

Completed acquisition by Ryanair Holdings plc of a minority interest in Aer Lingus Group plc

ME/4694/10

The OFT's decision on reference under section 22 was given on 15 June 2012. Full text of decision published 5 July 2012.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. **Ryanair Holdings plc** (Ryanair) is an airline based in the Republic of Ireland and listed on the Dublin, London and NASDAQ stock exchanges. Ryanair operates flights to 27 countries in Europe and North Africa, carrying around 75 million passengers per year. Its turnover for the year ending 31 March 2011 was €3.6 billion.
2. **Aer Lingus Group plc** (Aer Lingus) is an airline based in the Republic of Ireland and former national flag-carrier. It is listed on the Dublin and London stock exchanges. Privatised in 2006 with the Irish government retaining a minority stake in the airline, Aer Lingus offers short-haul flights in Europe and long-haul flights to the US, carrying just under 10 million passengers per year. Aer Lingus has a number of code-sharing and interline agreements with other airlines, including a franchise agreement with Aer Arann, which operates services between Ireland and primarily UK regional airports under the brand Aer Lingus Regional. Aer Lingus' turnover for the year ended 31 December 2011 was €1.3 billion.

TRANSACTION

3. The minority stake in Aer Lingus was acquired by Ryanair in a number of stages with the initial aim of acquiring full control of Aer Lingus (Table 1).

Table 1: Ryanair shareholdings in Aer Lingus, 2006–present (per cent)

Date	Shareholding
27 Sept 2006 – 5 Oct 2006	19.2
By 28 Nov 2006	25.2
20 Aug 2007	29.4
2 July 2008 to present	29.8

Source: Ryanair

4. Ryanair's minority shareholding in Aer Lingus represents 29.82 per cent of Aer Lingus' total issued share capital and makes Ryanair the largest shareholder in Aer Lingus. The Irish Government is the next largest shareholder with a stake of around 25 per cent. The consideration that Ryanair paid for its stake was around €400 million.
5. On 5 October 2006, Ryanair announced a public bid for the entire share capital of Aer Lingus. This bid was investigated by the European Commission (the Commission) which prohibited it on 27 June 2007.¹ The Commission concluded in its investigation that the public bid for the entire share capital as well as the shares acquired before and during the public bid constituted a single concentration for the purposes of the EC Merger Regulation.^{2,3} However, it concluded that the minority stake acquired before the full bid did not constitute a concentration with a Community dimension for the purposes of the EC Merger Regulation.
6. The Commission explained this in a further decision on 11 October 2007.⁴ It said:

¹ Case M.4439 *Ryanair/Aer Lingus*.

² Council Regulation (EC) 139/2004, OJ L 24, 29/1/2004.

³ Case M.4439 *Ryanair/Aer Lingus*, paragraph 12.

⁴ On 17 August 2007, Aer Lingus formally requested that the Commission open proceedings against Ryanair with respect to forcing a divestment of its minority stake, forcing Ryanair to adopt interim measures and for the Commission to take a position on the interpretation of Article 21 of the EC Merger Regulation in the *Ryanair/Aer Lingus* case.

The Commission considers that the concentration assessed in the present case had not been implemented. Ryanair has not acquired control of Aer Lingus and the prohibition decision also excludes that Ryanair acquires control of Aer Lingus in the future by way of the notified operation. The transactions that have been carried out during the Commission's proceedings can therefore not be considered as part of an implemented concentration.⁵

7. The General Court later confirmed this finding when it stated:

'It is apparent from the above that the acquisition of a shareholding which does not, as such, confer control as defined in Article 3 of the merger regulation does not constitute a concentration which is deemed to have arisen for the purposes of that regulation. On that point, European Union law differs from the law of some of the Member States, in which the national authorities are authorised under provisions of national law on the control of concentrations to take action in connection with minority shareholdings in the broader sense ... the Commission cannot be accused of infringing Article 8(4) of the merger regulation by considering that no concentration had been implemented in the present case and that it did not have the power to require Ryanair to dispose of its shareholding in Aer Lingus. Only if such a shareholding had enabled Ryanair to control Aer Lingus by exercising de jure or de facto decisive influence on it, which is not the case here, would the Commission have had such a power under the merger regulation.'⁶

8. As such, the minority shareholding in Aer Lingus does not fall under the jurisdiction of the Commission, but may fall under the jurisdiction of the UK, which is discussed below.

⁵ Case M.4439 *Ryanair/Aer Lingus*, Regulation (EC) No 139/2004 Merger Procedure, Article 232, 11/10/2007, paragraph 10.

⁶ Case T-411/07 Judgment of the General Court, 6 July 2010, paragraphs 64 and 78.

JURISDICTION

Relevant Merger Situation

9. Under section 23 of the Enterprise Act 2002 (the 'Act'), a relevant merger situation arises when two or more enterprises cease to be distinct, either the UK turnover test or share of supply test is met, and the merger has taken place not more than four months before any reference is made subject to a number of exceptions (see specifically paragraph 75 below).
10. Ryanair has acquired its current shareholding in Aer Lingus through a series of transactions within a period of two years. Given that Ryanair has carried out a series of transactions which have collectively enabled Ryanair to exercise material influence over Aer Lingus (as discussed below), the OFT considers it appropriate for the following jurisdictional assessment to treat the transactions as having occurred simultaneously on the date on which the last of these transactions occurred (namely 2 July 2008) and to assess the case for jurisdiction with respect to the level of the shareholding at that time by virtue of section 29 of the Act.

Enterprises ceasing to be distinct

11. Under the Act, two enterprises will cease to be distinct if they are brought under common ownership or control. Control includes situations falling short of outright voting control, including the ability directly or indirectly to control or materially to influence the policy of an enterprise (section 26(3) of the Act). Three levels of control are therefore recognised: a controlling interest (**de jure** control); the ability to control policy (**de facto** control); and the ability materially to influence policy (material influence). The ability to exercise material influence is the lowest level of control that may give rise to a relevant merger situation.
12. The OFT is required to determine whether it is or may be the case that a relevant merger situation has been created; therefore it is sufficient for the OFT to show only that it may be the case that Ryanair has acquired material influence over Aer Lingus through its minority shareholding. The OFT notes that the concept of material influence is one that is based on a firm's ability to influence the commercial policy of the target company relevant to its behaviour in the marketplace and its ability to meet its

commercial objectives. Commercial policy means the management of the Aer Lingus business, in particular in relation to its competitive conduct, and thus includes the strategic direction of a company and its ability to define and achieve its commercial objectives.⁷

13. Assessment of material influence requires a case-by-case analysis of the overall relationship between the acquirer and the target. However, in keeping with its position as a first phase authority and its 'may be the case' standard, the OFT's general policy is that a shareholding of more than 25 per cent that enables the acquirer to block a special resolution 'is likely to be seen as presumptively conferring the ability materially to influence policy'.⁸ The OFT has applied this policy even where the remaining shares are held by a single shareholder.⁹
14. In cases where the shareholding is below 25 per cent the OFT has considered a number of other factors to determine if material influence exists, including the distribution and voting power of shareholdings, board representation, and commercial arrangements. Conversely, in cases where the shareholding is at least 25 per cent (as is the case here) the OFT has not always found the need to consider other factors.¹⁰
15. Ryanair does not consider that the acquisition of the stake has led to any ability materially to influence Aer Lingus. Ryanair submitted that in the five years it has held its stake, actual behaviour, during a period when Ryanair was unconstrained by any regulatory investigation, demonstrates that Ryanair has not been able to exercise material influence over Aer Lingus. Ryanair points to *BSkyB/ITV* where the Competition Commission (CC) acknowledged that 'the absence of evidence of actual influence being

⁷ OFT '*Jurisdictional and Procedural Guidance*', paragraphs 3.15.

⁸ OFT '*Jurisdictional and Procedural Guidance*', paragraphs 3.19 and 3.21 and has been applied in numerous past cases by the OFT. See, for example, the OFT's investigation into *BSkyB/ITV* ('*Acquisition by British Sky Broadcasting Group plc of a 17.9 per cent stake in ITV plc: report to the Secretary of State for Trade and Industry*, 27 April 2007).

⁹ *Completed acquisition by Emap plc of a 27.8% share in Scottish Radio Holdings plc*, OFT, 13 May 2004; and *Completed acquisition by Creative Broadcast Services Ltd of BBC Broadcast Ltd*, OFT, 2 November 2005.

¹⁰ *Completed acquisition by Emap plc of a 27.8% shareholding in Scottish Radio Holdings plc*, ME/1633/04, 13 May 2004; and *Completed acquisition by Caisse du dépôt et placement du Québec of a 25 per cent stake in Interconnector (UK) Limited*, ME/3128/07, 31 July 2007.

exerted to date' constituted a countervailing factor in the assessment of material influence.¹¹

16. Ryanair points to a number of instances where it has failed to have any effect on the commercial operation of Aer Lingus:
 - A number of resolutions it has either put forward without success or attempted unsuccessfully to block, including a US\$2.4 billion aircraft order, the appointment of a director, and a reduction in directors' remuneration.
 - Unsuccessful attempts to convene Extraordinary General Meetings and table resolutions at AGMs.
 - An unsuccessful attempt to prevent Aer Lingus' closure of the Shannon – Heathrow route and entry on a Belfast – Heathrow route.
 - Attempts by Ryanair to end certain perquisites for former directors.
 - Use of certain facilities at Dublin Airport.
 - Regular investor information requests that are ignored by Aer Lingus.
17. The OFT reiterates that it does not consider it necessary for there to be actual evidence that control or material influence has been exercised. The key issue is whether Ryanair is able to exercise material influence over Aer Lingus as a result of its minority shareholding. The OFT does not accept that the history of Ryanair's actions points to the absence of material influence. First, as discussed below, the OFT considers the actual behaviour of Ryanair is clear evidence of material influence, including its history of blocking special resolutions.
18. Second, even if it were the case that Ryanair demonstrated no material influence during the period since the acquisition of the shareholding – which the OFT considers is not the case – the OFT notes that such evidence is not conclusive given Ryanair's ability to manipulate its behaviour as it chooses over this period. Specifically, until July 2010, there were ongoing appeals in the European Courts. There was also the

¹¹ Acquisition by British Sky Broadcasting Group plc of 17.9 per cent of the shares in ITV plc: Report sent to the Secretary of State, 14 December 2007, paragraph 3.35.

possibility of inquiry into the minority stake by the UK and Germany. As a result, it is possible that Ryanair may have modified its behaviour mindful of such regulatory scrutiny.

Ability to block special resolutions

19. As noted above, the OFT's general policy is that a shareholding of more than 25 per cent that enables the acquirer to block a special resolution 'is likely to be seen as presumptively conferring the ability materially to influence policy'.¹² However, Ryanair has submitted that, in the circumstances of this case, the evidence available demonstrates that its shareholding in Aer Lingus does not give it the power to exercise material influence over Aer Lingus. Recognising that the statement in the OFT's guidance is a presumption, rather than a hard rule, the OFT examines in this section: first, the level of the shareholding, and Ryanair's voting pattern to date; second, the need for special resolutions for Aer Lingus; and third the extent to which the facts of this case rebut the presumption that the ability to block special resolutions provides the acquirer with material influence over the target.

Ryanair has the ability to block special resolutions

20. As outlined above, Ryanair's shareholding of 29.8 per cent confers on it the right and ability to block special resolutions (which require at least 75 per cent of shareholder voter approval to pass). Ryanair has demonstrated this ability by blocking some special resolutions since its acquisition of the minority stake in Aer Lingus (Table 2).

¹² OFT '*Jurisdictional and Procedural Guidance*', paragraphs 3.19 and 3.21 and has been applied in numerous past cases by the OFT. See, for example, the OFT's investigation into *BSkyB/ITV* ('*Acquisition by British Sky Broadcasting Group plc of a 17.9 per cent stake in ITV plc: report to the Secretary of State for Trade and Industry, 27 April 2007*).

Table 2: Selected Aer Lingus special resolutions, 2007–2012

Year	Issue	For (%)	Against (%)	Eligible votes cast (%)
2007	Disapplication of pre-emption rights	68.2	31.8	79.0
2008	Disapplication of pre-emption rights			
	Own share purchase	N/A	N/A	N/A
	Re-issue of treasury shares			
2009	Disapplication of pre-emption rights	63.0	37.0	81.8
2010	Disapplication of pre-emption rights	61.3	38.7	77.6
	Amend Articles of Association	61.3	38.7	77.6
2011	Disapplication of pre-emption rights	57.0	43.0	69.9
	Amend Articles of Association	56.2	43.8	68.2
2012	Disapplication of pre-emption rights	58.4	41.6	71.9
	Amend Articles of Association	56.2	43.8	68.2

Source: Aer Lingus.

21. Based on voter turnout, Ryanair was responsible for over 99 per cent of the vote against the special resolutions in each of the instances presented in the table. It is therefore clear that Ryanair’s shareholding has given it the ability to block special resolutions being passed by Aer Lingus.

Need for special resolutions by Aer Lingus

22. Special resolutions in the time since Ryanair acquired the minority shareholding have predominantly concerned votes on the disapplication of pre-emption rights and amendments to the Articles of Association.
23. Pre-emption rights ensure that any new equity issued by a company must first be offered to existing shareholders to prevent dilution of their share of a company. The amendments to Aer Lingus’ Articles of Association relate to the rights of shareholders in proposing a resolution at an Extraordinary General Meeting.
24. The provisions under Irish company law that require approval of shareholders by means of a special resolution, in addition to the

disapplication of statutory pre-emption rights and any amendment to the company's Articles of Association include:¹³

- modification of the company's fundamental characteristics (for example, conversion from a public to private company, de-listing the company from the Irish Stock Exchange, modify the company's name)
- reduction or modification of a company's share capital (including the repurchase of Ryanair's shares or varying the class rights attached to any shares)
- modification to directors' rights and liabilities
- organising the liquidation and winding-up of the company
- takeover or merger by Scheme of Arrangement, and
- approval of the proposed terms of certain types of cross-border merger.¹⁴

Implications for material influence over Aer Lingus

Ryanair arguments

25. Ryanair argued that its ability to block special resolutions does not enable it materially to influence Aer Lingus' policy relevant to its behaviour in the marketplace, and that Aer Lingus shareholders have little or no involvement in the day-to-day management of the company.
26. Ryanair submitted that the blocking of pre-emption rights waivers were motivated by its wish not to have its shareholding diluted and that such actions did not confer material influence over Aer Lingus for a number of reasons. In particular, Ryanair argued that the ability to block the waiver by Aer Lingus of pre-emption rights of shareholders does not constrain Aer Lingus' ability to access and raise finance, and so does not equate to material influence, pointing to a number of factors.
27. First, Ryanair submitted that it has always supported any attempt by Aer Lingus to issue new equity so long as it is offered to all shareholders by

¹³ Section 141 of the Companies Act 1963.

¹⁴ Regulation 10 of the European Communities (Cross-Border Mergers) Regulations 2008.

retaining pre-emption rights. Indeed, the special resolutions that Ryanair has blocked in relation to pre-emption rights have been limited to issuing five per cent of currently issued share capital. Ryanair has argued that this is not a level of funding which would materially alter Aer Lingus' commercial strategy. For example, Ryanair submitted that at the 2011 Aer Lingus AGM Ryanair supported the authorisation of Aer Lingus directors to raise an aggregate nominal amount of €8,811,661.45 (equivalent to 176,233,229 shares).

28. Second, Ryanair argued that Aer Lingus' access to finance is not dependent on passage of such a resolution. Ryanair highlighted that in *BSkyB/ITV* the CC indicated that the speed of raising funds was important.¹⁵ The concern about raising funds quickly is inapplicable to the present case, according to Ryanair, since:

- it is unlikely Aer Lingus would require quick access to finance to fund a large strategic acquisition as Aer Lingus is downsizing its operations: reducing short-haul and, in particular, long-haul capacity, selling aircraft and deferring deliveries of additional long-haul aircraft
- Aer Lingus has large cash reserves of approximately €1 billion and can easily obtain debt financing, as demonstrated by the aircraft lease financing it is granted, either of which could be used to fund any large strategic acquisition
- the attempts by Aer Lingus to waive pre-emption rights would have enabled Aer Lingus to raise, at most, €15.5 million (per year), or two per cent of its gross cash position, and
- the difference in the time it takes to raise finance through a rights issue and placing shares directly with an investor is not material.¹⁶

29. Third, Ryanair submitted that Aer Lingus' ability to purchase aircraft is unaffected by Ryanair's ability to block the waiver of pre-emption rights. In 2008 Aer Lingus was given approval from shareholders for the purchase of

¹⁵ *BSkyB / ITV*, paragraph 3.41

¹⁶ Ryanair submitted that a rights issue requires a minimum offer period of 21 days and in practice – taking into account issuing a circular, prospectus, underwriting the issue, applying for listing and admission to trading – can take at least six to eight weeks. Placing shares directly with an investor, while not requiring the 21-day period, would in practice still take a number of weeks to document and agree.

12 aircraft from Airbus for US\$2.4 billion. Further, Ryanair submitted that any further investment by Aer Lingus in new aircraft will involve very long lead times, providing plenty of opportunity for Aer Lingus to raise finance.

Aer Lingus arguments

30. Aer Lingus submitted that Ryanair's continual (since 2007) blocking of the disapplication of pre-emption rights amounts to material influence over its commercial policy relevant to its behaviour in the marketplace. A disapplication of such rights would allow Aer Lingus to:
- offer new shares to the wider market, equivalent to five per cent of issued share capital
 - obtain a single cash injection in the company for an equity stake,¹⁷ and
 - issue new shares for cash equivalent to approximately 33 per cent of its issued share capital where this is done as part of a rights issue for all ordinary shareholders, with the exception of those shareholders with registered addresses outside Ireland.
31. Aer Lingus argued that no rights issue can in practice be undertaken strictly complying with statutory pre-emption rights for all existing shareholders. This is because some of these shareholders will be located in jurisdictions with regulatory requirements which make the offering of a rights issue to persons in those jurisdictions impracticable. For this reason, Aer Lingus argued, that it is now standard for all companies listed on the Irish Stock Exchange to seek a general disapplication of the statutory pre-emption rights so as to be able to undertake a rights issue on the basis that shareholders in these jurisdictions are to be excluded. Aer Lingus pointed to the equivalent resolution which was passed at the Ryanair AGM last year.

