanair had not provided sufficient evidence to demonstrate that any efficiency claims would materialize and counteract the competitive harm likely to arise from the transaction. We noted, however, that unlike in the transaction being considered by the European Commission, in the event of a combination between Aer Lingus and another airline, Ryanair would remain as a strong competitive constraint on Aer Lingus.

In addition, we found that Ryanair's shareholding could make it more difficult for Aer Lingus to attract an investor seeking to build a strategic minority shareholding in Aer Lingus.

7.63 Furthermore, we provisionally found that, in the absence of Ryanair's minority shareholding, it was likely that Aer Lingus would have been involved in the period since 2006, or would be involved in the foreseeable future, in an acquisition, merger or joint venture. In reaching this conclusion, we took into account the general trend of consolidation in the airline industry and the need to exploit economies of scale and maintain or reduce costs per passenger; Ryanair's view that Aer Lingus would be unlikely to have an independent long-term future; Aer Lingus's view of the importance of scale to its future competitiveness; the discussions between Aer Lingus and other airlines since 2006; several favourable characteristics of Aer Lingus as an acquisition target; and the Irish Government's stated intention to sell its shares in Aer Lingus at the right time and at the right price.

7.64 The scale of any efficiencies—in particular economies of scale—arising from a combination would depend very heavily on the identity of the acquirer and the specific nature of the transaction being contemplated. Nevertheless, we provisionally found that synergies would be likely to arise from a combination between Aer Lingus and another airline that would not arise from looser forms of cooperation between Aer Lingus and other airlines. This would be likely to make Aer Lingus a more effective competitor with Ryanair on routes between Great Britain and Ireland than it would otherwise be.

*Aer Lingus's ability to issue shares in order to raise capital*

- 7.65 A second way in which Ryanair might use its shareholding to reduce the effectiveness of Aer Lingus as a competitor might be by hampering its ability to raise capital by issuing shares. This mechanism is discussed in more detail in Appendix G.
- 7.66 As set out in paragraphs 4.18 and 4.19, Ryanair has blocked the special resolution required to permit the disapplication of pre-emption rights at each AGM between 2007 and 2013. We note that there have been no instances since 2006 where Aer Lingus had sought to carry out a rights issue in order to raise capital, but had been unable to proceed due to Ryanair's actions. We considered the likelihood of this occurring in the future.
- 7.67 We found that Aer Lingus has limited capacity to increase its current level of debt and the company's management had a clear preference to use equity rather than debt capital. Aer Lingus told us that its headroom for incremental debt was [redacted] and Aer Lingus operated in a commercial environment which was subject to significant volatility and risk of impacts by one-off events beyond the control of management.
- 7.68 We considered whether Aer Lingus could use alternative methods to raise new equity capital without needing to pass a special resolution. We noted that Aer Lingus had strong reasons to seek to avoid the additional expense and time needed to undertake a rights issue with full pre-emption rights available to all shareholders around the world and that this would not represent its preferred approach to capital raising. However, we also noted that Aer Lingus may be able to address Ryanair's particular concerns about the risk of a dilution of its shareholding relative to other shareholders, by proposing an alternative special resolution to shareholders that would allow shareholders to approve a rights issue with pre-emption rights available to shareholders in Ireland but not necessarily in overseas jurisdictions where this was

impractical. Ryanair has signalled that it would support a resolution on these terms (see Appendix G).

- 7.69 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 to finance its current operations or its existing plans for a major aircraft replacement programme in the medium to long term.<sup>71</sup> Even after the forecast [~~€~~] in cash balance over the forecast period by €[~~€~~], Aer Lingus would retain a strong balance sheet.
- 7.70 We identified circumstances in which Aer Lingus might need to raise additional equity. We noted that historically Aer Lingus had experienced volatility in its earnings and had experienced periods of restructuring charges, losses and operating cash outflows (for example, in 2008/09 as a result of economic downturn and 2001/02 following the 9/11 terrorist incident in New York) and that macro-economic conditions could result in earnings volatility for airlines generally. We thought it possible that there would be a future downturn in the economy as a whole or in the airline industry more specifically, or a specific adverse development for Aer Lingus (such as a court imposed obligation to make a major contribution to the Aer Lingus pension funds).
- 7.71 Most significantly, however, as discussed in paragraph 7.63, we found it likely that, absent Ryanair's shareholding, Aer Lingus would have been, or would be in the future, involved in a large-scale combination with another airline. If Aer Lingus were making a significant acquisition, or a significant strategic investment, we thought it likely that, in order to fund the transaction, Aer Lingus would need to issue shares for cash.

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<sup>71</sup> We note that a major aircraft replacement programme was approved by shareholders via an ordinary resolution at the 2008 EGM (with a 64 per cent vote in favour).

7.72 We provisionally found that Aer Lingus may need to raise new capital in future. 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 its ability to do so could cause Aer Lingus to become a less effective competitor on routes between Great Britain and Ireland than it would otherwise be.

*Aer Lingus's ability to manage its portfolio of Heathrow slots*

7.73 A third way in which Ryanair might use its shareholding to reduce Aer Lingus's effectiveness as a competitor might be by using its voting rights to oppose transactions involving the sale or lease of slots at London Heathrow.

7.74 Aer Lingus said that its Heathrow slot portfolio was a major asset, and likely to be worth in excess of €250 million.<sup>72</sup> It said that there were two ways in which it could use its slot portfolio to finance its commercial strategy. First, excess slots could be traded or exchanged with another airline for slots at other airports where Aer Lingus sought to expand its operations. Second, Aer Lingus may be able to obtain debt secured against these slots at a lower cost than unsecured debt.