¹⁷ Aer Lingus submitted that on at least one occasion in the last 10 years, it entered into negotiations with other airlines with this objective. These negotiations took place prior to the IPO of Aer Lingus. While Aer Lingus has not provided any details or evidence of these negotiation, it submitted that there have been several examples of similar arrangements, such as the cross shareholdings of 10 per cent and 13 per cent, respectively, that BA and Iberia held in the other prior to the subsequent merger. Alliances with airlines outside the EU are more likely to be structured on this basis, according to Aer Lingus, as applicable bilateral regimes restrict cross shareholdings to less than 50 per cent.

32. Aer Lingus argued that, if the special resolution relating to pre-emption rights had been passed at the 2011 AGM, Aer Lingus could, if needed to fund an acquisition, undertake a rights issue to raise approximately €150-200 million.
33. Finally, Aer Lingus submitted that, while it has been well-capitalised as a consequence of the funds raised in its IPO, the airline industry is cyclical and airlines which maintain large cash balances have been shown to be the best at surviving the periodic downturns in the industry. Aer Lingus has been close to insolvency on at least two occasions in the last 20 years and has had to resort to funding from its shareholders as well as significant cost reductions on the part of its employees (this has been a common occurrence in other airlines and is likely to be repeated in the airline industry).
34. Aer Lingus argued that such waivers are routinely available to other listed companies and they allow for flexibility in capital raising options, particularly in the context of an acquisition. By blocking the disapplication of pre-emption rights, Ryanair is denying Aer Lingus one of the normal mechanisms available to listed companies to raise fresh capital.

OFT analysis

35. The OFT first considers Ryanair's ability to prevent Aer Lingus from disapplying pre-emption rights, and thereby restrict the way in which Aer Lingus may obtain funding. It notes in this respect that in *BSkyB/ITV* the CC found that the ability to block special resolutions, particularly in blocking resolutions to waive pre-emption rights, was a key component to Sky exerting material influence over ITV. The CC said that 'the ability to block a waiver of pre-emption rights may be particularly important if the company is looking to raise funds quickly to finance a strategic acquisition'.¹⁸
36. The OFT recognises that raising finance involving the disapplication of pre-emption rights is not the only way in which Aer Lingus may obtain funds. However, that Aer Lingus has access to other forms of finance does not mean that Ryanair does not or cannot exercise material influence over Aer

¹⁸ Acquisition by British Sky Broadcasting Group plc of 17.9 per cent of the shares in ITV plc: Report sent to the Secretary of State, 14 December 2007 (*BSkyB/ITV*), paragraph 3.41.

Lingus by blocking waivers of pre-emption rights. Access to such finance would unquestionably provide Aer Lingus management with more flexibility in raising capital, irrespective of the merits of such finance in terms of shareholder rights and protection, or fund raising.¹⁹ Moreover, Ryanair's perception of Aer Lingus' current expansion plans does not reflect investment opportunities that have been considered by Aer Lingus in recent years.

37. Moreover, the OFT notes that the disapplication of pre-emption rights is normal commercial behaviour. For example, Aer Lingus submitted that in 2010, amongst the FTSE 350 companies, out of almost 290 AGM Notices, companies disapplied pre-emption rights in around 97 per cent of instances. The OFT also notes that other airlines have special resolutions to in order to disapply these rights. Recent examples are Flybe (2012) and indeed Ryanair (2011). Finally, the OFT notes that almost all other Aer Lingus shareholders were willing to disapply pre-emption rights in the years analysed in Table 2.

38. Further, there are a range of other commercial and strategic policies which require special resolution which Ryanair can block. The ability to exert material influence over Aer Lingus is not limited only to those aspects of Aer Lingus commercial policy or strategy that Ryanair happens to have already blocked. The OFT is conscious that it is the ability to exercise material influence which is relevant for establishing jurisdiction. This point was made by the CC in *BSkyB/ITV*:

'The test that we have to apply in deciding whether a relevant merger situation has been created is whether the ability to exert material influence has arisen, not whether, in practice, that ability has been exploited.'²⁰

39. The OFT considers that Ryanair has the right and ability to block additional commercial decisions relating to the capital structure of Aer Lingus. Should Aer Lingus wish to engage in recapitalisation through repurchasing its own stock, that is distributing cash in exchange for reducing the number of shares outstanding, Ryanair can block this. Share repurchases offer an

¹⁹ Aer Lingus submitted airlines will generally hold around half of their annual revenues as cash reserves. [].

²⁰ *BSkyB / ITV*, paragraph 3.65.

alternative option for management of a company to distribute funds to shareholders without committing to a dividend. Share repurchases can be used strategically by management to take advantage (or signal) undervaluation of the company in the market. The OFT notes that Ryanair sought agreement from its own shareholders in 2006 to undertake a €300 million share buy-back programme, which was granted. In February 2008, Ryanair announced a second share buy-back programme of up to €200 million worth of shares, again ratified by shareholders at an AGM in September 2008.

40. Another possibility is that Ryanair could block a merger favoured by Aer Lingus through blocking a scheme of arrangement or under the European Communities (Cross Border Mergers) Regulations 2008. Mergers implemented through either method require at least 75 per cent shareholder approval. Both methods offer some advantages, according to Aer Lingus, including allowing the bidder to save one per cent stamp cost as well as 100 per cent control within two days of the Court approval. Ryanair submitted that this does not confer material influence as Aer Lingus is well capitalised and therefore does not require a takeover or merger to pursue its business strategy. Further, Ryanair told the OFT that it is not opposed to a takeover of Aer Lingus and, even if it were, it does not have the ability to block a takeover by other means such as acquiring shares on the open market.
41. The OFT also notes that historic evidence supports the contention that Aer Lingus has taken account of Ryanair's voting rights in determining which matters are put to a vote. It is notable in this respect that in 2008 Ryanair had lodged a proxy vote against the three special resolutions which ensured that they would be defeated (see Table 2). Aer Lingus therefore withdrew the resolutions. [].²¹ Ryanair said that [].
42. In relation to the above, however, the OFT considers that, [], the circumstances highlight that Ryanair has the ability to affect and influence materially the implementation of Aer Lingus' commercial strategy. The OFT notes that in *BSkyB/ITV*, the CC indicated that one of the ways in which material influence might be exercised is through the target taking into

²¹ Ryanair said that [].

account any expected opposition from the holder of the minority stake in formulating its policy and in deciding whether to bring it forward.²²

43. Taking the above evidence in the round, and taking a prospective view albeit with due account of historical evidence, the OFT considers that it may be the case that, as a result of its ability to block special resolutions, Ryanair has acquired the ability directly or indirectly materially to influence the policy of Aer Lingus within the meaning of section 26 of the Act and, consequently, the enterprises Aer Lingus and Ryanair have ceased to be distinct. In particular, the OFT notes that Ryanair can (and has) prevented Aer Lingus from disapplying pre-emption rights and it can block takeovers of Aer Lingus through schemes of arrangement.
44. Further factors other than special resolutions pertaining to whether Aer Lingus and Ryanair have ceased to be distinct are discussed below.

Patterns of attendance and voting at recent shareholders' meetings

45. In considering whether material influence may be present in a particular case, the OFT has also considered the position in respect of ordinary resolutions in this case.²³ Given the size of its shareholding, Ryanair may be able to block ordinary resolutions.
46. The evidence provided to the OFT shows that there was a decline in turnout and voting since the 2007 AGM with total votes falling from around 80 per cent of total issued share capital to around 70 per cent in 2011, which rose to 72 per cent this year.²⁴ The reason for this significant fall is principally attributable to the dispersion of Aer Lingus Employee Share Ownership Trust's (ESOT's) shares to individual shareholders, where previously ESOT would have voted as a single block.²⁵

²² *BSkyB/ITV*, paragraph 3.47

²³ *Ibid.* paragraphs 3.19 and 3.21. The OFT notes that this consideration is ordinarily made in respect of shareholdings of 25 per cent or less, where the acquirer does not have the right and ability to block a special resolution, but is considered here in the context of the ability to block an ordinary resolution.

²⁴ Although one resolution at the 2012 AGM was voted on by poll and the voting participation for that resolution was 68 per cent.

²⁵ In December 2010, 62.5 million shares were distributed to 4,234 beneficiaries of the ESOT, representing 11.7 per cent of the issued share capital. The ESOT had a total of 66.5 million shares (12.47 per cent of issued share capital) but four million of these (0.75 per cent) were not distributed due to tax issues and remain on the share register in the short-term as an ESOT

47. Since Ryanair has been a shareholder the lowest voting participation in an Aer Lingus general meeting was 65.45 per cent. In such circumstances, the OFT notes that Ryanair would have an effective voting share of 45.6 per cent of the total votes cast and would require only an additional 2.9 per cent of the votes cast to obtain 50 per cent of votes cast and to be able to determine the outcome of ordinary resolutions.
48. Overall, the evidence indicates that since the dispersion of the ESOT shares Ryanair's effective voting power in Aer Lingus has increased from 36 per cent (in 2009) to over 40 per cent and can be 46 per cent in some instances. Although this is not sufficient in itself to determine the outcome of ordinary resolutions, the OFT does note that Ryanair would need only a relatively small number of votes from other shareholders to achieve this. This is further evidence of Ryanair holding material influence over Aer Lingus.

Disposal of slots

49. The effective voting position of Ryanair – in addition to Ryanair's right and ability to block a special resolution – is significant in light of Aer Lingus' Articles of Association. These state that any disposal of take-off and landing slots at London Heathrow airport (where 'disposal' includes lease, surrender, mortgage, or actual disposal) requires approval by shareholders. Any shareholder with greater than 30.1 per cent of votes cast can block such a disposal.²⁶ Given the effective voting share of Ryanair is around 43 to 46 per cent based on recent shareholder participation, the OFT considers that Ryanair has the **ability** to block, and therefore has an effective veto for, disposal of slots.
50. Aer Lingus has provided an example where it considered exchanging a Heathrow slot with another airline in 2009 (which would have involved disposal of the slot). The option was not pursued as it was considered that

block. Of the 4,324 beneficiaries of the ESOT who received their shares in 2010 only 171 of them voted on an individual basis at the 2011 AGM, representing 2.7 million shares and only 0.5 per cent of the issued share capital.

²⁶ The percentage required to approve disposal of any London Heathrow slots is 100 per cent less the percentage of issued share capital held by the Irish Government (Minister for Finance) plus five per cent at an Extraordinary General Meeting. Based on the current Irish Government shareholding of 25.1 per cent, the percentage required to approve a disposal is 69.9 per cent.

such an arrangement could and probably would have been blocked by Ryanair if put to shareholders, which would have been required under Aer Lingus' Articles of Association. The OFT considers, on the evidence available to it, that Ryanair, through its effective veto on the disposal of these slots, restricts Aer Lingus' ability to manage freely and flexibly its principal assets. The asset swap highlighted by Aer Lingus is an illustration of how Ryanair's shareholding position can impede the commercial activity of Aer Lingus.²⁷

51. In addition to this asset swap example, the OFT notes that Aer Lingus' Heathrow slots are one of its principal assets. The OFT notes that recent reports suggest a single Heathrow slot pair can be sold for £30 to 50 million.²⁸ Aer Lingus currently has 332 Heathrow slots.²⁹
52. Aer Lingus does not book the value of the slots on its balance sheet since there was no acquisition cost (the slots were 'grandfathered' to them) so Aer Lingus' debt finance may therefore not be affected by Heathrow slots.³⁰ However, for other airlines debt could potentially be secured explicitly on the Heathrow slots alone. This is not the case for Aer Lingus, as such security implicitly presumes that a creditor could obtain the slot in the event of default. Aer Lingus would be unable to dispose of the slot in this instance as Ryanair would have a veto over its disposal. Ryanair's shareholding thus has the potential to further restrict Aer Lingus' access to finance, thereby potentially affecting the cost of such finance.
53. The OFT thus considers, on the evidence available, that Ryanair's effective voting position is a relevant factor that supports the finding that Ryanair has the ability materially to influence the policy of Aer Lingus. In particular, Ryanair's effective veto over the disposal of Heathrow slots points clearly to Ryanair having the ability to impact Aer Lingus' commercial operations and its strategic position in the marketplace and thus represent the ability materially to influence Aer Lingus.

²⁷ The OFT notes that the Irish Government stated a commitment to dispose of its interest in Aer Lingus, but that no timetable or details for how this might be achieved have been determined.

²⁸ *Continental pays Heathrow Record*, Financial Times, 3 March 2008: 'Continental Airlines ... has paid a record €209 million for four pairs of take-off and landing slots at London Heathrow airport'.

²⁹ Summer 2011 allocation (Airports Coordination Limited)

³⁰ Debt finance would generally be secured and priced on the basis of Aer Lingus' perceived creditworthiness, which in turn is determined partly by its balance sheet.

Blocking an ordinary resolution

54. An ordinary resolution at Aer Lingus general meetings requires a majority of votes cast. An ordinary resolution is necessary, for example, to approve the annual accounts, increase the share capital and raise significant finance, approve purchase of aircraft, appoint directors, approve the remuneration of directors and senior management, and determine dividend payouts. The OFT considers that it is not inconceivable that Ryanair, with an effective voting share of up to 46 per cent, may be influential in blocking (or passing) such ordinary resolutions, requiring only a small proportion of additional votes in order to obtain the majority of votes cast.³¹
55. The OFT also notes that Ryanair has requested and obtained a copy of the share register from Aer Lingus' Registrars (Capita) on two separate occasions: just prior to the 2009 AGM and 19 November 2011. Ryanair has used this share register to write to other Aer Lingus shareholders or to copy those other shareholders into written communication with Aer Lingus management.³² Ryanair has also written open letters to Aer Lingus shareholders asking them to make their views on matters of commercial and policy relevance to Aer Lingus known to Ryanair.³³
56. The OFT considers that by reason of Ryanair's position as Aer Lingus' largest shareholder (and its effective voting position) there is a real possibility that Ryanair may be able to block or pass an ordinary resolution. As such, Ryanair, on a 'may be the case' standard, has the ability materially to influence the policy of Aer Lingus. Ryanair's behaviour in seeking and obtaining Aer Lingus' share register and writing to other

³¹ The OFT note that, as an illustration, if we were to add to the 46 per cent of effective votes held by Ryanair, the c. four per cent of votes of shareholders that also have a shareholding in Ryanair, which based on turnout have an effective voting share of close to seven per cent, Ryanair plus other cross-shareholders (that the OFT are aware of) would have a total voting share sufficient to pass an ordinary resolution.

³² See, for example, written letter from Michael O'Leary, CEO of Ryanair, to Colm Barrington, Chairman of Aer Lingus, dated 13 September 2011, where Ryanair discusses proposals for specific dividend payouts by Aer Lingus, demands that no further payments are made to pension schemes without prior shareholder approval, and details its perception of 'catastrophic mismanagement' by Aer Lingus' Board and Management.

³³ For example, Open Letter through RNS dated 2 February 2012 (Re: Aer Lingus' Defined Contribution Pension Schemes).

shareholders, seeking support for its position, represent additional factors that support that finding.

Board representation

57. The OFT has also considered whether Ryanair's shareholding may give it the right or ability to obtain Board representation. Ryanair currently has no directors on the Aer Lingus Board and submitted that it has never sought to have any of its nominees elected to the Aer Lingus Board and does not intend to do so in the future. In order to have a nominee elected, it would be necessary for Ryanair to obtain a simple majority of votes cast (that is, passage of an ordinary resolution) at a general meeting.
58. Ryanair emphasises that lack of representation on Aer Lingus' board severely limits its ability to influence company behaviour. Two examples are provided by Ryanair where it attempted to table resolutions at Aer Lingus' 2011 AGM related to Aer Lingus' dividend policy and payments to the company's pension scheme. The Aer Lingus board refused to table either resolution, a decision challenged by Ryanair and upheld by the Irish High Court,³⁴ which ruled that the Board had been granted exclusive decision-making power for those matters.
59. Under Aer Lingus' Articles of Association the Irish Government is allowed to appoint and remove three Directors (of the current total of 13 and a maximum of 15). Previously the Articles of Association also conferred the right on ESOT to nominate two directors. However, following the dispersion of ESOT shares its entitlement to nominate directors has ceased.
60. Some Aer Lingus shareholders indicated that Ryanair would have the ability, should it want to, to obtain board representation, highlighting its voting share and that other shareholders have achieved board representation with a lower shareholding.
61. Given its effective voting position, its position as the largest shareholder, the views of other shareholders, and the current make-up of the Aer Lingus board, the OFT considers that it is not inconceivable that Ryanair could seek and obtain the additional votes to enable it to take-up board representation.

³⁴ Ryanair vs. Aer Lingus, Judgment of the Irish High Court, 15 April 2011.

Distribution and holders of the remaining shares

62. The OFT considers below the distribution and holders of the remaining shares and in particular whether the acquiring entity's shareholding makes it the largest shareholder.³⁵ Ryanair is the largest shareholder in Aer Lingus. The second largest shareholder is the Irish Government with 25.1 per cent. Beyond this, the next largest shareholder holds only 3.8 per cent, around one-tenth of Ryanair's share.

Table 3 Aer Lingus' main shareholders (above two per cent)

Shareholder	Holding (per cent)
Ryanair	29.8
Irish Government (Minister for Finance)	25.1
Denis O'Brien	3.8
Etihad Airways	3.0
Irish Life Investments	2.9
Pilots Pension Scheme	2.2

Source: Aer Lingus (May 2012)

63. Ryanair submitted that in past cases where material influence has been found the acquirer was by far the largest shareholder and that in this case the minority stake, at 29.8 per cent, is only marginally larger than the stake held by the Irish Government, at 25.1 per cent.
64. As discussed above, in 2010 almost all of the ESOT shares (amounting to 11.7 per cent of Aer Lingus) were distributed to 4,234 beneficiaries. Ryanair argued that before 2010 the ESOT shares were consistently voted in line with Aer Lingus' third largest shareholder, Denis O'Brien (3.8 per cent) and the Irish Government. Together these shareholders accounted for over 40 per cent of the issued share capital of Aer Lingus and, according to Ryanair, were able to appoint and control the entire Board of Aer Lingus. However, now that the ESOT shares have been distributed to individuals, the OFT believes that a new dynamic may have emerged at shareholder meetings.
65. For example, Ryanair's position as largest shareholder may be stronger as a result. Ryanair submitted that the dispersion is of little practical significance

³⁵ OFT – Mergers – jurisdictional and procedural guidance, paragraph 3.21.

given the likely voting patterns of the ESOT shareholders. However, at the 2011 AGM, the first since the ESOT share dispersal, the overall turnout of ESOT shareholders fell, which gave Ryanair proportionately greater voting power (equivalent to around 43 per cent). At the 2012 AGM the increased voter turnout made Ryanair's effective vote around 41 per cent.

66. The dispersion of smaller shareholders is far greater than might initially be thought to be the case as many of the larger shareholders in Aer Lingus are nominee accounts, with the nominee acting in an execution capacity only and having numerous fund manager clients, which in turn may have many clients. The voting rights themselves may lie with individual shareholders and often the aggregate manager will not even provide a recommendation as to how to vote to those individual shareholders.
67. In addition, a number of shareholders of Aer Lingus are also shareholders of Ryanair. The OFT's market investigation has indicated that shareholders representing at least around four per cent of the total issued share capital and voting rights of Aer Lingus are also shareholders in Ryanair.³⁶ The OFT considers that the incentives of these shareholders are more aligned with those of Ryanair than would otherwise be the case, such that they may be more inclined to vote with, or be influenced by, Ryanair, albeit there is no evidence of this occurring in any votes that have taken place to date.
68. Finally, the OFT generally has regard to the status and expertise of the acquirer, and its corresponding influence on other shareholders, and will consider whether the acquirer may be able materially to influence policy formulation at an earlier stage through, for example, meetings with other shareholders.³⁷ Ryanair is the largest shareholder that is active in the industry with industry knowledge, experience and expertise. A number of other Aer Lingus shareholders pointed to this as a factor which may influence its own voting.
69. The OFT has not been presented with any evidence that Ryanair has influenced other shareholders in order to materially influence its rival, Aer Lingus. However, for the reasons given above, the OFT cannot dismiss the possibility that Ryanair will not be able to do so in the future.

³⁶ Goodbody Stockbrokers, Barings Asset Management, Blackrock and Norges Bank Investment Management (as at November 2011).

³⁷ *Jurisdictional and Procedural Guidance*, paragraph 3.22.

Conclusion on material influence

70. The OFT considers that as a result of its ability to block special resolutions and the recent voting patterns of shareholders the effective ability to block other strategic options of Aer Lingus, and the possibility of determining the passage of an ordinary resolution – whether unilaterally or by influencing other shareholders – Ryanair has the ability materially to influence the policy of Aer Lingus.³⁸

The share of supply test

71. The merger parties together account for more than 25 per cent of passengers flown between the UK and the Republic of Ireland. Data from the UK's Civil Aviation Authority show that together the parties account for more than 80 per cent of passengers between the UK and Republic of Ireland and over 65 per cent of flights. Therefore, the OFT considers that the share of supply test set out in section 23 of the Act is satisfied.

Time period for investigation

72. Ryanair first acquired a shareholding in Aer Lingus on 27 September 2006 and built up its share to July 2008 (Table 1). Following Ryanair's public bid for the entire share capital of Aer Lingus in October 2006, the Commission investigated the proposed merger and prohibited it (paragraph 5). The Commission's prohibition decision was issued on 27 June 2007 ('the Prohibition Decision'). On 11 October 2007, the Commission adopted a formal decision confirming that it did not have the power under Article 8(4) of the EC Merger Regulation to order divestment of the minority shareholding ('the Article 8(4) Decision').
73. Ryanair appealed the Prohibition Decision to the Court of First Instance (now the General Court). Aer Lingus appealed the Article 8(4) Decision. Ryanair's appeal sought to annul the Commission's decision so that the Commission could re-examine the evidence and find that either the concentration was compatible with the common market or that the commitments offered by Ryanair were sufficient to remedy the

³⁸ The OFT considers that, in line with paragraph 3.16 of the OFT's *Jurisdictional and Procedural Guidance*, it is appropriate to treat material influence as equivalent to control for the purpose of section 26(3) of the Act.

Commission's competition concerns. Aer Lingus' appeal, however, wanted the court to rule that the Commission did have jurisdiction over the remaining minority stake and that, therefore, the Commission could order a divestment of those shares.

74. The General Court, in separate judgments given on the same day, dismissed both appeals.³⁹ The period for appealing against either judgment on a point of law to the Court of Justice expired on 17 September 2010. Neither judgment was appealed.
75. The OFT considered that, in effect, its period for considering this matter started on 18 September 2010 by virtue of the operation of section 122(3) of the Act given that the conditions in section 122(4) of the Act were satisfied, namely that a reference could not have been made earlier because of the EC Merger Regulation or anything done under or in accordance with it. In this case, clearly the separate appeals by Ryanair and Aer Lingus to the General Court were matters undertaken under or in accordance with the EC Merger Regulation.
76. The OFT considered that it could not have made a decision on reference during the period from the Commission's decision to the end of the time for appeal from the General Court's judgments. This is because the various outcomes of any OFT decision and the General Court's judgments may have been in conflict.
77. For example, if Ryanair had been successful in its appeal, it may have been the case that the Commission, on re-examining the public bid, would have ultimately decided that the concentration was compatible with the common market or that appropriate remedies would be for Ryanair to divest certain take-off and landing slots. In the meantime, if the UK authorities (the OFT and CC) had started and continued investigations of Ryanair's minority stake the CC may have found a substantial lessening of competition which required Ryanair to divest some or all of that stake.⁴⁰ This would have created a clear conflict with the Commission.

³⁹ Case T-342/07 *Ryanair Holdings plc v Commission* [2011] 4 CMLR 245; and Case T-411/07 *Aer Lingus Group plc v Commission* [2011] 4 CMLR 358.

⁴⁰ Or Ryanair may have offered to the OFT, pursuant to section 73 of the Act, undertakings in lieu of a reference to divest some or all of its stake.

78. On the other hand, if Aer Lingus was successful in its appeal and the Commission was able to take jurisdiction over the residual minority stake for remedy purposes, any OFT and/or CC investigation of this minority stake would have been in breach of Article 21(3) of the EC Merger Regulation. Moreover, if the Commission had required Ryanair to divest its minority stake but the OFT or CC had cleared the transaction, the UK would be in conflict with the Commission.
79. The OFT has a duty of sincere cooperation with the Commission by dint of Article 10 of the EC Treaty (as it was at the time), now Article 4(3) of the Treaty on European Union. This Article, as currently worded, says:
- ‘Pursuant to the principle of sincere cooperation, the Union and the Member States shall, in full mutual respect, assist each other in carrying out tasks which flow from the Treaties. The Member States shall take any appropriate measure, general or particular, to ensure fulfilment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the Union. The Member States shall facilitate the achievement of the Union's tasks and refrain from any measure which could jeopardise the attainment of the Union's objectives.’
80. Ryanair disagreed with the OFT’s approach and challenged the matter before the Competition Appeal Tribunal (the Tribunal)⁴¹ and then the Court of Appeal.⁴² Both the Tribunal and the Court of Appeal ruled that the OFT is in time pursuant to s.122(4) to consider the minority stake. Ryanair sought permission to appeal the Tribunal’s judgment from the Supreme Court and a further stay of the OFT’s investigation. The Supreme Court refused permission.
81. The OFT’s statutory deadline was extended (section 25(2) of the Act) between 19 October 2010 to 31 August 2011 following the OFT’s information request to Ryanair pursuant to section 31 of the Act. Further, the Court of Appeal stayed the OFT’s investigation on 24 November 2011 until its Judgment on 22 May 2012. All parties – the OFT, Ryanair and Aer Lingus – agreed a 15 day extension to the statutory deadline pursuant to section 25(1) of the Act.

⁴¹ *Ryanair Holdings plc vs. OFT*, [2011] CAT 23.

⁴² *Ryanair Holdings plc vs. OFT*, [2012] EWCA Civ 643.

82. The OFT's statutory deadline in this case is therefore 18 June 2012.

Conclusion on Jurisdiction

83. The OFT considers that as a result of the minority shareholding Ryanair and Aer Lingus have ceased to be distinct. The transaction meets the share of supply test. The duty on the OFT to make a reference is preserved pursuant to section 122(3) of the Act given that the conditions in section 122(4) are satisfied. The OFT therefore considers that it is or may be the case that a relevant merger situation has been created.

FRAME OF REFERENCE

PRODUCT SCOPE

84. In *Ryanair/Aer Lingus*, the European Commission found for the purpose of analysing the loss of competition between Ryanair and Aer Lingus (the parties):

- It is not appropriate to distinguish between different types of airline operations or the level of service offered. Differences between carriers will, however, determine the degree of constraint that a competitor will exert on the parties.
- Charter airline services involving the sale of seats to tour operators and the sale of package holidays to end customers were not in the same market as scheduled airline services. Charter airline services involving the sale of 'dry-seats' to end customers was left open, although the Commission noted that only a few charter airlines offered a limited number of 'dry-seats' on a limited number of frequencies and in no case do they exceed five per cent of all seats offered.
- Distinctions on the basis of time-sensitivity, between business and leisure passengers, time between booking and departure, and price insensitivity were all considered inappropriate or not relevant.

85. In relation to these points, Ryanair submitted that there is now a strong case that charter services should be placed within the same relevant product market as scheduled airline services as the two have converged over time. Passengers are increasingly constructing their own packages

holidays using online services, meaning that package holidays are no longer exclusively the preserve of charter airlines. At the same time, previously charter-only airlines have begun to sell seats on their aircraft in the same way as low-cost scheduled carriers.

86. The OFT notes that in this case, there are a number of overlapping routes on which charter airlines offer regular or seasonal services. On some of these, the charter airlines operate from the same airport as one or both of Aer Lingus and Ryanair. No evidence was provided by Ryanair to support or substantiate the assertions that charter airline and scheduled airline services have converged over time or the extent of the competitive constraint represented by charter airlines has increased. Indeed many of the same points were also raised by Ryanair and considered by the Commission in *Ryanair/Aer Lingus*. Nor was any submission made by Ryanair on departing from the European Commission's approach in relation to different types of airline or other distinctions. As a result, the OFT follows the approach taken in past cases, although notes that inclusion of charter services would have no effect on the outcome of the OFT's competitive assessment.⁴³

Geographic Scope

Origin and Destination Pairs

87. The approach to the geographic scope in past airline cases by the OFT and European Commission has generally been to focus on overlap routes as defined by matching origin and destination (O&D) pairs.⁴⁴
88. Under such an approach, the narrowest candidate geographic market is an airport pair, where Ryanair and Aer Lingus fly to and from the same respective airports. However, past cases – and in particular the European Commission's assessment of *Ryanair/Aer Lingus*⁴⁵ – have pointed to a sufficient competitive constraint from O&D pairs to different airports in the

⁴³ See below for details of the overlaps between Ryanair and Aer Lingus.

⁴⁴ For example, *Ryanair/Aer Lingus* and *Anticipated acquisition by Flybe Group Ltd of the BA Connect business of British Airways plc*, OFT, 15 February 2007.

⁴⁵ See also *Completed acquisition by Air France finance S.A.S/ City Jet Ltd of VLM Airlines N.V.*, OFT, 10 June 2008.

near vicinity of one another such that the market may be viewed more broadly in some instances.

89. In *Ryanair/Aer Lingus*, the Commission considered a 100km or 1 hour drivetime to be a conservative estimate of, and a useful starting point in determining, an airport's typical minimum catchment area. More specifically, the Commission found:⁴⁶
- all five London airports (Heathrow, Gatwick, Stansted, Luton and City) part of the same market
 - Manchester to be in the same relevant market as Liverpool Airport and Leeds Bradford Airport, and
 - Birmingham to be in the same market as East Midlands airport.
90. Neither Ryanair nor Aer Lingus provided any evidence to suggest an alternative approach is relevant in relation to any of the relevant cities (that is, origins and/or destinations) identified above.⁴⁷ As a result, the OFT takes a cautious approach and considers overlaps based on the narrowest candidate geographic market of airport pairs as well as the wider O&D markets as identified above for the purposes of the competitive assessment.
91. The OFT has considered other airports not previously considered in past cases. For these airports, Ryanair follow a similar rule but widens the catchment area to 115 km or a one hour, nine-minute drivetime. On this basis, Ryanair submitted that O&D routes involving Cork airport are unlikely to be constrained by routes involving either Kerry Airport or Shannon Airport and vice versa. Kerry Airport is 105km and 94 minutes drivetime away from Cork but the area between the two airports is very sparsely populated and there are few customers that would therefore be choosing between the airports on the basis of a broadly equal travel time to the two airports, according to Ryanair. Shannon Airport is 132 km and 199 minutes drivetime from Cork Airport and few people live in the area between the airports.

⁴⁶ *Ryanair/Aer Lingus*, Section 6.

⁴⁷ Evidence from internal documents [].

92. The closest airport to Shannon Airport is Galway Airport, 79km and 63 minutes drivetime away. Ryanair submitted this is close enough for the airports to compete with one another. No submissions were made regarding Knock airport.
93. Ryanair submitted that Derry Airport is 113 km and 95 minutes drivetime from the centre of Belfast and it is unclear whether services from Derry would represent a competitive constraint on those from Belfast International Airport and vice versa. Belfast also has another airport, Belfast City, which Ryanair previously operated services from. Aer Lingus also indicated that for some passengers, routes from the two airports would be substitutable, although were unable to indicate the extent of this substitution. As a result, and in absence of evidence to the contrary, the OFT takes a cautious approach and considers O&D pairs involving Derry and Belfast to be substitutes (a cautious approach as Ryanair operate from Derry and Aer Lingus from Belfast).

UK to/from Ireland and certain Irish Airports

94. In *Ryanair/Aer Lingus*, the European Commission also examined the possibility of a wider candidate market for a bundle of routes, in addition to individual overlapping routes between a specific point of origin and point of destination, on the basis that the transaction would combine two airlines with large scale operations to and from Ireland and in particular routes out of Dublin.^{48,49}
95. The Commission point to arguments in support of this proposition on the supply-side – whereby having a significant presence in Dublin allows both airlines to switch between routes and to add other routes out of the airport more easily than other competitors without such a significant base – but question whether the competitive constraints from the supply-side are sufficiently immediate and effective. A number of barriers are highlighted

⁴⁸ *Ryanair/Aer Lingus*, paragraph 55. Note this approach – of examining a bundle of routes – was also considered in Case No IV/M.259 – *British Airways/TAT*, 27 November 1992, paragraph 17 & 19; and supported by the CFI in an appeal related to this case (see CFI case T-2/93 *Air France v Commission*, 19 May 1994 ECR 320, paragraph 85). See also Case No COMP/M.5830 *Olympic/Aegean Airlines*.

⁴⁹ At the time of the EC investigation around 41 out of around 48 total short-haul aircraft of all airlines based in Dublin belonged to either Ryanair or Aer Lingus and Aer Lingus and Ryanair together held a share of around 80 per cent of all scheduled European traffic to and from Dublin.

which may prevent airlines from reacting to competition by opening new routes and the significant investment, strategic decision and times on the part of any entrant.

96. In this case, the overlaps between the parties are concentrated on routes between the UK and Ireland and relate to only a limited number of airports and/or cities. In addition, as outlined below, Aer Lingus and Ryanair are the most significant passenger airlines on UK to Ireland routes by a considerable margin. The OFT notes that the brand recognition of the two airlines among Anglo-Irish consumers, given their significant relative presence on routes between the countries compared to other airlines, their relative strength at Irish airports compared to other airlines (at Dublin, Cork, Shannon, and Knock airports, Ryanair and Aer Lingus account for around 80 per cent or more of all passenger traffic⁵⁰), and the absence of significant sunk costs involved in switching capacity between routes from existing airport bases may justify aggregating a bundle of routes.
97. The OFT considers that, as a result, the overlapping routes cannot be considered in isolation and the ease with which Ryanair and Aer Lingus can switch and reallocate capacity, enter, expand and exit on routes between the UK and Republic of Ireland as a result of the two airlines' presence on such routes relative to other airlines, may be materially greater than any other airline.⁵¹ This proposition is broadly supported by, first, the entry and exit decisions of both airlines in recent years and, second, the significant marketing activity of Ryanair, which targets Aer Lingus for purposes of comparison pointing to a bundle of overlapping routes, routes in which there is no overlap, or does not specifically mention an overlap, only fares from a certain Irish Airport.^{52,53} As a result, the OFT also considers relevant routes on which Ryanair and Aer Lingus do not currently overlap but may

⁵⁰ Source: CAA March 2012 data.

⁵¹ It may also point to 'system-wide' competition between the UK and Ireland.

⁵² It may therefore be the case that a wider candidate market for a bundle of routes is plausible to the extent there is substitutability between the routes comprised within it. Ryanair also argued that there is a market for a 'bundle' of routes but due to substitution on the demand-side, arguing that a significant proportion of passengers are 'destination-insensitive' whereby leisure passengers are looking for a value for money break without being overly concerned where that break takes place, although no evidence has been provided to support this. The OFT is sceptical as to the extent to which a significant proportion of passengers are likely to be so-called destination insensitive on routes between the UK and Ireland. Even if it could be argued that passengers consider a 'cheap weekend' in Prague substitutable with a 'cheap weekend' in Tallinn, as Ryanair submitted, the extent to which there would be demand-side substitutability

potentially do so going forward and in this context on the effect of the shareholding on potential competition between the UK and Ireland.

Conclusion on Frame of Reference

98. The OFT considers it appropriate to assess the effects of the acquisition on O&D overlaps involving the UK and, where applicable, the extent to which the acquisition may affect competition on a wider bundle of routes or on routes on which Ryanair and Aer Lingus do not currently overlap.

THE COUNTERFACTUAL

99. The OFT assesses the competitive effects of a merger by comparing the prospects for competition with the merger against the competitive situation absent the merger.⁵⁴ The description of the latter, the counterfactual, is affected by the extent to which events or circumstances are foreseeable. In practice the OFT generally adopts the pre-merger situation as the counterfactual against which to assess the merger. However, the OFT will assess the merger against an alternative counterfactual where, based on the evidence available to it, it considers that the prospect of prevailing conditions continuing is not realistic.

100. It has not been suggested in this case that the counterfactual should be anything other than the position absent Ryanair owning the minority stake in Aer Lingus. As such, it is incumbent on the OFT to examine the merger against a counterfactual in which Ryanair did not own shares in Aer Lingus, but to take into account evidence of recent marketplace dynamics that have occurred since the acquisition of the minority stake that the OFT considers to be relevant to that analysis.