7.75 As set out in paragraphs 4.35 to 4.39, Aer Lingus's Articles of Association give Ryanair, with its current shareholding, the ability to request an EGM and vote against a proposed disposal of its Heathrow slots. Ryanair would be highly likely to be able to block such a vote.

7.76 Aer Lingus said that it had limited flexibility on slot trades. In addition to a pre-existing slot arrangement with British Airways, Article 10 of its Articles of Association allows Aer Lingus to lease a slot (or pair of slots) for up to 36 months without having to

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<sup>72</sup> Equity analyst reports support Aer Lingus's valuation of its slot portfolio. For example, a report from Goodbody Stockbrokers dated 15 March 2013 says: 'While it is difficult to value these slots with a great degree of accuracy, recent transactions that we are aware of imply that the portfolio could be worth between €200–€300m at an average of €9–10m per slot.'

inform its shareholders and obtain shareholder approval. Only one such short-term lease can be in effect at any one time and a renewal of a short-term lease (ie beyond 36 months) will also trigger the approval mechanism set out in Article 10.

7.77 Aer Lingus told us of two examples where Ryanair had influenced or been in a position to influence its commercial strategy as a result of its voting rights over Heathrow slot disposals:

(a) Aer Lingus said that in 2009 it had been interested in acquiring [redacted] slots [redacted] and had entered into negotiations with [another airline] to explore whether it could exchange Heathrow slots [redacted]. However, Aer Lingus told us that [the other airline] expressed concern when it was made aware that the deal could be brought to an EGM where it would be exposed to Ryanair's veto, and the particular proposal regarding the exchange of Heathrow slots did not ultimately proceed. [redacted]

(b) Aer Lingus said that in 2013 it was seeking to enter into another agreement with British Airways involving the disposal of Heathrow slots which had triggered the disposal provisions in its Articles of Association. In April 2013, Aer Lingus notified the Irish Government and Ryanair of the proposed slot transaction. Aer Lingus said that such a transaction would clearly be in the commercial interests of the company as it would otherwise result in the loss of a valuable slot for no consideration. It said that the transaction would facilitate the early return (from summer 2014) of another slot pair currently on lease to British Airways, thereby enabling Aer Lingus to increase the frequency of its Heathrow services. It told us that the transaction had been significantly delayed by the uncertainty caused by Ryanair's bid, and by whether Ryanair would oppose it. We note that Ryanair has subsequently informed Aer Lingus that it would not be exercising its right to call an EGM on the matter.

- 7.78 Airport Co-ordination Limited said that the general direction of slot trading at Heathrow was from short-haul to long-haul routes, since long-haul operators could afford to purchase slots outright.
- 7.79 Ryanair told us that rather than disposing of its Heathrow slots, Aer Lingus had recently sought to acquire a significant portfolio of additional slots at Heathrow (from the IAG/bmi remedy) and was therefore extremely unlikely to seek to dispose of its existing Heathrow slots which it values commercially. We did not agree with Ryanair's view. The utility of one slot will differ to that of another, and Aer Lingus may seek to acquire some slots at Heathrow while disposing of others in the context of managing its overall slot portfolio. Moreover, even if Aer Lingus's current strategy were one of increasing its slot portfolio at Heathrow, its position may well change over time—as was the case in 2009, when Aer Lingus was considering disposing of Heathrow slots [redacted].
- 7.80 The Irish Government told us that it had retained a significant minority shareholding in Aer Lingus in part to ensure access to Heathrow for onward connectivity. Similarly, the Aer Lingus IPO Prospectus makes clear that the Irish Government regards Aer Lingus's continued access to its slots at London Heathrow airport as being of strategic interest to Ireland. Given this, we thought it possible that Heathrow slot disposals proposed by Aer Lingus might be opposed by the Irish Government, irrespective of Ryanair's minority shareholding. If this were the case, the potential incremental effect of Ryanair's minority shareholding would be limited only to instances where the Irish Government consented to Aer Lingus disposing of Heathrow slots.
- 7.81 We thought that, in general, given the strategic importance that it attaches to them, the Irish Government would be unlikely to support a large-scale sale of Heathrow

slots in order to raise cash. We thought that the Irish Government might support a disposal in the context of an exchange that allowed Aer Lingus better to meet the Irish Government's transport objectives. In the context of the discussions between Aer Lingus and [another airline] of a proposed exchange of Heathrow slots [✂] in 2009 (see paragraph 7.77), Aer Lingus told us that the Irish Government would not have insisted on an EGM regarding the proposal as it would not have given rise to a reduction in services or impacted on connectivity via Heathrow. Finally, we considered that consent was much more likely to be forthcoming if Aer Lingus was simply seeking to optimize its slot portfolio at Heathrow, without significantly lessening its presence at the airport.

- 7.82 As discussed in paragraphs 4.26, the Irish Government has announced its intention to sell its shareholding in Aer Lingus at the right time and at the right price, and we considered that the likelihood of it disposing of its shareholding would be higher absent Ryanair's minority shareholding. An alternative independent shareholder would be likely to support a Heathrow slot disposal proposed by management, so long as this were considered to be in the interests of the company.
- 7.83 The potential constraint on Aer Lingus's ability to dispose of its slots could reduce its effectiveness as a competitor by limiting its strategic options, particularly if Ryanair's influence prevented Aer Lingus from trading its slots in order to optimize its network. We were less persuaded that there would be an effect if Ryanair were able to restrict Aer Lingus's ability to dispose of slots in order to unlock their value given Aer Lingus's current share register, since as long as the Irish Government remained a minority shareholder Aer Lingus's ability to do this was likely to be restricted in any event. Although the scale of any impact would depend on the specific transaction being considered, this could serve to increase Aer Lingus's costs and restrict its



flexibility with regard to its network, causing it to be a less effective competitor on routes between Great Britain and Ireland than it would otherwise be.