101. For example, some of the origin/destination overlaps between the parties and the affected UK-related routes have changed over time, the shares in Aer Lingus formerly held by ESOT have been dissipated among its members, competing airlines have entered and exited some routes and

between say Manchester and London from Dublin, or between Birmingham and Prague, is less clear.

⁵³ The OFT recognises that it is concerned only by the effect that such a candidate product market would have on UK consumers but notes that almost two-thirds of Aer Lingus' short-haul passengers are to/from the UK.

⁵⁴ *Merger Assessment Guidelines*, section 4.3.

there has been some merger activity by some of the parties' competitors in the UK-related routes.⁵⁵ These developments, with the possible exception of changes in overlap routes, cannot realistically be considered as merger specific and as such should clearly be taken into account in the OFT's analysis. To the extent that the changes in routes might be considered merger specific, the OFT does not consider that these particular changes would change the outcome its competitive assessment in any event.

102. In applying the counterfactual the OFT is mindful that the CAT has said in regard to the CC applying a stated counterfactual:

'Competitive conditions can and do change over time, and it is important to take into account the potential for change in the market in order to consider as fully as possible the level and intensity of the competition without the merger.'⁵⁶

103. Further, the Court of Appeal upheld the CAT's judgment on this point.⁵⁷ Indeed, both the UK competition agencies and European Commission have taken into account evidence on competitive conditions contemporary to the investigation in cases when the pre-merger conditions were some time ago (possibly years), rather than ossifying the analysis at the pre-merger time.⁵⁸

COMPETITION BETWEEN RYANAIR AND AER LINGUS

104. In *Ryanair/Aer Lingus*, the Commission found that Ryanair and Aer Lingus were competing prior to the attempted takeover and were closest competitors, pointing to a wide range of evidence supporting this.⁵⁹

105. The OFT's investigation in this case has confirmed that many of the same conclusions of the Commission on the extent of competition between Ryanair and Aer Lingus continue to apply. The OFT considers for the purposes of the competitive assessment in this case that Ryanair and Aer

⁵⁵ For example, IAG has acquired bmi.

⁵⁶ *British Sky Broadcasting Group plc v Competition Commission* [2008] CAT 25.

⁵⁷ [2010] EWCA Civ 2.

⁵⁸ For example, for the CC, *A report on the acquisition of the Co-operative Group (CWS) Limited's store at Uxbridge Road, Slough, by Tesco plc*, 28 November 2007; *A report on the completed acquisition by Kerry Foods Limited of the frozen ready meals business of Headland Foods Limited*, 2 December 2011; and for the Commission, Case M.3333 *Sony/BMG*.

⁵⁹ See *Ryanair/Aer Lingus*, Sections 7.2 to 7.6.

Lingus were competing prior to the acquisition, and continue to compete, this competition taking two forms:

- actual competition on overlapping routes.⁶⁰ and
- potential competition on currently non-overlapping routes.

Actual competition⁶¹

Ryanair and Aer Lingus

106. On the basis of O&D airport pairs, there are currently five overlaps between Ryanair and Aer Lingus:⁶²

- | | | |
|-------------------|---------|----------------------|
| a. Birmingham | to/from | Dublin |
| b. Manchester | to/from | Dublin |
| c. Edinburgh | to/from | Dublin ⁶³ |
| d. London Gatwick | to/from | Dublin |
| e. London Gatwick | to/from | Cork |

107. On each of these Ryanair and Aer Lingus face no competition from any other airline.

⁶⁰ Whilst this may also involve a bundle of overlapping routes or 'system wide' competition, the OFT focuses its competitive assessment on the overlapping routes.

⁶¹ All data used in the decision are from the Civil Aviation Authority and refer either to March 2012 or the latest IATA season, winter 2011/12 or, where appropriate, summer 2011 season. Limited flight landings are excluded from the analysis.

⁶² A sixth airport pair overlap, London Gatwick to Shannon, ended in September 2011 after Aer Lingus terminated its service.

⁶³ Aer Lingus reduced capacity significantly on this route with Aer Arann providing services under the Aer Lingus franchise agreement (see below). Aer Lingus submitted their remaining capacity on this route – a single flight per day at lunchtime – is not in direct competition with Aer Arann, which operates at peak times. Indeed, more recent data appears to show Aer Lingus having reduced its capacity even further on the route.

108. On the basis of the wider O&D market pairs outlined above, there are twelve direct O&D overlaps between Ryanair and Aer Lingus:⁶⁴

- | | | |
|----------------------------------|---------|----------------------|
| a. London (all airports) | to/from | Dublin |
| b. London (all airports) | to/from | Cork |
| c. London (all airports) | to/from | Shannon |
| d. London (all airports) | to/from | Knock |
| e. London (all airports) | to/from | Malaga ⁶⁵ |
| f. London (all airports) | to/from | Belfast (/Derry) |
| g. Birmingham (/East Midlands) | to/from | Dublin |
| h. Manchester (/Liverpool/Leeds) | to/from | Dublin |
| i. Belfast (/Derry) | to/from | Tenerife |
| j. Belfast (/Derry) | to/from | Alicante |
| k. Belfast (/Derry) | to/from | Faro |
| l. London (all airports) | to/from | Turin |

109. On the Manchester and Birmingham to Dublin routes,⁶⁶ London to Cork, Shannon, and Knock routes, Ryanair and Aer Lingus face no competition and each has a material share of passenger traffic (above 40 per cent, with the exception of Knock where Ryanair carries 76 per cent and Aer Lingus 24 per cent of passenger traffic, respectively).

110. On the London to Dublin route, Aer Lingus operates services from Gatwick and Heathrow and carries 46 per cent of passengers. Ryanair operates from Gatwick, Luton and Stansted, carrying 40 per cent of passengers. BMI operates a Heathrow service, carrying nine per cent of passengers,⁶⁷ and CityJet operates a London City service carrying five per cent of passengers. However, Ryanair and Aer Lingus together account for the large majority (86 per cent) of passengers on this route.

⁶⁴ At the time of the European Commission's decision in *Ryanair /Aer Lingus* (Comp/M.4439) of June 2007 there were the following UK-Ireland overlaps: Dublin to/from: –Glasgow, –Birmingham, –Manchester, –Edinburgh and –Newcastle, on all of which Ryanair and Aer Lingus were the only active carriers at the time of the investigation; London to/from: –Dublin, –Cork, and –Shannon, on all of which Ryanair and Aer Lingus has a share of capacity between 79 per cent and 91 per cent; and Cork – Manchester, which Aer Lingus entered in 2007.

⁶⁵ Aer Lingus submitted they have since exited the London – Malaga route.

⁶⁶ Aer Arann operate a service from Blackpool to/from Dublin, which carries, if Blackpool were included alongside Manchester, Liverpool and Leeds Bradford in a wider North West England market, only around one per cent of passengers.

⁶⁷ BMI were acquired by IAG in 2012.

111. On the five routes referred to in paragraph 109, where Ryanair and Aer Lingus are the only operators, by the nature of a duopoly, the OFT considers the carriers are likely to be closest competitors and the degree of substitutability between them especially high. On the London to Dublin route where Ryanair and Aer Lingus represent a significant majority of passengers, the OFT also considers Ryanair and Aer Lingus are likely to be closest competitors. These six routes are collectively referred to as the **'Key Overlap Routes'** for the purposes of the OFT's competitive assessment, below.

112. The OFT notes that Ryanair and Aer Lingus also have a significant majority of passengers on the Belfast to Tenerife route. Aer Lingus operates from Belfast International and Ryanair from Derry, carrying 63 and 32 per cent of scheduled passengers, respectively. The other scheduled operator is Jet2. However, the position on this route is more nuanced given that Ryanair does not operate on this route in the winter season and given that charter lines are also materially present.⁶⁸ Without prejudice to whether competition concerns could arise on this route, the OFT has therefore not included this route in the Key Overlap Routes.

113. For the sake of completeness, there are a number of other routes on which Ryanair and Aer Lingus also compete but on which there are other significant competing airlines.

- On the Belfast to Alicante route, Aer Lingus operates from Belfast International and Ryanair from Derry, together accounting for 33 per cent of scheduled passengers in summer 2011. Ryanair only operate in summer season and had significantly reduced passenger traffic in 2011, giving it a share of scheduled passengers of only 6 per cent. Easyjet, operating from Belfast International, is the largest carrier with 64 per cent of scheduled passengers (summer 2011).⁶⁹
- On the Belfast to Faro routes, Aer Lingus operates from Belfast International and Ryanair from Derry, together carrying 49 per cent of

⁶⁸ Ryanair did not operate on this route in the winter season 2011/12, nor did Jet2. Figures therefore relate to the summer 2011 season. Thomas Cook (all year) and Thomson (summer season only) also operate on the route, accounting for 34 and 14 per cent of total passengers, respectively, during summer 2011.

⁶⁹ The charter airline Thomas Cook operates on the Alicante route in summer season only, accounting for around nine per cent of total passengers.

scheduled passengers (summer 2011). Ryanair and Aer Lingus operate with significantly reduced capacity during winter seasons on this route. EasyJet, operating from Belfast International, is the largest airline on the route carrying 51 per cent of scheduled passengers (summer 2011). Easyjet also retains significantly more capacity than Aer Lingus and Ryanair in the winter season.⁷⁰

- On London to Malaga, Ryanair and Aer Lingus together carry 22 per cent of passengers (summer 2011) with easyJet and Monarch the largest scheduled carriers. Aer Lingus submitted it has since exited this route.
- On London to Belfast, Ryanair and Aer Lingus carry only around 17 per cent of passengers, there are three other scheduled airlines carrying a similar or greater number of passengers, and the other airlines operate from the same airport and/or city as Aer Lingus in Belfast, whereas Ryanair operate from Derry.⁷¹
- On London to Turin, Ryanair carry 53 per cent and Aer Lingus five per cent of scheduled passengers. The other carrier, BA, carries 42 per cent.^{72, 73}

114. The OFT considers Ryanair and Aer Lingus likely to compete on these additional routes but recognise there are other competing airlines that provide a competitive constraint and may, in some cases, represent stronger competition to Ryanair and/or Aer Lingus than Ryanair and Aer Lingus are to each other. The OFT has therefore reached no conclusion as to whether the test for reference is met in relation to any loss of competition on these routes (as well as Belfast-Tenerife).

⁷⁰ The charter airline Thomson operates on the Faro route in summer season only, accounting for five per cent of total passengers.

⁷¹ On the London to Belfast route, where Aer Lingus operate from Heathrow to Belfast International and Ryanair from Stansted to Derry, easyJet operate from Gatwick, Luton and Stansted to Belfast International, BMI operate from Heathrow to Belfast City, and Flybe operate from Gatwick to Belfast City.

⁷² The charter airlines Thomson and Thomas Cook both operate the route in winter season, along with one other charter carrier, together carrying 21 per cent of total passengers.

⁷³ One further minor overlap has been identified, London–Grenoble, on which Ryanair carry 19 per cent of scheduled passengers and Aer Lingus carry charter passengers equivalent to three per cent of total passengers (W11/12). There are four other airlines – scheduled and chartered – operating on the route.

Aer Lingus and Aer Arann

115. In January 2010, Aer Lingus and Aer Arann entered into a franchise agreement pursuant to which Aer Arann operates a number of routes – the majority of which were operated directly by Aer Lingus prior to 2010 – from Dublin and Cork to primarily UK regional airports under the ‘Aer Lingus Regional’ brand. Aer Lingus submitted that all flights on the franchise services are sold and distributed exclusively through the Aer Lingus website. Aer Lingus therefore collects all revenues and remits these to Aer Arann, less some costs and franchise fee on gross sold fare revenue (excluding taxes and charges). The potential benefit to Ryanair, in proportion to its shareholding, would be less than [0 – five] per cent of that earned by Aer Arann on overlapping routes.
116. Aer Arann assumes full operational and commercial responsibility for the services (including prices and frequencies), which are operated by Aer Arann aircraft and crew, with Aer Lingus receiving a franchise fee in recognition for providing its brand and product suite to Aer Arann.
117. The franchise agreement was subsequently extended so that every Aer Arann route is now branded as an Aer Lingus Regional service.⁷⁴
118. Ryanair submitted that the Aer Arann overlaps should be excluded from any analysis as no theory of harm can credibly apply to these overlaps. Such an approach would be consistent, according to Ryanair, with the European Commission’s recent treatment of airline alliances.⁷⁵

Conclusion on actual competition

119. No evidence has been submitted by Ryanair (or Aer Lingus) to suggest the parties are not competing. Third parties in this case supported Ryanair and Aer Lingus as closest competitors on overlapping routes including the Key Overlap Routes. Whilst acknowledging the commercial relationship between Aer Lingus and Aer Arann, the OFT has not found it necessary for the

⁷⁴ These include Dublin to/from: –Aberdeen, –Blackpool, –Bournemouth, –Bristol, –Cardiff, –Edinburgh, –Glasgow, –London Southend, –Manchester; Cork to/from: –Birmingham, –Bristol, –Edinburgh, –Glasgow, –Manchester; Shannon to/from: –Birmingham, –Bristol, –Edinburgh, –Glasgow, –Manchester; Waterford to/from: –London Luton, –London Southend, –Manchester.

⁷⁵ See COMP/M.5440 – *Lufthansa/Austrian Airlines*, European Commission, August 2009.

purposes of its decision to decide on the extent to which Aer Arann overlaps should be included or excluded from the analysis. The OFT has identified six Key Overlap Routes (see paragraph 111) which are relevant for the purposes of its competitive assessment, below.

Potential competition⁷⁶

120. Ryanair and Aer Lingus together account for 82 per cent of passengers flying between the UK and the Republic of Ireland (Table 4) with only five other airlines operating routes between the countries. One of these, Aer Arann (with nine per cent of passengers) currently operates as a franchisee for Aer Lingus and provides services under the 'Aer Lingus Regional' brand. The other four carry less than five per cent each of total passenger movement between the countries.⁷⁷

⁷⁶ All data used in the decision are from the Civil Aviation Authority and refer either to March 2012 or the latest IATA season, winter 2011/12 or, where appropriate, summer 2011 season. Limited flight landings are excluded from the analysis.

⁷⁷ CityJet with a single route carries less than two per cent of passengers; BMI with two route carries 4 per cent of passengers; Flybe operates five routes, four of which overlaps with neither Ryanair nor Aer Lingus, and carries less than two per cent of passengers; and Jet2 operates a single route, which does not overlap with either Ryanair or Aer Lingus, and carries only 0.2 per cent of total passengers.

Table 4: Airlines on routes between the UK and Rep. of Ireland

Carrier	Routes	Flights	Passengers	Share of passengers (per cent)
Aer Lingus	8	876	108,479	29
Ryanair	23	1,473	195,993	53
Aer Arann	16	727	34,163	9
BMI	2	150	16,615	4
CityJet	1	134	7,564	2
Flybe	5	149	6,864	2
Jet2	1	9	919	0
Total	56	3,518	370,597	100

Notes: Data refer to March 2012

Single flight landings or diversions are excluded

BMI includes BMI and bmibaby. BMI was acquired by IAG in March 2012.

In May 2012 IAG announced that BMI baby will be grounded from September 2012, with some services discontinuing from June 2012.

Source: UK Civil Aviation Authority

121. Ryanair and Aer Lingus also overlap at a number of airport bases, together responsible for around 80 per cent or more of passenger traffic at Dublin, Cork, Shannon and Knock airports.
122. The OFT considers that supply-side flexibility, particularly between the UK and Ireland and from airports in which Ryanair and Aer Lingus have a base, suggests that Ryanair and Aer Lingus may also compete on a wider array of routes and are closest competitors at certain airports in the Republic of Ireland. A third party in this case supported this proposition.
123. The OFT therefore considers that it is relevant in this case to also focus on routes on which Ryanair and Aer Lingus do not overlap but may represent potential competitors to each other. Individual routes cannot be regarded in isolation or considered independent from each other. Instead a dynamic analysis is required, which takes account of entry and exit of both carriers over time. In particular, the OFT has examined those routes where only one of Ryanair or Aer Lingus is currently active but either may be constrained by the potential entry of the other.⁷⁸ These routes are determined by the

⁷⁸ The OFT makes a distinction between 'actual potential competition' (the constraint from likely actual entry) and 'perceived potential competition' (the constraint from the threat of entry)

ease with which either could enter the route, by shifting capacity in response to competitive conditions on the route. The OFT considers, first, the extent to which Aer Lingus or Ryanair are likely to enter against each other (relative to other carriers), and, secondly, the extent to which entry would lead to greater competition.⁷⁹

124. The OFT considers it appropriate as a starting point to identify routes in which one of the two carriers operates that are between the UK and Ireland and to/from an airport where either of the two airlines has a base and no other competing airline also has a base. This initial filter is based on the two airlines carrying a significant majority of passengers with few competing carriers between the UK and Ireland and their relative strength at airport bases in the Republic of Ireland, where the two carriers are the largest airlines, and one in particular, Dublin, has capacity constraints. The OFT therefore considers that on these routes, Ryanair and Aer Lingus may compete dynamically, as each is well-placed without significant sunk costs to enter and compete against the other.^{80,81}

125. In an extended dynamic consideration, an incumbent may keep prices lower than in the absence of the potential entrant to avoid reallocation of capacity to the route in question by the rival airline for the next IATA season.⁸²

without entry actually occurring). In this case, while such a distinction is appropriate, the key analysis underpinning an assessment of each is the same.

⁷⁹ See *Merger Assessment Guidelines*, paragraph 5.4.15.

⁸⁰ This may happen if demand conditions improve on a given route and passenger numbers expand but also as a result of relatively higher decline of demand on a certain route where one enjoys spare capacity; that is, where the carrier shifts its planes and crew to other relatively more profitable routes.

⁸¹ The OFT notes that, given the nature of competition, this analysis may be considered as actual competition on capacity. Prices can be adjusted quickly by the airline, while routes, frequencies and services are normally predetermined for an IATA season. An incumbent on any route is therefore competing on capacity at the beginning of an IATA season with other relevant airlines (as they set capacity simultaneously). Entry by a carrier which shares a base presence at the same airport may be more likely than completely new entry by another carrier without such a base. As far as capacity is concerned therefore, two airlines operating a base at the same airport may be actual competitors since every IATA season they must decide separately but simultaneously to allocate capacity.

⁸² The Court of First Instance supported this in *Case T-342/07 Ryanair Holdings v Commission* [2010] ECR, paragraph 162, which states that for routes operated by Aer Lingus out of Dublin, 'it is in fact likely that Aer Lingus would charge lower fares than it would charge if Ryanair did not have a base at Dublin airport'.

126. The OFT understands that Ryanair has five routes between the UK and Ireland,⁸³ and a further three from Northern Ireland to other parts of the UK,⁸⁴ on which it does not overlap with Aer Lingus.⁸⁵
127. Of these routes, four involve airports at which Aer Lingus has a significant base and is the second largest airline (Dublin, Shannon, Knock) by passenger traffic by a significant margin and where Aer Lingus likely represents the closest potential competitor to Ryanair.⁸⁶ Indeed Aer Lingus has in fact entered against Ryanair on other routes from these airports since the acquisition began in 2006.
128. The OFT considers therefore that on these routes Aer Lingus may be a potential competitor to Ryanair.
129. On two of these routes,⁸⁷ the OFT understands that Ryanair faces no material competition and so entry from Aer Lingus would be expected to result in a substantial increase in competition. These two routes are referred to for the purposes of the OFT's assessment as the '**Ryanair Routes**'. On one other route (Knock-Manchester), Ryanair faces competition from Flybe but Ryanair carries over 80 per cent of passenger traffic. The OFT notes that the same conclusions may apply to this route but has not found it necessary to consider this route as part of its assessment. The OFT notes that on routes from Belfast, Aer Lingus is a potential entrant but not necessarily the most likely. On routes to/from Kerry, Aer Lingus is not considered as likely an entrant as it does not have a base or operate any services from the airport.

⁸³ Dublin to/from Newcastle; Knock to/from: –Manchester (Liverpool), –Birmingham (East Mids.), –Bristol; Kerry to/from London.

⁸⁴ Belfast (Derry) to/from – Birmingham (East Mids.), Manchester (Liverpool), and Glasgow (Prestwick).

⁸⁵ The European Commission's decision in *Ryanair/Aer Lingus* (Comp/M.4439) of June 2007 did not identify routes in which there was no current overlap but either Ryanair or Aer Lingus may be considered a potential competitor against the other. However, in August 2006 the OFT notes Ryanair was active on the following routes between the UK and Ireland and did not overlap with Aer Lingus: Dublin to/from: –Blackpool, –Bournemouth, –Doncaster, –Humberside, –Newcastle, –Aberdeen; Cork to/from Manchester; Shannon to/from: –Birmingham, –Bristol, –Glasgow, –Manchester; Knock to/from London; Kerry to/from Manchester; and Belfast to/from – Birmingham, –Manchester, and –London.

⁸⁶ Dublin to/from Newcastle; Knock to/from: –Manchester (Liverpool), –Birmingham (East Mids.), –Bristol.

⁸⁷ Dublin – Newcastle; and; Knock – Bristol.

130. The OFT understands there are four routes which Aer Lingus operate on – and the origin or destination is in the UK – where it does not currently compete with Ryanair, all of which are from Belfast to Spain or Italy,^{88,89} on some of which, Aer Lingus is the only carrier (for example, Rome) or there is only a single other carrier present (for example, Barcelona, where easyJet operate⁹⁰). These routes are referred to as the ‘**Aer Lingus Routes**’ for the purposes of the OFT’s competitive assessment.

131. The OFT therefore considers that Ryanair and Aer Lingus, in addition to competing on overlapping O&D routes, may also be potential competitors on a number of other routes, where those routes are between the UK and Ireland and have their origin or destination at an airport in the Republic of Ireland where one or the other has a base.

HORIZONTAL ISSUES

Theories of Harm and Use of Evidence

132. The OFT considers five theories of harm.

- I. Aer Lingus has been or may be weakened as a competitor
 - i. Directly through the use of the shareholding
 - ii. Indirectly through the existence of the shareholding
- II. Ryanair has reduced incentives to compete against Aer Lingus
- III. Aer Lingus has reduced incentives to compete against Ryanair, and
- IV. Tacit coordination may be created or strengthened.

133. The OFT notes that its test for reference will be met when it considers there to be a realistic prospect of a substantial lessening of competition in

⁸⁸ Belfast (Derry) – Barcelona (Ryanair operate a number of different services from both Belfast (Derry) and Barcelona El Prat, Barcelona (Girona) and Barcelona (Reus)); Belfast (Derry) – Lanzarote; Belfast (Derry) – Gran Canaria; and Belfast (Derry) – Rome (Fiumicino).

⁸⁹ The European Commission’s decision in *Ryanair/Aer Lingus* (Comp/M.4439) of June 2007 did not identify routes in which there was no current overlap but either Ryanair or Aer Lingus may be considered a potential competitor against the other. However, in August 2006 the OFT notes Aer Lingus was active on Birmingham – Cork where there was no overlap with Ryanair.

⁹⁰ The charter airlines, Thomas Cook (all year) and Thomson (summer season), are also active on this route.

respect of one or more of the theories it considers but that, in line with its guidance, these theories may be mutually exclusive.⁹¹

134. The OFT is mindful in this case of the significant period of time that has occurred since acquisition of the minority stake and the OFT's decision (that is, almost four years since the last share purchase by Ryanair). In accordance with its guidance, the OFT's judgement on whether there is a realistic prospect of a substantial lessening of competition will take due account of the extent of the evidence available to it at the time of its decision,⁹² including evidence that has occurred since the merger in the event of a completed merger.
135. The circumstances of this case mean that – unusually – the OFT is able to take account of events that have taken place over an extended period since Ryanair acquired its minority shareholding. In this respect, Ryanair argued strongly that events since the acquisition have demonstrated that it and Aer Lingus have competed vigorously and effectively against each other, thereby demonstrating that the acquisition of the minority stake has in no sense led to any lessening of competition between them.
136. The OFT has taken due account in its analysis below of evidence pertaining to the situation that has prevailed since the acquisition of the minority stake. It also acknowledges that Ryanair has not been subject to any form of interim measure from the European Courts or the OFT in relation to the rights accompanying the shareholding and that as such there has been no legal fetter on its use of its shareholding.
137. The OFT considers it important to emphasise two distinct points in relation to the above considerations. First, as a matter of law, the OFT is not required in its evaluation of completed mergers to demonstrate that harm has arisen from the merger at the time of its decision. The statutory test in respect of completed mergers is whether it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition. To this extent, it is not necessary for the OFT to show that a substantial lessening of competition (or the adverse effects of it) has already resulted, provided it believes that there are reasonable grounds to

⁹¹ *Merger Assessment Guidelines*, paragraph 4.2.5, footnote 36.

⁹² *Merger Assessment Guidelines*, paragraph 4.2.5, paragraph 2.7.

believe that a substantial lessening of competition may be expected to result from the merger going forward.

138. Second, the OFT believes that considerable caution is required in placing weight on events since Ryanair acquired the minority shareholding as evidence of what may be expected to occur going forward. Specifically, the OFT considers that, even if there were no historic evidence that pointed toward a substantial lessening of competition, this should not be regarded as conclusive, as Ryanair has been able to adapt its behaviour over the intervening years since the acquisition. Specifically, Ryanair has been involved in some form of merger control proceedings relating to its shareholding in Aer Lingus (either the attempted takeover or the residual shareholding) at all times since the acquisition. This was initially by the European Commission and latterly by the OFT. The OFT cannot therefore exclude the possibility that Ryanair, retaining competition lawyers during this entire period, was aware of the risk that the OFT could feasibly begin an investigation of the minority stake subsequent to these proceedings, and had regard to this possibility in determining how it exercised its rights in Aer Lingus.
139. Linked to the caution expressed above is the practical point that, in relation to certain of the theories of harm considered by the OFT, there may not be direct evidence of any substantial lessening of competition over the intervening period because Aer Lingus would itself have taken account of the existence of Ryanair's shareholding in determining its commercial conduct and deciding what commercial proposals it should seek to take forward. This is particularly relevant in relation to the first theory of harm (Aer Lingus as a weakened competitor) in so far as Aer Lingus would be unlikely publicly to propose actions that it knew or suspected Ryanair would prevent.
140. For these reasons, whilst the OFT has considered carefully the events that have taken place over the period since Ryanair acquired the shareholding, it has also considered, as it would in any completed merger, whether the acquisition may be expected to result in a substantial lessening of competition prospectively.

Aer Lingus as a weakened competitor

141. The OFT has examined the possibility that Ryanair could weaken the competitive constraint it faces from Aer Lingus, first, by Ryanair using its shareholding, and the level of corporate control it confers on Ryanair, to worsen Aer Lingus' competitive offering or otherwise diminish Aer Lingus as a competitor and, second, by the mere existence of the shareholding in Aer Lingus. For each we consider the potential effect on competition on relevant markets in the UK.

Direct weakening of Aer Lingus

142. Ryanair submitted that this theory of harm could not be maintained since an examination of matters taken to a shareholder vote over the last five years shows that the vast majority of resolutions could have had no conceivable impact on Aer Lingus' commercial strategy.

143. Ryanair argued that there would only be an impact on the competitiveness of Aer Lingus from its active use of its shareholding if relevant decisions required a shareholder vote and Ryanair could block those decisions with its voting rights. In this context, Ryanair pointed to Aer Lingus' decisions to open new routes or change its competitive stance in the market, which have never been the subject of a shareholder vote and are within the control of Aer Lingus management.

144. Ryanair submitted that the majority matters taken to a shareholder vote over the last five years could have had no conceivable impact on Aer Lingus' commercial strategy. Indeed, Ryanair could not defeat the only resolution in the last five years (according to Ryanair) that did concern Aer Lingus' commercial strategy: a US\$2.4 billion aircraft order.

145. The OFT does not agree with the narrow view taken by Ryanair of the potential effect of its shareholding on Aer Lingus' competitive position. There are a number of reasons why Ryanair's shareholding may impact and impede Aer Lingus' competitiveness.

Special Resolutions

146. The right of Ryanair to block a special resolution enables Ryanair to:

- restrict Aer Lingus' access to finance
- influence the use of different types of finance and alter their relative cost to Aer Lingus
- control the extent to which Aer Lingus can purchase its own shares (on or off-market)
- effect the determination of the price range for the re-issue of treasury shares off market, and implicitly the feasibility of re-issuing treasury shares
- effect and veto the terms of certain cross-border mergers, and
- block changes to the characteristics of the company, including a re-branding.

147. Aer Lingus submitted that Ryanair has already restricted Aer Lingus' funding options by not allowing the waiver of pre-emption rights. Ryanair submitted that, in terms of fund raising, whether Aer Lingus is able to waive pre-emption rights is not especially material. For example, Ryanair submitted that in 2011, the Aer Lingus directors have shareholder authority to issue a nominal amount of €8,811,661.45 representing approximately 33 per cent of the nominal issued share capital of the company – an amount potentially over six times greater than that which would have been allowed without pre-emption rights (which represented five per cent of nominal issued share value).⁹³ Despite this, Aer Lingus submitted that the ability to waive pre-emption rights would give it the flexibility to raise additional funds, should it wish to do so, and the ability to do so. To have it otherwise restricts some of its strategic options where an equity issue without pre-emption rights may be more effective.

⁹³ The same ordinary resolution involving the same amount was passed at the 2012 Aer Lingus annual general meeting.

148. Waiving pre-emption rights, for example, would allow Aer Lingus to obtain cash injection from a company in return for a minority stake of five per cent at the discretion of the directors. Aer Lingus submitted that on at least one occasion in the last 10 years, it has entered negotiations with other airlines whereby the other airline would take a minority shareholding in the company in exchange for a cash payment.
149. In addition, while Aer Lingus in principle has authority to issue new shares for cash equivalent to approximately 33 per cent of its issued share capital, if this is done as part of a rights issue in favour of all of its ordinary shareholders then this may be impractical or expensive for those shareholders with registered addresses outside Ireland (or who are hard to find).
150. For these reasons, Aer Lingus argued, it is now standard for all companies listed on the Irish Stock Exchange to seek a general disapplication of the statutory pre-emption rights so as to be able to undertake a rights issue on the basis that shareholders in these jurisdictions are to be excluded. Aer Lingus pointed to the equivalent resolution passed by Ryanair's shareholders at Ryanair's own 2011 AGM.
151. Further, Aer Lingus submitted that although the company has been well capitalised as a consequence of the funds raised in its IPO, the airline industry is notoriously cyclical and Aer Lingus has been close to insolvency on at least two occasions in the last 20 years and had to resort to funding from its shareholders.

Effective voting share

152. Ryanair has an effective veto over the disposal of Heathrow slots by Aer Lingus. Aer Lingus' Articles of Association require a voting share of 69.9 per cent to approve a disposal of a Heathrow slot.⁹⁴ Based on shareholder voting patterns, Ryanair's shareholding of 29.8 per cent has had an effective voting share in excess of 30.1 per cent at every shareholder vote over the last five years. Aer Lingus provided the example whereby it attempted to exchange a Heathrow slot with another airline when it was setting up a new base at Gatwick Airport in 2009, for which it required slots. The option was not pursued, according to Aer Lingus, as such an

⁹⁴ Aer Lingus Articles of Association, paragraphs 10(d) and 10(e).

arrangement could and probably would have been blocked by Ryanair at a shareholder vote.⁹⁵

153. The OFT considers that the effective veto Ryanair has over the disposal of slots at Heathrow Airport is indicative of the ability of Ryanair to influence the commercial strategy of Aer Lingus and, should it seek to do so, restrict Aer Lingus' commercial options. The Aer Lingus example, demonstrates that Ryanair's shareholding can have a material impact on the ability and ease with which Aer Lingus can expand, enter and exit routes, re-allocate aircraft across different routes, and set-up and exit bases at airports.

154. In addition to this asset swap example outlined above, the OFT notes that Aer Lingus' Heathrow slots are one of its principal assets. The OFT notes that recent reports suggest a single Heathrow slot pair can be sold for £30 to 50 million.⁹⁶ Aer Lingus currently has 332 Heathrow slots.⁹⁷

155. Ryanair, through its effective veto on the disposal of these slots may impact Aer Lingus' operations, commercial policy, strategy, access to finance, and cost of finance and thus Aer Lingus' competitiveness.⁹⁸

Ordinary resolutions

156. A number of examples of Ryanair attempting to interfere with Aer Lingus' commercial policy, were submitted by Aer Lingus:

- Ryanair attempted to disrupt Aer Lingus' exit from the Shannon to/from London Heathrow route and reallocate capacity to Belfast in 2007.⁹⁹

⁹⁵ Internal business documents [].

⁹⁶ *Continental pays Heathrow Record*, Financial Times, 3 March 2008: 'Continental Airlines ... has paid a record €209 million for four pairs of take-off and landing slots at London Heathrow airport'.

⁹⁷ Summer 2011 allocation (Airports Coordination Ltd)

⁹⁸ The OFT highlight also that other special provisions in the constitution of a company (such as Aer Lingus' Articles of Association) as another key factor conferring material influence in its *Jurisdictional and Procedural Guidance* (paragraph 3.21).

⁹⁹ Aer Lingus submitted the effect, if successful, would have been to maintain Aer Lingus capacity serving the Shannon-London routes instead of Belfast- London routes, which Ryanair operated (from Belfast City) services on at the time. Ryanair, in its initial press release at the time, stated that Aer Lingus should instead shift capacity away from its Dublin-London route, where it competes against Ryanair, to Belfast, where it is predominantly competing against easyJet.

- Ryanair opposed Aer Lingus' acquisition of aircraft amounting to US\$2.4 billion in 2008.
- Ryanair attempted to force Aer Lingus to surrender its lease at Hangar 6, Dublin Airport (an aircraft hangar used for maintenance) in 2010. Aer Lingus submitted that its cost base would have increased significantly had it been forced out of Hangar 6.¹⁰⁰

157. The OFT notes that in each example Ryanair's interference caused a distraction to management time and, in the case of the first example, delay in Aer Lingus shifting to Belfast, but ultimately Ryanair was not able to prevent Aer Lingus from achieving its objective. Nevertheless, it may be of some relevance that the above examples occurred before the ESOT shares were dispersed and therefore, going forward, it may be the case that Ryanair will be in a stronger position than previously to influence matters such as these.

158. The issue of concern to the OFT is that, should Ryanair be able to block or pass an ordinary resolution, a significant number of commercial and strategic options for Aer Lingus may be affected by Ryanair. In addition to those above, for example, these could include: Board representation; the acquisition of a package of Heathrow slots (an ordinary resolution would be required if the value of the slots were to be around €130 million or higher,¹⁰¹ potentially around two to three or more additional slots at current reported values); and dividend payout decisions.

159. In the Shannon and Hangar 6 examples, Aer Lingus submitted that Ryanair put significant public and political pressure on the Irish Government (Aer Lingus' second largest shareholder) and Aer Lingus considers that it is possible the Irish Government would find it difficult (for political purposes) to vote on some issues, thereby increasing the effective voting power of Ryanair (and possibly enabling Ryanair to push through resolutions relating more directly to commercial decisions of Aer Lingus). However, the OFT accepts that it has not seen any evidence of this (indeed, Ryanair submitted that the Irish Government has not abstained from voting).

¹⁰⁰ Of these, only the acquisition of aircraft was put to a shareholder vote.

¹⁰¹ Irish Stock Exchange listing rule 7.5.1, based on current Aer Lingus market capitalisation.

160. Nevertheless, if voter turnout at the last Aer Lingus AGM (of 72 per cent) is to be representative of future voter turnout at general meetings, Ryanair would have an average of over 40 per cent of the vote at general meetings (and has had up to 46 per cent of the vote). On the basis of the maximum voting share, Ryanair would only need other shareholders amounting to around 2.9 per cent of the issued share capital – and around four per cent of the effective vote – to support it in order to achieve an outright majority.
161. The OFT considers, first, that on the evidence available in some circumstances, given Ryanair's effective voting share and, in particular, the material change to shareholder voting patterns since the dispersal of the ESOT shares, there is a real prospect that Ryanair may be able to block or pass an ordinary resolution.
162. Moreover, there may be some circumstances in which other shareholders are more inclined to support Ryanair and Ryanair may be able to obtain sufficient supporting votes to block or pass an ordinary resolution. For example, shareholders that also have a stake in Ryanair represent around four per cent of the issued share capital of Aer Lingus and may have incentives aligned with Ryanair or be influenced by them. Or if Ryanair were to continue to push for a high dividend payout, it is not inconceivable that other shareholders, perhaps if they were seeking to exit from their position or their investment was short-term, would support Ryanair.
163. Indeed, the OFT notes that Ryanair has twice – prior to the 2009 AGM and in November 2011 – requested details of the other shareholders in Aer Lingus. The OFT considers that such behaviour points to the intention of Ryanair to communicate with these other shareholders (as has been the case) and seek to influence their voting behavior.
164. In summary, the OFT considers that Ryanair – through restricting access to finance, having an effective veto over the disposal of Heathrow slots, and possibly being able to veto other commercial decisions that are taken to a shareholder vote – has the ability to restrict Aer Lingus' commercial and strategic options.