7.84 We provisionally found that:

- (a) 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;
- (b) Aer Lingus would have been likely, or would be likely to want to manage its portfolio of Heathrow slots in the context of optimizing its network and that this would be likely to involve the sale or lease of slots; and
- (c) any constraint on Aer Lingus's ability to dispose of its slots could reduce its effectiveness as a competitor by limiting its strategic options.

*Aer Lingus's ability to pass or defeat an ordinary resolution*

7.85 Another way in which Ryanair might use its shareholding to reduce the effectiveness of Aer Lingus as a competitor might be by using its voting rights to oppose Aer Lingus's management in a shareholder vote.

7.86 We considered Ryanair's ability to pass or defeat an ordinary resolution in Section 4 and Appendix C. We found that, if the Irish Government retains and votes its shares, it is unlikely that Ryanair alone will be able to secure a majority in opposition to the Irish Government. We also found that, although Ryanair has historically lacked the support of other shareholders on resolutions at shareholder meetings, if it were able to mobilize the support of other shareholders, it would be possible for Ryanair to achieve a majority in opposition to the Irish Government.

7.87 We identified several examples of issues that could be particularly contentious and where other shareholders (eg those with an 'activist' stance) would be more likely to oppose Aer Lingus's management in a shareholder vote—board nominations, a

payment to Aer Lingus's pensions scheme, major investments (eg class 1 transactions) and/or a request that the company increases or accelerates the distribution of cash to shareholders, for example through higher dividends and disposal of Heathrow slots and other assets (see Appendix C).

7.88 Ryanair told us that if a sufficient number of shareholders feel strongly about a measure proposed by the Aer Lingus Board in the future and they wish to oppose it, this would be entirely due to the content of the proposal, rather than due to Ryanair's shareholding. Nevertheless, we considered that although a resolution might be defeated by other shareholders even absent Ryanair's shareholding, Ryanair would have a significant additional incentive relative to other shareholders to vote on a contentious resolution in a way that adversely affected the company's effectiveness as a competitor. For example, Ryanair might oppose a Board proposal to make a significant capital investment or an investment in another airline (requiring a shareholder vote as a class 1 transaction). In the past, Ryanair has opposed a resolution to purchase a number of long-haul Airbus aircraft, but said that it did so on the grounds that the aircraft were being purchased at the top of the cycle and Aer Lingus was paying too much for them.

7.89 If the Irish Government were to abstain from a vote and turnout was at the average level, Ryanair could secure a majority on its own. The Irish Government said that it was unlikely to sell its shares in Aer Lingus while Ryanair continues to be a significant minority shareholder and in the event that it did, it would prefer to sell its shareholding to a group that would drive effective competition on routes between the UK and Ireland. However, in the event that, in future, it chose to sell and its shares were dispersed, Ryanair could become the largest shareholder by a considerable margin, and might be able to carry a majority in matters requiring an ordinary resolution.

- 7.90 An absention might occur in the event of a shareholder vote on a related party transaction or if the Irish Government was unwilling to take a position for political reasons. However, we were aware that the Irish Government had not abstained in any votes in the past, and it told us that it would expect to take an active role at shareholder meetings. It said that it would not necessarily preclude voting on potentially sensitive political issues, for example Aer Lingus's pensions situation or the appointment of a Ryanair board member.
- 7.91 If Ryanair were to achieve a majority in the future, there could be very significant implications for Aer Lingus because of the importance of company decisions put to a shareholder vote (for example, it could allow Ryanair to prevent Aer Lingus from making a payment to the pension scheme, remove or prevent the reappointment of board members, or block a major transaction (for example, acquisition of a company or aircraft fleet)).
- 7.92 We provisionally found that:
- (a) It would be relatively unlikely for Ryanair to pass or defeat an ordinary resolution at an Aer Lingus general meeting. However, this could occur if other shareholders 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.
  - (b) 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.

*Aer Lingus's management resources and strategy*

- 7.93 Another way in which Ryanair might use its shareholding to reduce the effectiveness of Aer Lingus as a competitor might be by taking actions to raise Aer Lingus's

management costs or impede its management from concentrating on Aer Lingus's commercial strategy.

7.94 As set out in Appendix C, Aer Lingus identified a number of ways in which it said Ryanair had sought to use its position as a shareholder to challenge Aer Lingus's management, including making complaints to regulators, initiating judicial review proceedings, seeking undertakings or commercially sensitive information and significant lobbying campaigns.

7.95 In addition, Aer Lingus said that the various takeover bids which Ryanair had mounted since Aer Lingus's IPO had impacted on Aer Lingus's management. It noted that it had been placed in an offer period for 25 per cent of its time as a publicly listed company. It said that in addition to the enormous costs and drain on resources resulting from the bids, the obligations placed on Aer Lingus during the bid periods imposed a very significant burden and restricted its commercial freedom.<sup>73</sup>

7.96 Specifically, it said that during the offer periods, Aer Lingus had to abide by restrictions on its activities as set out in the Irish Takeover Panel Rules. It said that this could cause Aer Lingus to avoid certain commercial decisions so as to avoid the time and cost of liaising with the Panel and the risk that onward communication of its intentions by the Panel to Ryanair could damage its commercial interests. It referred in particular to Rule 21, which requires the target company to obtain prior approval of its shareholders before entering into any contract other than in the ordinary course of business, and any action which may result in frustration of the offer. In the context of the most recent bid, Aer Lingus said that it had decided not to pursue, or at least to postpone, certain actions because the Panel would have been likely to consult with Ryanair which might have led to a shareholder vote (for example, implementing a

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<sup>73</sup> Aer Lingus initial submission, paragraph 140. See [www.competition-commission.org.uk/our-work/directory-of-all-inquiries/ryanair-aer-lingus/evidence](http://www.competition-commission.org.uk/our-work/directory-of-all-inquiries/ryanair-aer-lingus/evidence).

long-term retention incentive for the CEO, entering into a slot disposal transaction with British Airways).

7.97 Aer Lingus told us that the professional fees and costs associated with defending the three Ryanair bids were in excess of €40 million. It also said that Ryanair's second bid for Aer Lingus had delayed it from making necessary changes to its operations to react to the economic crisis, and estimated that this had cost the company at least €[X]. It also referred to the diversion of management time in board meetings, and said that although the company aimed to hold six or seven board meetings a year, it had held 15 Board meetings and 7 Defence Committee meetings in the previous year.

7.98 Aer Lingus told us that the minority shareholding makes further Ryanair bids more likely for four reasons:

- (a) first, it guarantees that Ryanair would not face competition on any bid that it makes—there is no risk of a bidding war;
- (b) second, it prevents Aer Lingus from engaging in M&A activity that would have the effect of reducing or eliminating Ryanair's ability to bid for or effect a full takeover of Aer Lingus;
- (c) third, further bids become necessary to justify the initial investment to Ryanair shareholders; and
- (d) fourth, the minority shareholding makes future bids less expensive for Ryanair.

7.99 We did not consider that Ryanair's minority shareholding was required for it to lobby against the decisions of Aer Lingus (see paragraph 7.94).

7.100 We note that Ryanair's minority shareholding allows it to request information, call EGMs or propose resolutions at AGMs. We reached the provisional view that the

requesting of information would not affect Aer Lingus's effectiveness as a competitor. Nor did we expect that requesting EGMs or seeking to propose resolutions at an AGM by Ryanair would materially affect Aer Lingus's effectiveness as a competitor. While we recognized that additional management resources would be required to respond to the various challenges made by Ryanair, we did not consider that Ryanair's minority shareholding would have a material impact on Aer Lingus's effectiveness in this way.

7.101 We did, however, recognize that the minority shareholding would increase the likelihood of further bids by Ryanair relative to a situation in which Ryanair had not owned the shares. With a 29.82 per cent shareholding it would have a smaller absolute number of shares to acquire and there would be a reduced likelihood of a counterbidder. Full bids were more likely to have led in the past, or to lead in the future, to a significant disruption to Aer Lingus's commercial strategy.

7.102 We provisionally found that:

- (a) Ryanair's minority shareholding was not required for it to lobby against Aer Lingus's decisions;
- (b) Ryanair's requesting of information as a minority shareholder would not 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; and
- (c) 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.

*The impact on the incentives of Aer Lingus's management*

- 7.103 In theory, the transaction might also affect Aer Lingus's effectiveness as a competitor if Ryanair's shareholding were to change the incentives of Aer Lingus's management, such that they decided that the interests of Aer Lingus were better served by competing less fiercely with Ryanair.
- 7.104 We note that there is no financial incentive for Aer Lingus management to take the impact of its actions on Ryanair—its largest shareholder—into account in setting its own offering. In normal circumstances, we would expect a company to be mindful of the views of its major shareholders. Aer Lingus said that Ryanair's presence might deter Aer Lingus's management from taking actions that may antagonize its largest shareholder, because of the costs of personal attacks ([§]), increased workload, stress and uncertainty. There was a tension between the company's natural tendency to listen to its shareholders, and the fact that Aer Lingus and Ryanair are close competitors.
- 7.105 We note the often acrimonious relationship between the management of Aer Lingus and Ryanair, as evidenced by correspondence between the two airlines. We were also conscious that Ryanair does not have any board representation. Aer Lingus told us that it had not tempered how fiercely it competed with Ryanair in the period since 2006. We formed the view that the current Aer Lingus management was unlikely to compete less aggressively with Ryanair because of Ryanair's position as its largest shareholder.
- 7.106 We considered whether this was likely to continue to be the case if Ryanair were to retain its shareholding in the future. The composition of management could change over time. Aer Lingus told us that if it must face a future of coexistence with Ryanair, accommodating behaviour by Aer Lingus could become an issue of greater concern.

We note that, in any case, Aer Lingus's management would have a duty to further the interests of the company as a whole, rather than those of any particular shareholder.

7.107 We provisionally conclude that Aer Lingus does not compete less fiercely with Ryanair in order to avoid antagonizing its largest shareholder and was unlikely to do so in the future, as Aer Lingus's management has a duty to the company as a whole, rather than the interests of any particular shareholder.

### *Ryanair's incentives*

7.108 We considered Ryanair's incentives to use its influence to weaken Aer Lingus's effectiveness as a competitor through the mechanisms set out above.