Effect on Competition

165. Given Ryanair's ability to restrict Aer Lingus' commercial and strategic options, the OFT has considered the extent to which such restrictions may

affect competition and, in particular, Aer Lingus' ability to act as an effective competitor to Ryanair. The OFT considers that there may be an effect on Aer Lingus' ability to compete on both (i) the Key Overlap Routes where Aer Lingus currently overlaps with Ryanair and (ii) the Ryanair Routes on which there is no current overlap but the potential for Aer Lingus to enter a route on which Ryanair is currently active (and such entry by Aer Lingus would enhance competition) may be reduced. Before considering these route effects, the OFT considers the different mechanisms by which Aer Lingus' ability to compete would be impaired.

Mechanisms through which Aer Lingus' ability to compete is reduced

166. Restricting the flexibility to use Heathrow slots as Aer Lingus' optimal commercial policy dictates allows Ryanair to reduce Aer Lingus' flexibility to operate different routes into and out of London. This may be by preventing Aer Lingus from acquiring a package of new slots or indeed by Ryanair using its ability to prevent Aer Lingus from disposing of any existing slots at London Heathrow.
167. Aer Lingus submitted an example of a failed attempt to exchange slots at London Heathrow for slots at London Gatwick airport. This shows the potential impact of Ryanair's shareholding on the ease with which Aer Lingus can expand, enter and exit routes, re-allocate aircraft across different routes, and set-up and scale-down airport bases. As a result, the OFT is concerned this may impact Aer Lingus' ability to increase frequency on routes at the margin of profitability, on which it currently overlaps with Ryanair and thus provide a more effective competitive constraint.
168. By way of illustration, to the extent that Aer Lingus wanted to transfer more capacity out of London Heathrow into London Gatwick to compete more directly against Ryanair, the possibility exists for Ryanair to control the disposal of Aer Lingus' London Heathrow slots, thereby allowing Ryanair to control, at the margin, the extent to which Aer Lingus can enter and expand in competition against it.
169. Aer Lingus' ability to compete may also be affected by its ability to raise appropriate finance quickly []. As an example, Aer Lingus submitted that []. This is an investment opportunity that may require [].

170. The OFT considers that the restrictions effectively placed on Aer Lingus in this regard may also hinder Aer Lingus' ability to expand (and potentially increase competition against Ryanair) through acquisition of other airlines. Aer Lingus provided []. While it is not clear to the OFT that funding through the waiving of pre-emption rights would have been necessary [], the fact remains that Ryanair can alter the relative cost, timing and availability of different financing options for Aer Lingus.

Impact of such restriction on routes

171. The OFT considers that the effect of the above restrictions may be felt through a substantial lessening of competition on both overlap routes and non-overlap routes.

172. In relation to existing overlap routes between the parties, the OFT considers the commercial and strategic options outlined above may hinder Aer Lingus' ability to expand its presence on these routes (for example, by increasing its frequency). On some overlapping routes, Aer Lingus currently operates a greater frequency than Ryanair and on others Aer Lingus' frequency is significantly less than Ryanair's frequency. If Aer Lingus were to expand on Key Overlap Routes, there would likely be an increase in

competition and increased competitive constraint exerted on Ryanair.¹⁰²

The ability to prevent Aer Lingus from undertaking this would be a clear indication of Ryanair disrupting the commercial strategy of Aer Lingus, its closest competitor on a number of UK-Ireland overlaps.

173. The effect of such restriction on the existing overlap routes between the parties is likely to be significant. The parties are either the only carriers, or together account for a significant majority of passengers, on the Key Overlap Routes and are considered to be closest competitors. In these circumstances, a material restriction on the ability of Aer Lingus to improve its competitive offering on some or all of these routes can be expected to give rise to a substantial lessening of competition to the detriment of UK consumers.

¹⁰² By way of potential example of candidate routes, Aer Lingus has reduced capacity on certain routes on which it competes with Ryanair through entering a franchise agreement with Aer Arann operating smaller aircraft. Aer Lingus could potentially, for example, increase its competitive offering on some of these routes by returning to use its own larger aircraft on these routes if circumstances permitted.

174. The OFT is also concerned that Ryanair, through the means by which it limits Aer Lingus commercial options above, may reduce Aer Lingus' ability to enter on existing Ryanair routes on which Aer Lingus does not operate currently.

175. The OFT considers that such an effect may be especially felt on the Ryanair Routes (that is Ryanair routes between the UK and Ireland on which Aer Lingus does not currently fly but which involve airports at which Aer Lingus has a significant base (Dublin and Knock), where Aer Lingus represents the closest competitor to Ryanair). The OFT considers that on these Ryanair Routes, Aer Lingus is the most likely potential new competitor to Ryanair and that there would likely be a substantial increase in competition following entry by Aer Lingus.

Conclusion on direct weakening Aer Lingus as a competitor

176. In summary, the OFT considers that Ryanair may be able to restrict Aer Lingus' commercial options sufficiently so as to: diminish Aer Lingus' ability to expand on routes on which the parties currently overlap; and diminish Aer Lingus' ability to enter on routes on which there is no current overlap but Ryanair operate between the UK and Ireland and Aer Lingus is the most likely entrant. Such restrictions are crucial given that an expansion of Aer Lingus could deliver substantially more competition given the parties' position on the Key Overlap Routes and that Aer Lingus is the most likely entrant against Ryanair on the Ryanair Routes. The OFT considers that freed from such constraints Aer Lingus may be a more active competitor and the OFT believes that the test for reference is met through Ryanair's ability to diminish Aer Lingus as a competitor.

Indirect effect on Aer Lingus from the existence of the shareholding

177. The very existence of Ryanair's shareholding in Aer Lingus may also have the effect of impeding the commercial and/or strategic options of Aer Lingus.

178. The OFT notes that the mere presence of Ryanair on the Aer Lingus share registry may deter other airlines from acquiring or investing significantly in Aer Lingus. Such an effect is considered alongside Ryanair's active ability to block certain takeovers (involving a scheme of arrangement). Aer Lingus

submitted that [] and one third party contacted by the OFT suggested that Ryanair's shareholding may be an impediment to a takeover or merger, while another airline has publicly stated that the shareholder structure of Aer Lingus, including the Irish Government and Ryanair, means that Aer Lingus is not an attractive target for M&A activity.¹⁰³ Should such a restriction on Aer Lingus' ability to enter such a commercial arrangement with a third party strategic investor exist, Aer Lingus submitted this would inhibit its ability to expand.

179. Indeed, Aer Lingus told the OFT that [].

180. Similar concerns have been examined previously by competition agencies. The Monopolies and Mergers Commission (MMC) investigated a merger in the razors and razor blades market involving rivals, Wilkinson Sword and Gillette.¹⁰⁴ The shareholding in that case was a 22 per cent shareholding with pre-emption rights and loan facilities. The MMC was concerned that Gillette could determine who controlled Wilkinson Sword thereby keeping out a strong competitor to Gillette.¹⁰⁵ The MMC said that the mere existence of Gillette's capacity to determine takeovers for the Wilkinson Sword business was likely to affect bids being made at all for the business.¹⁰⁶ This may have lessened existing competition and potential competition.¹⁰⁷

181. Similarly, the European Commission had concerns in relation to an abuse (by Gillette) of a dominant position. It said:

'No other competitor on the market ... can improve its competitive position through the acquisition of Eemland. It [Gillette's rights] also ensures that no other company hostile to Gillette can take over Wilkinson and effectively prevents the management of Eemland from entering into a merger or joint venture with someone of whom Gillette does not approve... Other competitors on the market are adversely affected

¹⁰³ *'BA eyes dozen suitors as it moves towards mass mergers'* Irish Independent, 6 September 2010.

¹⁰⁴ MMC, *'Stora Kopparbergs Bergslags AB/Swedish Match NV, and Stora Kopparbergs Bergslags AB / The Gillette Company: a report on the merger situations'*, March 1991, Cm 1473.

¹⁰⁵ *Ibid.* paragraphs 7.67–7.69.

¹⁰⁶ *Ibid.* paragraph 7.68.

¹⁰⁷ *Ibid.* paragraph 7.82.

because they are deprived of one of the most obvious ways of challenging Gillette's market dominance, namely by taking over Eemland.¹⁰⁸

182. In the current case, third parties have indicated that this may be the case, with one describing Ryanair's shareholding as a 'poison pill' in the sense that other airlines would not wish to acquire Aer Lingus while Ryanair is on the share register.
183. The OFT is mindful, however, as emphasised by Ryanair in its submissions, there has been a recent purchase by Etihad Airways of Aer Lingus shares on the open market, equivalent to around three per cent of Aer Lingus. []. The OFT has considered carefully whether this evidence negates the potential for Ryanair's stake to impede investment in Aer Lingus, but believes it does not. [].
184. Further, the OFT notes that the business model of Etihad, in being a full service, high quality carrier, is markedly different to that of Ryanair and so as a shareholder of Aer Lingus, Etihad may not find itself in conflict with Ryanair. [].
185. In a more general sense, Aer Lingus put to the OFT that Ryanair has the ability to act as 'gatekeeper' to Aer Lingus by putting off potential buyers (by blocking schemes of arrangement and/or being a disruptive shareholder) willing to invest in Aer Lingus who might constitute a greater threat to Ryanair while welcoming others whose incentives are not in conflict with Ryanair's.
186. Finally, as part of this theory of harm, the OFT note also that, as a result of the above, the possibility that Aer Lingus will be acquired by another airline may provide an incentive to Aer Lingus' management to be as efficient as possible. Corporate finance theory suggests that the threat of takeover is one of the most important mechanisms for aligning the interests of managers and shareholders. Managerial discipline is shown likely to worsen

¹⁰⁸ Cases IV/33.440 Warner-Lambert/Gillette and Others, and IV/33.486 BIC/Gillette and Others, 10 November 1992, paragraph 26. Note that by this stage Swedish Match had changed its name to Eemland and the rights referred to are pre-emption rights, conversion rights and options in Eemland.

as the threat of takeover decreases.¹⁰⁹ This 'market' for corporate control serves to discipline management.

187. The OFT is thus concerned that Ryanair's shareholding effectively impedes or removes entirely this 'market' for corporate control in Aer Lingus. The incentives on Aer Lingus to become more efficient, expand and compete strongly as a result of the disciplining effect of the capital markets may be impeded or removed as a result of the shareholding because the only strategic investor that would seek to acquire Aer Lingus is likely to be another airline.

Effect on competition

188. The OFT has considered the potential impact on competition of Ryanair impeding a takeover of, merger or significant investment in Aer Lingus and considered two possibilities.

189. First, if another airline acquired or merged with Aer Lingus it may be able to offer stronger competition against Ryanair than Aer Lingus currently does. In this scenario Ryanair's shareholding in Aer Lingus may weaken Aer Lingus as a competitor. A more effective Aer Lingus could result from, for example:

- scale economies which lower Aer Lingus' unit costs and enable it to price more competitively on existing overlaps
- enhanced investment that allows Aer Lingus to improve its level of service, expand on routes in which it currently overlaps with Ryanair, or enter on routes in which it does not, and
- network effects from access to an expanded network more comparable to Ryanair's wider network of operations.

190. By way of sense check of the likelihood of such a scenario the OFT notes that the acquisition of the minority stake in Aer Lingus by Ryanair must be considered in the wider context of developments in the airline industry. Aer Lingus submitted that almost all large European airlines have been actively

¹⁰⁹ See, for example, *The market for corporate control: The scientific evidence*, Jensen, Michael and Richard Ruback, 1983, *Journal of Financial Economics* 11, 5-50.

involved in a process of consolidation with almost every former national flag-carrier, with the exception of Aer Lingus, being involved in a takeover or acquisition and a number of significant mergers or strategic relationships having taken place (for example, Lufthansa/Austrian/BMI/Swiss, BA/Iberia/American, Air France/KLM).

191. Aer Lingus submitted that this is largely driven by the potential for scale economies and positive network effects, implying that the minimum efficient scale in the airline industry, at least for those airlines that, by the nature of their business model, have a relatively high cost base, is significantly higher than that which Aer Lingus is operating at. Aer Lingus submitted that []. These benefits have also been the primary justification given by the airlines for much of the merger and acquisition activity that has taken place in recent years.
192. Ryanair argued that Aer Lingus' public statements indicated that it was not seeking such merger and acquisition activity. However, the OFT considers that such statements should not be regarded as conclusive in relation to the relevance of this theory of harm given that Aer Lingus would not necessarily publicize any intentions to seek a merger partner or other such arrangement. As such, the OFT is concerned that Ryanair's shareholding is impeding Aer Lingus from entering a merger or engaging in other strategic investment options and so impeding it from competing more efficiently and effectively (and thus lessening the competitive constraint exerted on Ryanair).
193. Furthermore, many of these strategic options may require shareholder approval and, if they require Aer Lingus to change its fundamental characteristics, as many may, approval by special resolution, giving Ryanair the potential to block them. Some of these investment options may plausibly involve a scheme of arrangement, which Ryanair can also block.
194. Alternatively, it may be the case that Ryanair wishes to encourage a particular buyer for Aer Lingus if that buyer were to promote in some way Ryanair's commercial objectives to the detriment of competition overall.
195. Ryanair may be able to use its stake in Aer Lingus to dissuade investors who intend to strengthen Aer Lingus as a whole – and by extension strengthen the level of competition that Ryanair would face on existing overlapping routes and possibly other routes – while allowing buyers

(possibly by offering its own shares in Aer Lingus) who will break up Aer Lingus to the extent that Ryanair would face less competition on some or all of its UK related routes.

196. Second, the OFT is concerned that managerial discipline and the incentive for efficiency may be removed or impeded as a result of the shareholding effectively blocking the 'market' for corporate control. Aer Lingus may therefore become less efficient as a result. Aer Lingus management – perceiving the shareholding impedes strategic investors from replacing them, as Aer Lingus management do – may not have the same incentives to reduce cost and improve performance on those relevant routes on which it overlaps with Ryanair. Further, it may affect management's willingness to enter on routes on which there is no current overlap but Ryanair operate between the UK and Ireland and Aer Lingus is the most likely entrant.

Conclusion on the existence of the shareholding

197. In summary, the OFT considers that Ryanair may be able to hinder Aer Lingus' from obtaining investment, either strategic investment or takeover and merger activity, sufficiently so as to:

- diminish its ability to expand on routes on which they currently overlap, and
- diminish its ability to enter on routes on which there is no current overlap but Ryanair operate between the UK and Ireland and Aer Lingus is the most likely entrant.

198. The OFT is also concerned that, by a reduction in managerial discipline as a result of a weakening in the market for corporate control, Aer Lingus may not compete as strongly as it would otherwise do.

199. Alternatively, Ryanair's shareholding may allow Ryanair to act as the 'gatekeeper' to outright control of Aer Lingus with the ultimate result that Ryanair will face less competition on some or all of its UK related routes.

200. For the reasons given in paragraphs 172 to 175, these effects would be felt in relation to the Key Overlap Routes (in terms of routes on which the parties overlap) and the Ryanair Routes (where there is no overlap but Aer Lingus is the most likely entrant).

201. The OFT considers that freed from such constraints Aer Lingus may be a more active competitor. The test for reference may therefore be met as a result of Ryanair diminishing Aer Lingus as a competitor through its ability to hinder Aer Lingus expansion plans.

202. Overall, therefore, the OFT considers that test for reference is met as a result of the existence of Ryanair's shareholding in Aer Lingus .

Ryanair's reduced incentives to compete

203. The third theory of harm that the OFT has considered relates to Ryanair's incentives to compete given that it now owns a minority stake in Aer Lingus. The OFT has examined the possibility that Ryanair may unilaterally deteriorate its competitive offering below that which would be offered absent the minority shareholding. In this regard, the OFT considers a wide-range of different aspects of the competitive offering, including prices, levels of investment, capacity (fleet, frequency), range of routes, entry and exit decisions, and quality of service.

204. If Ryanair diminishes its competitive offering (for example, increases price), it will lose customers, some of which will divert to Aer Lingus. Post-acquisition, Ryanair may be able to re-capture a proportion of the value of those lost customers that divert to Aer Lingus, through its shareholding (as outlined below). Once Ryanair takes these additional 'investment' profits into account, it may have an incentive to compete less strongly against Aer Lingus.

Evidence of Actual Behaviour

205. Ryanair submitted that any unilateral effects theory of harm is disproved by the intense competition that has occurred between the two companies over the five years since Ryanair first acquired its minority stake. In particular, Ryanair submitted:

- a. internal documents []
- b. press releases, which point to Ryanair targeting Aer Lingus on the basis of its lower prices and larger network

- c. print advertising, which includes many examples of adverts that target Aer Lingus specifically, and
 - d. a history of dealings between the parties, which points to Ryanair being an aggressive, activist shareholder to Aer Lingus.
206. Ryanair also submitted analysis comparing the average prices charged by Ryanair before and after the acquisition¹¹⁰ on six overlapping routes¹¹¹ relative to a set of control routes, on which Ryanair does not overlap with Aer Lingus, in an attempt to isolate the effects of the acquisition on prices. Ryanair submitted that if the shareholding has an adverse effect on competition one would expect to observe an increase in Ryanair's prices on routes where it competes with Aer Lingus, relative to the comparison routes where it does not.
207. Ryanair submitted that the Aer Lingus minority stake has resulted in no economically or statistically significant increase in Ryanair prices, refuting the contention, according to Ryanair, that Ryanair has softened competition on routes where it competes against Aer Lingus.
208. Ryanair have also examined instances when it has entered or exited UK-Ireland routes, or changed capacity on routes, submitted that entry decisions have generally been motivated by favourable airport charges. Exit decisions or reductions in capacity have been prompted by falling demand, taxes and duties, poor performance or increased airport charges and have generally been less common than those made by other airlines serving UK and Ireland routes.
209. In relation to the analysis submitted by Ryanair, the OFT has a number of concerns, including the time periods used in the analysis, the identity of the O&D markets and thus overlapping routes, and the failure to disaggregate results by individual route.