7.109 Ryanair told us that when it had opposed Aer Lingus's management, it had done so only to protect the value of its shareholding. On various occasions Ryanair has made public statements saying that it was willing to consider an offer for its shareholding,<sup>74</sup> and it has repeatedly stressed that it would support any Aer Lingus fundraising initiatives. Ryanair told us that there was no evidence that it would oppose the sale of additional Heathrow slots. It highlighted that it was willing to divest Aer Lingus's Heathrow slots as part of the commitments proposed to the European Commission and had not opposed Aer Lingus's most recent request to dispose of a slot (see paragraph 7.77(b)).

7.110 We would expect Ryanair's incentives with respect to its shareholding in Aer Lingus to depend on the specific actions being considered and the impact of the different alternatives on the ultimate profitability of Ryanair.

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<sup>74</sup> [www.ryanair.com/en/news/ryanair-statement-on-aer-lingus-2](http://www.ryanair.com/en/news/ryanair-statement-on-aer-lingus-2).



7.111 We noted that Ryanair has a financial interest in Aer Lingus as a result of its acquisition of the minority shareholding. We discuss the importance attached by Ryanair to the financial value of its shareholding in Aer Lingus in paragraphs 7.121 to 7.130. As discussed in those paragraphs, mechanisms exist by which we would expect Ryanair to benefit from Aer Lingus's financial success. However, given the context of the transaction as part of Ryanair's overall strategy of acquiring the entirety of Aer Lingus, it was not clear that Ryanair would have an interest in promoting Aer Lingus's financial success—and indeed its incentives might go in the opposite direction.

7.112 As set out in Section 5, we found that Ryanair and Aer Lingus impose a strong competitive constraint on each other, with each airline's actions having a significant impact on each other's offers. All else equal, the closeness of competition between the airlines indicates that Ryanair would be likely to benefit significantly from a weakening of Aer Lingus's effectiveness, and so would have an incentive to take actions that ultimately had this effect.

7.113 We considered the example of another airline trying to acquire Aer Lingus. In deciding whether to sell its shareholding, Ryanair would have an incentive (which would not exist for another shareholder which was not in competition with Aer Lingus) not to sell its shareholding (or to only sell at a significant premium, reducing the likelihood of a transaction taking place) to another airline which, in combining with Aer Lingus, would be expected to make it a more effective competitor to Ryanair. The value of the shareholding in Aer Lingus would be worth much more to Ryanair than it would be to a shareholder which was not in competition with Aer Lingus, because of the influence that it affords Ryanair over its closest competitor on routes from the Republic of Ireland.

7.114 We provisionally found that Ryanair would have an incentive to use its influence to weaken Aer Lingus's effectiveness as a competitor given the closeness of competition between them. This incentive would not exist for a shareholder which was not in competition with Aer Lingus.

*Provisional conclusion on Ryanair's influence over Aer Lingus's effectiveness as a competitor*

7.115 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, 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 on routes between Great Britain and Ireland than it would otherwise be.

(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 on routes between Great Britain and Ireland than it would otherwise be.

- (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 on routes between Great Britain and Ireland than it would otherwise be.
- (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.

7.116 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.

7.117 In the event that these mechanisms were realized, this could reduce the likelihood of Aer Lingus entering or expanding in competition against Ryanair, increase the likelihood of it withdrawing or reducing capacity or cause it to increase its fares on routes between Great Britain and Ireland, relative to the situation without Ryanair's minority shareholding.

#### *Ryanair's effectiveness as a competitor*

7.118 We next considered whether Ryanair's shareholding in Aer Lingus changes Ryanair's incentives with regard to its own commercial decisions, by linking its financial interests to those of Aer Lingus. This could occur if, as a result of its minority shareholding, Ryanair has an incentive to compete less fiercely with its rival because it shares in Aer Lingus's financial success.

7.119 In a standard assessment of the unilateral effects of a horizontal merger, two key factors drive the extent of any such change in incentives—the closeness of competition between the merging parties and their respective margins on the overlap products. As we discuss in Section 5, the two airlines compete very closely on a number of overlap routes, and given the scale of their variable margins, we would normally consider that the incentive for Ryanair to compete less strongly with Aer Lingus would be relatively strong (see Appendix I). However, this assumes that it takes into account the value of its shareholding in Aer Lingus when making decisions about its own commercial strategy.

7.120 Unlike in a standard merger, Ryanair only has a partial interest in Aer Lingus's profits and any increase in Aer Lingus's profits will only flow back to Ryanair indirectly and uncertainly. Furthermore, Ryanair's incentives might be affected by its expressed intention to acquire the entirety of Aer Lingus. We discuss these considerations in the remainder of this section.

7.121 We would expect Ryanair—as a partial owner of Aer Lingus—to have a financial interest in Aer Lingus's profitability. Ryanair will share in Aer Lingus's financial success through the value of its shareholding (realized on sale), or through any dividends paid by Aer Lingus.

7.122 As set out in paragraph 3.8, the cost to Ryanair of acquiring the 29.82 per cent shareholding in Aer Lingus was €407.2 million. We discuss the value of Ryanair's shareholding in detail in Appendix H. We find that the market value of Ryanair's shares in the period December 2012 to May 2013 was between €175 million and €223 million. Aer Lingus did not pay a dividend during its first five years as a listed company; it paid a dividend of €0.03 per share in July 2012 (worth €4.8 million to Ryanair), and a dividend of €0.04 has been approved in 2013 (with a value to

Ryanair of €6.3 million). Using the level of these payments as a guide to possible future dividends paid by Aer Lingus, we estimated the present value of the dividend stream to Ryanair to be in the range of €96 million to €159 million, which is lower than the market value because it does not reflect the potential for capital gains. The present value of Ryanair's share of the Aer Lingus future cash flow is substantially greater than the current market value, and exceeds the historical cost of the shares.

7.123 Ryanair said that it would not have an incentive to compete less strongly with Aer Lingus in order to avoid damaging its profitability because it lacks access to the information necessary in order to implement profitably a strategy of raising prices. First, it would not know Aer Lingus's profit margins on the overlap routes, and so would not know how to optimize its prices. If it were to raise prices by too much it would risk losing money. Second, it would have no control over Aer Lingus's dividend policy, and so Ryanair would not know whether any additional profits would be converted into dividends or used to compete more aggressively with Ryanair.<sup>75</sup> It said that there were too many factors affecting the value of Aer Lingus's shares to enable Ryanair to have any degree of control over it.

7.124 We considered that while the uncertainty and practical difficulties highlighted by Ryanair could reduce the incentive for Ryanair to compete less strongly with Aer Lingus, we did not find that these factors alone would eliminate its incentive to do so. Firms routinely operate in environments characterized by incomplete information,<sup>76</sup> and we considered that Ryanair would be able to estimate the impact of different actions on Aer Lingus's profitability. Despite any uncertainty about the effect of any additional profits made by Aer Lingus or the company's share price, additional profitability would still increase the expected value of Ryanair's shareholding.

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<sup>75</sup> Ryanair SLC submission to the OFT, paragraphs 5.11 & 5.12. See [www.competition-commission.org.uk/our-work/directory-of-all-inquiries/ryanair-aer-lingus/evidence](http://www.competition-commission.org.uk/our-work/directory-of-all-inquiries/ryanair-aer-lingus/evidence).

<sup>76</sup> See Salop, O'Brien (2001); *The Competitive Effects of Passive Minority Equity Interests: Reply*, *Antitrust Law Journal*.

- 7.125 More generally, Ryanair said that it did not take Aer Lingus into account in its strategic thinking. It submitted a difference-in-difference analysis showing that, on average, the fares set by Ryanair on overlap routes had not increased by more than fares on non-overlap routes in the period since the transaction took place, from which it concluded that the acquisition of the minority shareholding in Aer Lingus had caused no significant increase in its prices. We agreed that there was no evidence to suggest that Ryanair had increased its fares disproportionately on overlap routes since the transaction, although we considered that the results of the analysis should be treated with caution.<sup>77</sup> The analysis is discussed in more detail in Appendix E.
- 7.126 Ryanair also said that it used a compensation scheme [REDACTED]. Aer Lingus's profits were not taken into account in such a framework. Its business strategy—centred on maximizing load factor—was consistent across all routes. It said that as a matter of common sense the value of Ryanair's shareholding in Aer Lingus was so limited that it could never affect the way in which Ryanair operated its business.
- 7.127 We were not aware of any evidence that Ryanair's approach to setting its fares had changed since the transaction took place. However, while the management [REDACTED] scheme used by Ryanair may not (at present) explicitly take Aer Lingus's profitability into account, this scheme, or the general framework in which Ryanair's route managers operated, could, in principle, be adjusted to take into account the impact of price changes on Aer Lingus. We note that Ryanair and Aer Lingus also compete in other dimensions in addition to fares, and so even if there were no effect on prices, there could, for example, be an effect on frequency. Although Ryanair's general business strategy might be consistent across all routes, many decisions would be taken locally.

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<sup>77</sup> In particular, given the small number of overlap routes in the sample, it would be difficult to estimate the difference in fares for overlap and non-overlap routes with any precision. Consistent with this, the confidence intervals around most estimates of the relevant coefficient were large and included economically very significant positive and negative effects.

7.128 The acquisition of the minority shareholding was a first step in Ryanair's bid for the entirety of Aer Lingus, rather than an investment in its own right. Ryanair said that it had retained its minority shareholding because it believed that either it would eventually make a successful bid for Aer Lingus, or it would maximize the value of its shareholding by selling to a company willing to pay a significant premium over the market price to acquire control of Aer Lingus.

7.129 We considered that the context within which the transaction had taken place could affect Ryanair's incentives when considering the impact of its own commercial decisions on Aer Lingus. In particular, Ryanair's stated strategy of acquiring the entirety of Aer Lingus might cause it not to be concerned about any adverse impact of its own pricing, capacity and route decisions on Aer Lingus. This could be the case if by competing less strongly, Ryanair risked the price of acquiring the outstanding shares in Aer Lingus increasing or being less likely to be able to acquire the remainder of Aer Lingus at all.

7.130 Given the above, we provisionally found that Ryanair would not be expected to compete less strongly 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. Any incentive to compete less strongly might also be reduced by the uncertainty and indirectness by which Aer Lingus's profit would flow back to Ryanair.

### *Coordinated effects*

7.131 Another possible way in which the transaction might result in an SLC is if it increases the effectiveness of any existing coordination between Aer Lingus and Ryanair, or increases the likelihood of Ryanair and Aer Lingus coordinating on fares or some other aspect of their offering in the future.



7.132 Such an effect could arise if:

- (a) the acquisition increases the benefits of coordination (or reduces the benefits of competing). Because of its shareholding, Ryanair would benefit not only from its own increased profits, but from the higher profits of Aer Lingus that would be achieved in the event that a coordinated equilibrium were reached;
- (b) the acquisition gives Ryanair a greater range of punishment and reward strategies, improving its ability to maintain a coordinated equilibrium; and/or
- (c) the acquisition facilitates the flow of information between the two companies, making it easier for them to reach and monitor a coordinated equilibrium.