¹¹⁰ The time period before the acquisition is taken to be September 2005 to August 2006. While, for the time period after, three scenarios have been used: September 2007 to August 2010; January 2008 to December 2010; and January to December 2010.

¹¹¹ The six overlapping routes are: Birmingham, Edinburgh, Glasgow, and London to Dublin; and Shannon and Cork to London. Of these, two are operated under the franchise agreement between Aer Lingus and Aer Arann – not relevant overlaps according to Ryanair – for a significant proportion of the time period after the acquisition (in one scenario the entire period). On another – London to Shannon – Aer Lingus has since exited.

210. Further, as outlined in detail above, the OFT recognises that the unusual circumstances of this merger case allow for an examination of the five year period since Ryanair acquired its minority shareholding. However, the OFT is sceptical as to the weight that such evidence can be given. The OFT does not need to demonstrate that harm has arisen from the minority stake. This is based on the false premise that the OFT must prove that prices have already risen or other competitive harm has already occurred. The OFT proceeds to evaluate below Ryanair's arguments as to why a theory of harm based on it reducing its own competitive offering should be dismissed.

Imperfect Information

211. Ryanair submitted that it does not have the necessary information – Aer Lingus profit margins on overlapping routes – to pursue such a strategy, should it want to. Without such information Ryanair argued that it cannot ascertain the incremental profit impact of diminishing its own competitive offering and thus the optimal change to its own pricing and there is the risk of error if Ryanair raises its price by too much.

212. The OFT acknowledges that there are information constraints on Ryanair setting its profit maximising price. However, such information constraints characterise almost all price setting behaviour by firms as they attempt to maximise their profits. The absence of information on competitors' costs, volumes, pricing, revenue, and profits means that no firm sets their prices based on complete information. For example, in setting price a firm estimates the impact of a price increase or decrease on revenue and profits but such a change in price will also materially affect a rival's pricing policy, which the firm has no transparent information on but must take account of in their estimation of revenue and profit.

213. The price setting process, by its nature, involves information constraints and is often characterised by firms developing sophisticated means of setting their optimal pricing policy. A risk of error is inherent in such a process (and can even define it, for example, if firms in a fast-moving multi-period setting test and establish the profit maximising price through 'experimentation'). Firms seek to minimise these information imperfections to best enable them to set their profit maximising price and such behaviour would be expected of Ryanair.

214. The OFT does not therefore consider that it is necessary for Ryanair to have full access to, or full transparency over, Aer Lingus' profit margins, in order to develop its optimal pricing strategy, which takes account of the shareholding.
215. Furthermore, the OFT considers that Ryanair – as a competing airline on the same routes and thus subject to the same or similar demand and supply conditions as Aer Lingus – may be able to estimate such information with a relatively high degree of accuracy.¹¹²

Managerial Incentives

216. Ryanair submitted that [].¹¹³ [].
217. The OFT recognises that the implementation of such a strategy by Ryanair may raise additional agency problems that it would not otherwise face. However, it is not clear to the OFT that [].
218. The OFT notes that, at a general level, it is common for lower level managers to be rewarded with regard to the overall profitability of a firm, division or route (for example, through stock options or bonuses). Firms are able to put in place sophisticated means of compensating lower level managers and can refine these over time. More specifically in this context, Ryanair could, for example, [].

Recapturing Profits

219. Given that Ryanair would lose business by increasing fares or otherwise diminishing its competitive offering, the effect of the shareholding on Ryanair's incentives is framed around any financial benefits received by Ryanair, through either receipt of dividends or, related, through the capital gains associated with the share price of Aer Lingus.¹¹⁴

¹¹² For example, information on the passenger numbers, frequency of service, and capacity of Aer Lingus is available to Ryanair. Therefore, Ryanair can immediately begin to determine the effects of any deterioration of its own competitive offering on Aer Lingus and this may be particularly straightforward on duopoly routes.

¹¹³ [].

¹¹⁴ Note that it may be likely that Ryanair, subject to corporation tax but not a dividend tax, would prefer dividend payments to capital gains. Small shareholders, in contrast, are most likely individuals and would prefer returns as capital gains.

220. Ryanair submitted that it has limited ability to appropriate any of the incremental profits that Aer Lingus benefit from as it has no control over Aer Lingus.
221. Since privatisation, Aer Lingus had never paid a dividend to shareholders, despite several requests from Ryanair.¹¹⁵ The prospectus for the 2006 IPO stated that it was then the current policy of Aer Lingus not to pay any cash or share dividends. Aer Lingus have, however, recently changed this policy. On 4 May 2012, Aer Lingus announced that it intends to pay a dividend in future years in which it makes an operating profit, provided that the payment is appropriate and prudent in the context of the airline's financial position, strategic objectives and prospects. This change in policy resulted in Aer Lingus announcing that it would pay an annual dividend of approximately three cent per share in each of the next two years.
222. The OFT notes also that Ryanair has vigorously pursued the payment by Aer Lingus of a dividend. In internal business documents provided to the OFT Ryanair indicate [].¹¹⁶ Aer Lingus also note a dividend payment may be appropriate.¹¹⁷
223. Furthermore, the OFT notes that, given Ryanair's effective voting share following the dispersal of the ESOT shareholding, there may be a possibility that Ryanair may be able to influence the dividend policy of Aer Lingus (see above).
224. In relation to capital gains, Ryanair submitted that the average price it paid per share was €2.52 and the total cost of the acquisition was just under €400 million. The current share price is around €0.70 resulting in a significant reduction in the market value of Ryanair's shareholding (to less than €100 million).

¹¹⁵ Written communication with the Aer Lingus board and management and openly at AGMs.

¹¹⁶ [].

¹¹⁷ Ryanair submitted that Aer Lingus has made significant payments to individual shareholders with ESOT receiving over €30 million in December 2010. However, the OFT notes that this was not a dividend payment but a one-off cash payment of €25.3 million to remove Aer Lingus' obligation to pay any further share of profits to ESOT. This removed the profit share obligation on Aer Lingus, established at the time of Aer Lingus' IPO in 2006, requiring AL to pay an annual share of profits to ESOT until the later of April 2023 or full repayment of the ESOT's debt and associated interest.

225. The OFT recognises that, the initial objective of Ryanair in acquiring the minority stake was not to benefit through capital gains. Ryanair initially bought the stake as part of, and in preparation for, its attempted public bid for Aer Lingus. However, the issue for the OFT is not the initial motivation for acquiring the stake but the effect of ownership of the minority stake on Ryanair's incentives, given the acquisition.

226. Furthermore, the OFT also notes that Ryanair's shareholding is a partially sunk investment and the decision to retain the investment reflects an assessment of the return on that capital, relative to other opportunities to which the capital could be allocated by Ryanair management.¹¹⁸

227. Aside from the change in dividend policy that means Ryanair now benefits from its financial investment through payment of a dividend, the OFT does not accept that the decline in the capital value of Ryanair's investment is indicative of it failing to recapture the benefits of its investment. In contrast, the capital value of Ryanair's stake will mean that it will always benefit from any gain to Aer Lingus, by definition. This applies irrespective of other factors that might be driving the current share price up or down. For example, if Ryanair reduced the competitive constraint it exerted on Aer Lingus to the benefit of Aer Lingus, this would, other things equal, and assuming efficient markets,¹¹⁹ be reflected in Aer Lingus' stock price. The fact that other factors may be also affecting Aer Lingus' stock price is irrelevant.

228. The OFT also considers it appropriate that the assessment of the potential effects of the shareholding is forward-looking and takes account of the fact that while any losses to, or sacrifices by, Ryanair are immediate, the gains from such a strategy can occur in subsequent periods.

¹¹⁸ Ryanair has over the last year chosen to ground aircraft during various periods and pay a special dividend. The capital may therefore likely be held as cash by Ryanair or distributed to shareholders if not in Aer Lingus, which affect the discount rate that Ryanair applies to the investment (that is, the patience with which Ryanair is willing to wait for a return on its investment).

¹¹⁹ By efficient markets, we mean that financial markets are practically informationally efficient in that the stock price generally reflects past publicly available information and future earnings of a company are generally accurately reflected in the current stock price. The time period within which information translates to prices is not relevant in this context.

Incentives to Raise Price

229. Ryanair has examined its incentives to pursue a strategy of profit maximisation that includes both their own operations and investment return by calculating illustrative price rises (IPR). Ryanair submitted that the IPR framework can be adapted to be used as a screening device to assess the impact of Ryanair's minority stake in Aer Lingus on the prices charged by the two firms.
230. In past cases, in order to assess the extent of lost competitive rivalry likely to occur as a result of the merger, the OFT has examined the value of diverted sales that the merging parties lose to each other following a price rise. This analysis combines the closeness of substitution between the parties, as measured by, say, the diversion ratio between them, the gross profit margin on sales, and the degree of cost-price pass through.¹²⁰
231. In this pricing incentives framework, should it be applicable in this case, if the parties are close substitutes, unilateral effects are more likely as the share of sales recaptured by Ryanair in response to diminishing its competitive offering will be more significant, making the price rise less costly. Combining this with profit margins can be used to calculate pricing pressure indices and, with information or assumptions on cost-price pass through, illustrative price rises.
232. Ryanair adapt the original IPR formula to try to take account of the minority shareholding and reframe it to estimate a critical diversion ratio (the diversion ratio between Ryanair and Aer Lingus that would be required to result in an IPR of five per cent).¹²¹ On this basis, Ryanair submitted that the critical diversion is between 66 and 94 per cent and above the range of plausible diversion ratios in this case, as detailed in *Ryanair/Aer Lingus*.

¹²⁰ See, for example, *Anticipated acquisition by Unilever of the Alberto Culver Company*. OFT, 5 April 2011 and *Anticipated acquisition by Asda Stores Ltd of Netto Foodstores Ltd*, OFT, 23 September 2010.

¹²¹ Ryanair submitted the revised IPR is determined by the ratio of the prices charged by Aer Lingus to those charged by Ryanair, assumed to be between 20 and 50 per cent higher; the gross profit margins of Aer Lingus, which Ryanair assume to be between 20 and 30 per cent; the diversion ratios from Ryanair to Aer Lingus and vice versa and is as follows:

$$IPR_R = -2\alpha \frac{M_{AL} * D_{R-AL}}{4 - D_{AL-R} * D_{R-AL}} \frac{P_{AL}}{P_R} \quad \text{and} \quad IPR_{AL} = -\alpha \frac{M_{AL} * D_{R-AL}^2}{4 - (D_{AL-R} * D_{R-AL})}$$

where α is the shareholding, M the gross profit margin, D the diversion ratio and P prices.

233. The OFT acknowledges that such an analysis – based on Ryanair’s incentives to raise price – may be relevant to the assessment of the likelihood of competition concerns but there may be doubts as to Ryanair’s application of this methodology in this case for a number of reasons. First, for some commercial and/or strategic options and decisions, the shareholding may confer on Ryanair an element of control and, in particular, control over the unit costs of Aer Lingus although the extent to which this control may affect Aer Lingus’ optimal pricing decisions is less clear.
234. Second, the figures taken from the European Commission’s prohibition decision and used to proxy diversion ratios on overlapping routes may be underestimates.¹²² The figures reflect the proportion of a carrier’s customers that would consider flying with another airline, rather than the proportion that would switch in the event of a price rise. In particular, the OFT notes that when some element of relative prices was included in the questions asked by the Commission the proportion of passengers that indicated they would have switched rises considerably.¹²³
235. The OFT considers that relevant diversion ratios are likely to be higher than those suggested by Ryanair, particularly on duopoly routes, when switching is considered in the context of a price increase. Indeed, a ‘forced diversion ratio’ (what the passenger would have done at the time of purchase if the carrier was not available at all on this route), often used by the OFT at phase one, could see diversion ratios on duopoly routes significantly higher.¹²⁴ Each of these is above the critical diversion ratios

¹²² In *Ryanair/Aer Lingus*, the Commission found a ‘diversion ratio’ (carrier’s customers that considered flying with the other) on Dublin to London from Ryanair to Aer Lingus of 34 per cent and from Aer Lingus to Ryanair of 18 per cent. At the time, there were three additional competing airlines on the route. Now there is only one other airline competing with the parties, suggesting even these diversion ratios are likely to have risen. The ‘diversion ratio’ on Dublin to Birmingham is potentially higher at 54 per cent and 52 per cent, respectively. See Annex II, Tables A.4.1 to A.5.1.

¹²³ For Ryanair, 90.6 per cent of passengers would have bought a cheaper ticket from another airline and for Aer Lingus, 66.1 per cent of passengers would have bought a cheaper ticket from another airline. See Annex II: Customer Survey, table A.1.4.

¹²⁴ While this is clearly dependent on Aer Lingus’ relative capacity, should capacity constraints becoming binding for Aer Lingus (and other airlines), this would enable them to increase their own prices to a greater degree than otherwise and may therefore still result in feedback to Ryanair. As an illustration, diversion ratios based on shares of supply on overlapping routes –

calculated by Ryanair and would point to an incentive to raise price (and an IPR significantly greater than five per cent).

236. Third, Ryanair have assumed Aer Lingus' profit margin on overlapping routes is between 10 and 30 per cent. In calculating gross profit margins, the OFT tends to use variable cost as a readily observed proxy for marginal cost, recognising that there can be difficulty in ascertaining a firm's marginal cost. Nevertheless, generally, in principle, marginal cost is more appropriate to compare with price. In most cases, variable cost is a good proxy.¹²⁵ However, in this case, route-wide average variable cost may overestimate marginal cost not just per passenger but for a sizeable number of passengers, given Aer Lingus' load factors on overlapping routes. If this is the case, the effect may be to significantly increase the gross profit margins of Aer Lingus, and as a result, will increase considerably the incentives on Ryanair to raise price.
237. Fourth, the OFT considers it appropriate, given the uncertainties in applying such analysis, to undertake significant sensitivity analysis around the assumptions of any modelling used.
238. Ryanair's modelling assumes Bertrand price competition and linear demand, yet it is not clear the extent to which such an approach is appropriate in this case and no evidence has been provided – in relation to cost price pass-through – to support this approach.
239. Airlines may also compete on capacity in the long-run, as well as subsequent competition on prices. In addition, the OFT has generally considered linear demand to point to the lower of a range of possible price increase results.
240. Indeed, Ryanair themselves indicate scepticism as to the appropriateness of a simple model of Bertrand competition in prices to the airline industry¹²⁶

assuming that all sales lost are captured by other airlines and all airlines are equally 'close' – indicates that on the duopoly routes (see paragraph 71), the diversion ratio is 100 per cent and even on the London to Dublin route, on which the parties face competition from two airlines, the diversion ratio (from Ryanair to Aer Lingus) is 78 per cent.

¹²⁵ Marginal cost intersects average variable cost where average variable cost is minimised. The competitive firm's supply curve is the portion of the MC curve above AVC.

¹²⁶ Memorandum from Compass Lexecon to Ryanair Re: Limitations of the O'Brien-Salop Theory on Minority Equity Stakes, dated 4 October 2011, page 7, point (vi), submitted to the OFT.

and highlight that the optimal price increase would depend on the shape of demand and marginal cost functions.¹²⁷

241. The OFT has received route-level variable profit margins from Aer Lingus. Aer Lingus submitted alternative estimates of pricing pressure at a route-specific level based on these route-level margins. Aer Lingus' estimates point to far more significant pricing pressure arising from the minority stake with GUPPI estimated to be [] per cent on certain routes.¹²⁸

242. Finally, the OFT questions whether the application of an absolute threshold – which Ryanair suggest should be five per cent – is necessarily appropriate in this case for assessing if pricing incentives are sufficiently strong to raise competition concerns. The OFT's approach in past cases, contrary to Ryanair's submission, has never been to apply an absolute threshold, under which no unilateral effects concerns arise. A threshold has been used in a small number of specific cases only and the purpose has been as a mechanism to focus the competitive assessment on those overlaps which the OFT considers likely to raise greatest concern. In such cases, without exception, as in all cases, the OFT considers it appropriate to undertake sensitivity analysis around such an approach and consider all of the evidence in the round. In light of this, the OFT notes that if an illustrative price rise below five per cent was used, the critical diversion ratios would be lower than Ryanair suggests. As a result, Ryanair's approach would understate its incentives to diminish its competitive offering.

Effect on competition

243. The benefits to Ryanair from the shareholding are derived from Aer Lingus in the aggregate but would apply irrespective of the importance of the routes relevant to each company's total revenue or network, as incentives to compete would change on those routes.

¹²⁷ *Ibid.*, footnote 7.

¹²⁸ The OFT notes that these **ex-post** profit margins may be biased upwards, should Ryanair's pricing already be affected by the minority stake. However, the OFT does not consider this to materially affect the analysis or the general point that the estimates provided by Ryanair are subject to significant variation when the underlying assumptions are scrutinised, including taking account of Ryanair's own conflicting and confusing submissions from their economic consultants.

244. The OFT considers that the effect on Ryanair's incentives may have an increased incentive to compete less strongly against Aer Lingus and diminish its competitive offering. Such an effect, should it arise, would occur on the Key Overlap Routes (that is where Ryanair and Aer Lingus currently overlap and where the two airlines represent a significant share of passengers); on these Key Overlap Routes, the diversion ratio from Ryanair to Aer Lingus is likely to be greatest. As a result, the OFT considers the test for reference is met as a result of the shareholding increasing Ryanair's incentives to compete less strongly with Aer Lingus in relation to the Key Overlap Routes.
245. The OFT notes also the possibility that Ryanair's incentives to enter against Aer Lingus could be reduced at the margin as a result of the shareholding, removing a potential competitor on routes between the UK and Ireland. On those marginal entry decisions, Ryanair's incentives to enter will be reduced as the gain from any profit margin on those passengers that switch from Aer Lingus will be partially offset by the 'investment' loss to Ryanair through its shareholding, which would not be the case absent the acquisition. For the marginal investment decision, Ryanair may thus avoid head-to-head competition against Aer Lingus.¹²⁹ Such an effect would be felt on the Aer Lingus Routes (see paragraph 130 above). However, given its conclusion in relation to the Key Overlap Routes, the OFT has not needed to reach a decision on the effect of this theory of harm on these routes.