7.133 We note the limited operations of airlines other than Ryanair and Aer Lingus on routes between Great Britain and Ireland (with many routes being duopolies) and the relatively high level of transparency in the key dimensions of competition. These factors would be likely to facilitate the ease with which any coordinated equilibrium could be reached and monitored. As set out in the section on entry, we also identified a number of factors which would be likely to deter entry and expansion by other airlines and so which would ensure the external sustainability of any coordinated outcome.

7.134 On the other hand, the asymmetry between the two airlines' cost structures and the differentiation between the airlines' service offering could make coordination more difficult by causing a divergence in the incentives of the two airlines. In addition, the general complexity in pricing—with many passengers paying different fares—could make it difficult for firms to reach and monitor coordination on fares.

7.135 Dublin Airport Authority (DAA) told us that it had observed a matching pattern in the taxes and charges imposed by Ryanair and Aer Lingus, whereby one of the airlines would increase its charges and the other would often then match it. It said that at

times the airlines had charged exactly the same rate, although this was not always the case. It said that it was not always the same airline that increased its charges first.

7.136 It told us that the taxes and charges published by the airlines did not reflect the actual taxes and charges they incurred. The underlying airport services and facilities provided to the airlines were quite different—the cost per passenger was probably 10 per cent different in terms of input costs—and the airlines were earning margins of between 30 and 50 per cent on what were presented to customers as taxes and charges. DAA said that the pattern demonstrated the possibility of cooperation between the airlines, although this was not necessarily evidence that Aer Lingus and Ryanair were coordinating.

7.137 We asked Ryanair and Aer Lingus how they set their taxes and charges. Ryanair said that its prices were set with the aim of offering the lowest fares in the market and with the aim of reaching predetermined load factor targets. It explained that the majority of its fares were set at a level that was lower than the combined taxes and charges, so the ‘taxes and charges’ entry often appeared as ‘zero’ on the tickets. Ryanair said that it had never sought to coordinate its conduct with Aer Lingus, and that it would be unable to reach such coordination in any event.

7.138 Aer Lingus said that it did not impose a mark-up on airport charges, and rejected any suggestion of coordination with Ryanair in the setting of its charges. It said that it applied a cost recovery model in setting its taxes and charges under which it sought to recover all charges imposed by DAA—not only related to the arrival and departure of passengers, but also related to aircraft.

7.139 We reviewed Aer Lingus's internal documents relating to how it set its charges. We saw no evidence suggesting that Aer Lingus was setting charges higher than it otherwise would have on the understanding that Ryanair would do the same. Ryanair said that it did not produce any internal documents which related to how it set its charges.

7.140 We were not aware of any evidence suggesting that Ryanair and Aer Lingus were coordinating on their core fares or the geographical area of their operations. In general, the relationship between the management of the two companies appeared to be antagonistic, rather than cooperative. We found considerable evidence of price competition between the airlines, and of airlines' fares reacting to each other (and to the presence of the other airline on a route).

7.141 We provisionally found it unlikely that Ryanair's minority shareholding in Aer Lingus would lead to coordinated effects.

### ***Market entry/expansion***

7.142 In this section we consider possible entry and expansion by an airline wishing to enter new routes or expand capacity on existing routes between Great Britain and Ireland. We consider:

- (a) the history of entry, expansion and exit (see paragraphs 7.143 and 7.144);
- (b) the views of airlines and airports on likely future entry and expansion (see paragraphs 7.145 and 7.146); and
- (c) the issues which might affect the likelihood, timeliness and scale of entry (see paragraphs 7.147 to 7.155).

We then draw some provisional conclusions on whether entry and expansion would be likely to offset any possible SLC that we might identify. Further details of our analysis of entry are set out in Appendix J.

- 7.143 In response to a European Commission questionnaire, Aer Lingus said that ‘since the 2007 prohibition decision, there has been no entry of note on shorthaul routes out of Ireland. Indeed, the opposite is the case and the level of concentration in the market has increased’.
- 7.144 We found that Aer Lingus, Aer Arann and Ryanair are the only airlines which have opened and maintained new routes between Great Britain and Ireland in recent years. We found several examples of other airlines which had entered for a few seasons but then exited. British Airways has increased capacity on the London Heathrow–Dublin route following its purchase of bmi.
- 7.145 We asked airlines and airports for their views on the likelihood and timeliness of entry on routes between Great Britain and Ireland, as well as examining the relevant material submitted to the European Commission. We found that Aer Arann was the only airline which had specific plans to enter or expand on overlap routes in the next few years. Flybe had plans to expand on non-overlap routes between Great Britain and Ireland in the summer of 2013, although in its submission to the European Commission it said that it would consider expanding on overlap routes in response to a significant increase in prices. CityJet said that it might expand on routes from Dublin to Great Britain but that it did not have specific plans, and IAG said that [✂] easyJet said that [✂].
- 7.146 The airports that responded to us had mixed views on the likelihood of expansion by the airlines on routes between Great Britain and Ireland. DAA said that it was unlikely that there would be substantial and sustained entry by airlines other than Aer Lingus or Ryanair on UK–Republic of Ireland routes. Some airports, including Belfast International, thought a couple of new routes could open while others, including Glasgow Airport, were concerned about the loss of existing services.

- 7.147 We looked at four main issues that might affect the ability of competitors to enter or expand their capacity on routes between Great Britain and Ireland:
- (a) assets required to enter or expand (see paragraphs 7.148 to 7.152);
  - (b) threat of aggressive response (see paragraph 7.153);
  - (c) impact of the current and expected economic climate (see paragraph 7.154); and
  - (d) impact of taxes and airport charges (see paragraph 7.155).
- 7.148 Looking first at the assets required, we found that obtaining aircraft, pilots and aircrew was relatively straightforward. Aircraft can be purchased and staff can be hired; aircraft and crew are also available through leasing deals.<sup>78</sup> This is consistent with the views expressed by the European Commission in its prohibition decision on Ryanair's third bid for Aer Lingus.
- 7.149 We found that, based on the evidence we received, there were slot and stand capacity issues at Dublin Airport that were likely to act as a barrier to entry at peak morning times. In addition, we found that there were capacity constraints at several UK airports, again particularly in the peak morning periods. We note that, both in order to maximize aircraft utilization and in order to attract business passengers, airlines need to be able to schedule peak morning departures.
- 7.150 Airlines said that brands play an important part in the competitive process in the airline industry. Further, both Aer Lingus and Ryanair have well-known brands in Ireland. We therefore found that any airline seeking to compete effectively with Aer Lingus and Ryanair would need to build a well-known brand in Ireland. We recognize that some airlines may have a well-known brand in their home market and this may facilitate entry or expansion on some routes.

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<sup>78</sup> See, for example, Virgin's wet lease agreement with Aer Lingus.  
[http://corporate.aerlingus.com/investorrelations/regulatorynews/2012pressreleases/RNS\\_re\\_wet\\_lease\\_Final\\_Draft\\_071212.pdf](http://corporate.aerlingus.com/investorrelations/regulatorynews/2012pressreleases/RNS_re_wet_lease_Final_Draft_071212.pdf).

- 7.151 We also looked at whether an airline would need to establish a base in order to be an effective competitor. We found that airlines operating from bases benefit from a number of advantages, including economies of scope and scale and more flexibility over flight schedules. Both Aer Lingus and Ryanair operate bases at Dublin and an effective competitor is likely to need to establish a base at Dublin.
- 7.152 We recognize that a competitor which has a base at the other end of a route, for example IAG at London Heathrow would be able to place some constraint on Ryanair and Aer Lingus on routes to that UK airport. However, this constraint could be limited if they do not overnight aircraft in Ireland, because they would not be able to offer early morning peak flights from Dublin, or late night arrivals to Dublin.
- 7.153 We looked at whether the expectation of an aggressive response by existing operators would reduce the likelihood of entry on routes between Great Britain and Ireland. Several airlines said that possible entrants might expect an aggressive response by Ryanair and that this would be likely to deter entry. Such a response would be relevant to entry on all routes between Great Britain and Ireland, although its importance may vary depending on the entrant airline.
- 7.154 We also looked at the extent to which the current and expected economic climate in Ireland and Great Britain is likely to affect entry and expansion decisions and reduce the likelihood of entry. We found that the economic climate and the size of the Irish market might deter entry on routes between Great Britain and Ireland. While the economic climate in Ireland is improving, the responses from airlines suggested that investment in Ireland was still relatively unattractive. This is consistent with the fact that there was no substantial entry on routes between Great Britain and Ireland by airlines other than Aer Lingus, Aer Arann and Ryanair even when the Republic of Ireland was experiencing strong growth.

7.155 Finally, we looked at whether taxes and airport charges might reduce the likelihood of entry on routes between Great Britain and Ireland. We found that the relatively high level of air travel taxes in Great Britain may deter entry by making routes between Great Britain and the Republic of Ireland less attractive to entrants relative to other markets. The evidence on the impact of charges at Dublin was more mixed, but these may also serve to deter entry.

7.156 Based on the evidence we have reviewed, including the analysis carried out by the European Commission in its decision to prohibit Ryanair's third bid for Aer Lingus, we provisionally conclude that substantial entry on routes between Great Britain and the Republic of Ireland is unlikely due to several factors. These include 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.

7.157 This assessment is consistent with the general pattern of airlines exiting from the market which has been observed in recent years, as well as views expressed by airlines regarding their future entry plans. It is also consistent with the European Commission's findings. We therefore conclude that entry or expansion by other airlines would be unlikely to offset any SLC that we might otherwise find.

### ***Provisional conclusions on the SLC test***

7.158 We set out three possible competitive effects arising from Ryanair's minority shareholding in Aer Lingus in paragraph 7.2. We have focused, in particular, on Ryanair's influence over Aer Lingus's effectiveness as a competitor.

7.159 In reaching our provisional conclusion on any reduction in Aer Lingus's effectiveness, we attach 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 take 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 Aer Lingus's 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 note 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.

7.160 We consider 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.

7.161 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.

7.162 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 be 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.

7.163 In reaching our conclusions, we considered Ryanair's argument that we were bound to conclude, on the basis of the European Commission's assessment of competition between Ryanair and Aer Lingus, that the acquisition of the minority shareholding had not and would not result in an SLC. We looked carefully at the evidence of competition during the period since 2006, as well as the prospects for competition in future. Although we recognize that competition between Ryanair and Aer Lingus has remained intense since 2006 and that the extent of overlap between the airlines has increased, we have also taken into account that, absent Ryanair's minority shareholding, competition during the period since 2006 may have been different and stronger, as well as taking into account the effect of Ryanair's minority shareholding in the future.

7.164 We provisionally conclude that Ryanair's acquisition of a 29.82 per cent shareholding in Aer Lingus has 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.