Aer Lingus' reduced incentives to compete

246. The fourth theory of harm considered by the OFT is whether, as a result of the presence of Ryanair as a minority shareholder, Aer Lingus has a reduced incentive to compete against it. Pre-acquisition, if Aer Lingus were to diminish its competitive offering, the additional profit margin it would gain on retained passengers exactly offsets the lost profit margin on those passengers that would switch away (that is, Aer Lingus set the profit maximising price).

¹²⁹ This would apply, for example, to the Belfast/Derry to Tenerife route where Aer Lingus is the only scheduled operator and Ryanair has previously operated on the route (summer 2011) and operates from the Republic of Ireland to Tenerife or the Belfast/Derry to Barcelona route, where Ryanair operate a number of other services from both Belfast/Derry and Barcelona (El Prat, Reus and Girona).

247. Post-acquisition, if Aer Lingus were to diminish its competitive offering, Ryanair benefits: (a) from the additional profit margin it would gain on Aer Lingus' retained passengers (in proportion to its shareholding); and (b) from those passengers that switch away from Aer Lingus and divert to Ryanair, which on duopoly routes is likely to be especially high. Ryanair, Aer Lingus' largest single shareholder, thus has an incentive to 'encourage' Aer Lingus to diminish its competitive offering, thereby free-riding on the remaining 70 per cent of shareholders.
248. The OFT notes that the behaviour of Aer Lingus since the acquisition generally points to a reduced competitive constraint being exerted on Ryanair. Aer Lingus has significantly shifted its business model from competing head-to-head with Ryanair on price as a low-cost carrier (similar to Ryanair's business model) at the time when Ryanair first acquired a stake in Aer Lingus and the Commission investigated the public bid to a hybrid business model positioned between a low-cost carrier and a full service carrier.¹³⁰ As a result, the closeness of substitution between the airlines for passengers is likely to have reduced, resulting in reduced competition between the two carriers: the proportion of overall passengers that are 'marginal' may have reduced as Aer Lingus sought to differentiate itself from Ryanair (albeit the extent to which the closeness of substitution can be significantly reduced on a duopoly route is unclear).
249. Aer Lingus has also exited from direct competition against Ryanair on overlapping routes between the UK and Ireland over the last five years.
250. The theory of harm may arise through Aer Lingus, conscious of offending its largest shareholder with a significant degree of corporate control, foregoing making competitive decisions adverse to Ryanair. Similarly, Aer Lingus have the means, through competing less competitively on overlapping routes – or even exiting them – to potentially appease a burdensome, activist shareholder. Ryanair could easily take actions that allow it to signal to Aer Lingus its displeasure over certain behaviour. By merely threatening to exercise these powers (for example threatening to block a recapitalization programme that Aer Lingus needs or would benefit from), Ryanair can

¹³⁰ A hybrid business model aims to obtain a 'middle-ground' on price and benefit and service levels offered. For example, offering central airports, lounge access, seat amenities, crew engagement with customers, occasional use of jetways, multi-channel distribution, and some network connectivity.

encourage Aer Lingus to take actions that reduce its competitive offering against Ryanair.¹³¹

251. The OFT, on the evidence currently available, considers the extent to which these incentives would alter Aer Lingus' competitive behaviour to be uncertain.

Effect on competition

252. The OFT considers that such an incentive on Aer Lingus would reduce the competitive constraint it exerts on Ryanair, at the margin, on existing overlapping routes and the propensity of Aer Lingus, at the margin of profitable opportunities, to enter against Ryanair. Such an effect would be felt in relation to the Key Overlap Routes and the Ryanair Routes respectively.

253. However, given its conclusions on the first two theories of harm, the OFT has not found it necessary to conclude on whether the test for reference is met in relation to this theory of harm.

Coordinated effects

254. The fifth and final theory of harm considered by the OFT concerns whether the acquisition of the minority stake could increase the prospects for coordinated effects between Ryanair and Aer Lingus. In assessing the potential for coordinated effects to arise, the OFT considers the characteristics of the market for evidence of the ability to coordinate, as well as evidence of pre-existing coordination. The OFT points to the following three conditions for coordination to be possible:¹³²

- a. Firms need to be able to reach and monitor the terms of coordination.
- b. Firms must find it in their individual interests to adhere to the coordinated outcome (that is, internal sustainability).

¹³¹ An extension of this would be that Aer Lingus, in maximising shareholder wealth, maximises the wealth of its largest shareholder by making pricing and output decisions as if it has a 30 per cent stake in Ryanair. Such an outcome would generally be dependent less on the shareholding itself than on board composition.

¹³² See *Merger Assessment Guidelines*, section 5.5 for a details of the OFT's analytical framework in assessing if a merger may give rise to coordinated effects.

- c. There must be little likelihood of coordination being undermined by competition from outside the coordinating group (that is, external sustainability).

255. In addition to these three conditions, the merger must have an effect on the incentive to coordinate. We consider each of these conditions in turn, with the exception of external sustainability, which we consider in the supply-side responses section below.

Existing Coordination

256. Ryanair submitted that, in the absence of evidence of actual coordination over the last five years following the acquisition of the stake by Ryanair, which in this case there is not, coordinated effects can be dismissed as a theory of harm.

257. The OFT considers evidence relating to actual coordination – pre-existing or post-acquisition but prior to the OFT’s investigation – is relevant to assessing if the acquisition gives rise to coordinated effects. However, the OFT does not consider either to be a pre-requisite for coordinated effects to arise.¹³³ As outlined above, the OFT is sceptical as to the weight evidence of actual behaviour can be given in this case.

258. This scepticism is particularly strong when considering evidence as to whether coordination may have arisen. In the event that the Ryanair shareholding remains, Aer Lingus may have to re-evaluate its position and may be more likely to make the best of what it considers to be a bad situation. [].

259. Further, the OFT does not consider that evidence on the absence of any price increase or capacity reduction by Ryanair resulting from the shareholding necessarily precludes coordination from having occurred through another means.

260. Nevertheless, the OFT note that a third party in this case raised concerns that the parties may currently be coordinating around a disaggregated pricing charge over the last two to three years, and provided some

¹³³ See *Merger Assessment Guidelines*, paragraph 5.5.5

supporting evidence. Since the acquisition, Ryanair has sought detailed information from Aer Lingus on some of these disaggregated charges.

Reaching and Monitoring Coordination

261. For coordination to emerge, the firms involved need to be able to reach a common understanding about their objectives. To sustain coordination, firms will generally need to be able to monitor each other's behaviour sufficiently to ensure that deviation from the coordinated outcome can be detected.¹³⁴

262. The OFT considers the existence of significant structural links between firms in a market, such as holding cross-shareholdings, may assist in reaching and monitoring the terms of coordination. In this case, the OFT considers this may occur through two means: reducing Ryanair's incentives to deviate from, and punish deviations from, a coordinated outcome; and facilitating the sharing of information between Ryanair and Aer Lingus.

Incentives to deviate and punish reduced

263. Ryanair's incentives to deviate from any coordinated outcome may be reduced as a result of the acquisition: the benefits to Ryanair of coordination are increased; any deviation from a coordinated outcome would be less profitable for Ryanair; and punishment of Aer Lingus would be less beneficial to Ryanair.

264. Ryanair submitted that, as its cost base is much lower than Aer Lingus', it will always have an incentive to deviate: it can profitably price below Aer Lingus' marginal cost. Similarly, Ryanair argued that any attempt by Aer Lingus to punish deviation would be difficult due both to the lower cost base of Ryanair, [].

265. The OFT acknowledges that Ryanair has an incentive to deviate from a coordinated outcome due to its likely lower cost base relative to that of Aer Lingus. However, this does not consider the effect of the shareholding. Ryanair has this incentive to deviate absent the acquisition.¹³⁵ The OFT

¹³⁴ See *Merger Assessment Guidelines*, paragraphs 5.5.10 to 5.5.14.

¹³⁵ Following deviation, absent the acquisition, in the short-term Ryanair would benefit from those that switched to it from Aer Lingus. In the long-term, dependent on the punishment

considers the effect of the shareholding, by linking the overall profitability of Ryanair to the profitability of Aer Lingus, reduces this incentive. A coordinated outcome leads to larger joint profits. Aer Lingus benefits through its own increased profitability relative to the non-coordinated equilibrium. Ryanair would also benefit, through both greater profits on its own activities and through the additional profits to Aer Lingus.

266. Any punishment of Aer Lingus would be less beneficial to Ryanair as it would gain the short-term profits of the increment to its own activities but would lose: both the long-term coordinated profits (as would be the case, absent the acquisition) and the loss incurred through its shareholding.

267. Indeed, the OFT considers the fact that it is Ryanair's incentives to deviate that change as a result of the acquisition, rather than Aer Lingus', given it is Ryanair that has the greater incentive and ability to deviate absent the acquisition, makes a coordinated outcome more likely. It would make far less sense if it were Aer Lingus' incentives to deviate (through a shareholding in Ryanair) that were reduced as Aer Lingus, with a significantly higher cost base, would have little incentive to deviate anyway, absent the acquisition.

268. Furthermore, the OFT note that the shareholding provides Ryanair with a range of additional punishment strategies with which it can penalise deviation by Aer Lingus from a coordinated outcome. For example, it can take actions as a shareholder that affect Aer Lingus strategic options (see above).

269. More importantly, however, the shareholding provides Aer Lingus – otherwise potentially less able to punish Ryanair due to its higher cost base – a range of 'reward strategies' with which to 'encourage' Ryanair to a coordinated outcome. The difficulties Ryanair may face in obtaining an 'investment' return through its shareholding are shifted to Aer Lingus' incentives as Aer Lingus can feasibly explicitly reward certain competitive behaviour by Ryanair (that is, maintaining a coordinated outcome) through its shareholding. There is a time consistency to such behaviour: Aer Lingus benefits through additional earnings on its own operations, and Aer Lingus board and management benefit as their compensation structure is

strategy, Ryanair would lose the additional coordinated profits. Absent the acquisition, it is entirely feasible that a coordinated outcome could benefit both Ryanair and Aer Lingus.

determined by performance of Aer Lingus' operations; Ryanair benefits in a similar way; and then as a result of the shareholding Ryanair can also benefit (that is, be rewarded) through the payment of dividends by Aer Lingus at no cost to Aer Lingus management who have already been rewarded. Proposals of the exact dividend can come from Ryanair or Aer Lingus.

Facilitates sharing of information

270. The shareholding may facilitate greater sharing of information between Aer Lingus and Ryanair and provide a forum through which the management of both firms can communicate, thereby increasing the ability to determine a focal point, monitor deviations and detect punishment from a coordinated outcome.
271. Ryanair argued that both parties ensure they comply with stock exchange and competition rules regarding price sensitive and commercially sensitive information. Ryanair's stake does not give rise to any contact between competitors of the sort that might lead either to alter its commercial strategy.
272. However, Aer Lingus has submitted a number of examples of Ryanair attempting to obtain non-public commercially sensitive information from Aer Lingus – on intentions regarding fuel surcharges and expectations in relation to future yields – that could facilitate coordination. On each occasion, Aer Lingus has ignored Ryanair's request. Aer Lingus submitted that its senior management must meet with Ryanair regularly. Ryanair are able to seek such meetings and request information ('aggressively pressuring Aer Lingus into disclosing certain commercially sensitive information').
273. The OFT recognises that the right to request information is quite distinct from the right to access information.¹³⁶ However, the OFT considers that, in this case, the exchange of information may well be a direct consequence of the minority shareholding, as a result of: the access it grants Ryanair to

¹³⁶ See Case T-411/07, *Aer Lingus v. Commission*, July 6 2010, paragraph 70 where the General Court states: 'the application does not contain any evidence that confidential information was actually exchanged... In any event such an exchange... would not be a direct consequence of the minority shareholding.. but would constitute subsequent conduct on the part of the two companies which could potentially be examined under A81 EC'

Aer Lingus management; the potential for Aer Lingus management, should Ryanair retain its stake, to be more likely than currently to adapt to make the best of a bad situation and be incentivised, as a result of the shareholding, to pursue a tacitly coordinated outcome; and there is a realistic prospect that the shareholding could confer on Ryanair the ability to obtain board representation further facilitating information exchange.

Market Characteristics

274. Ryanair does not believe that it would be possible for airlines operating on UK – Ireland routes to reach an initial coordinated understanding on price or non-price factors, in any practicable way, to monitor adherence to that understanding. Ryanair pointed to a number of hindering factors that characterise the market.
275. The OFT does not consider that the market characteristics pointed to by Ryanair necessarily hinder coordination. In particular, the OFT does not accept there are no focal points around which coordination could occur. There are a wide range of focal points in which there is significant transparency – including frequency, additional charges, capacity, entry and exit decisions – that a coordinated outcome could feasibly develop around. The OFT notes that the absence of focal points is not borne out by recent cases involving coordination in this industry.¹³⁷

Effect on competition

276. The OFT considers the shareholding may make a coordinated outcome more likely to emerge and be sustained – as a result of materially reducing the incentives to deviate of the carrier that would have the greater incentive to deviate absent the shareholding and through facilitating information exchange – around any number of focal points on individual overlapping routes, particularly those on which Ryanair and Aer Lingus are the only carriers and have been for some time, or on a number of overlapping routes in the aggregate. The effect of such a loss of competition would therefore be experienced in relation to the Key Overlap Routes.

¹³⁷ The OFT recently reached a resolution in an investigation of alleged price fixing between two airlines in relation to a disaggregated charge, fuel price surcharges, in relation to flights to and from the UK under the Chapter 1 prohibition of the Competition Act 1998.

277. The OFT does not consider Ryanair's arguments on internal sustainability of a coordinate outcome – that Ryanair always has an incentive to deviate and Aer Lingus are unable to punish Ryanair – reflects the theory of harm being posited and the effect of the shareholding.

278. The OFT has not found it necessary to conclude on the potential for competition concerns to arise in relation to coordinated effects.

Supply-side responses

279. Entry or expansion may potentially prevent or mitigate competition concerns arising through the theories of harm outlined above: any incentive Ryanair or Aer Lingus may have to compete less vigorously against each other is reduced, and any ability Ryanair may have to diminish Aer Lingus' competitiveness offset, if such action would lead to entry or expansion by rivals. Similarly, the external stability of a coordinated outcome depends on the absence of a response from outside the coordinating group.

Low Barriers to Entry

280. Ryanair submitted the airline industry is generally characterised by low barriers to entry: there are low sunk costs and tickets for new routes can be advertised and distributed via the internet. Two potential barriers to entry that have been identified in past cases – runway capacity constraints¹³⁸ and the significant presence of both airlines at certain airports¹³⁹ – are no longer relevant, according to Ryanair. Ryanair submitted that relevant airports are not capacity constrained. In London, there is substantial off-peak capacity available, particularly at Stansted and Gatwick, and on-peak slots are regularly available at London airports other than Heathrow. London Luton is not capacity constrained at all.

¹³⁸ In this case, London (all airports except Luton), Dublin and Manchester are 'Level 3 Coordinated' airports, indicating that demand exceeds capacity for sufficient periods that formal allocation of available capacity (take-off and landing slots) is required.

¹³⁹ In *Ryanair/Aer Lingus*, the Commission found that entry was hindered by the fact that both Ryanair and Aer Lingus had large operations in Dublin. (See section 7.8). The Commission found that entry to and from Dublin airport is not likely, timely and sufficient to constitute a sufficient competitive constraint on the merged entity to defeat the likely anti-competitive effects of the merger. (section 7.8.10, paragraph 784).

281. In Dublin, the Level 3 classification is outdated as it does not reflect recent capacity expansions or reductions in traffic, including the opening of a new terminal and a new 'pier' at the existing terminal, according to Ryanair. Ryanair believes that Dublin Airport is currently operating at only one-third of this capacity.
282. Ryanair also submitted that concerns about the effectiveness of competition from rivals with a base at the other end of the route to/from Dublin (a 'destination-based' competitor) are not applicable today as a significant deterrent to entry.
283. The OFT's market investigation indicated that capacity constraints remain at Dublin Airport. While there are no terminal capacity constraints due to the opening of a new terminal in November 2010, Dublin Airport continues to have significant runway capacity constraints, particularly during peak hours.
284. The OFT also notes, as outlined above, the concentration of activity between Aer Lingus and Ryanair at Irish airports and the prevalence of the two company's brands on routes between the UK and Ireland relative to that of competitors may create economies of scale or strategic advantages – arising from experience, reputation or brand loyalty – and network effects that make the costs of entry for another carrier on routes between the UK and Ireland materially higher than those of Ryanair or Aer Lingus.¹⁴⁰

Likelihood of Entry

285. Ryanair point to a number of carriers in Europe that are able to divert capacity quickly to enter and expand on profitable routes. Four carriers that are already active in Ireland and/or the UK – easyJet, Flybe, Jet2, and Air Berlin – and three large network carriers – Air France/KLM, IAG (BA/Iberia), and Lufthansa – are highlighted by Ryanair in particular.
286. However, the OFT note that on UK and Ireland routes there has been no material entry or increased capacity, other than from the parties, in the last five years. Indeed, Ryanair and Aer Lingus have collectively accounted for more than 80 per cent of passengers between the UK and Ireland since the acquisition. More common on such routes over the period has been exit

¹⁴⁰ See *Merger Assessment Guidelines*, paragraph 5.8.5.

and reductions in capacity.¹⁴¹ Ryanair indicate this has been driven by reduced demand as a result of the economic downturn, the price of oil, and already highly competitive markets.

Conclusion on supply-side responses

287. The absence of material entry or capacity increases in recent years, irrespective of the cause, suggests the prospects for entry or expansion by other carriers is highly uncertain. Further, capacity constraints at Dublin Airport and the relative strength of Ryanair and Aer Lingus on routes between the UK and Ireland, relative to that of competing carriers, tend to support this. As a result, the OFT does not consider that, on the evidence available to it, supply-side responses would be timely, likely or sufficient so as sufficiently to mitigate or rule out any substantial lessening of competition.

THIRD PARTY VIEWS

288. During the course of its investigation the OFT contacted other airlines (including those who compete directly with the merger parties on overlapping routes and other airlines), Aer Lingus shareholders, regulators and the Irish Government (Department for Transport). Mostly, third parties did not have competition concerns about the merger. However, one third party raised concerns about the merger parties having high shares on various routes between the UK and Ireland (as well as between Ireland and Spain).

289. Another third party raised concerns about Ryanair using its shareholding to disrupt Aer Lingus' decision to exit from the Shannon/London Heathrow route and to prevent Aer Lingus from renewing its lease at Hangar 6 at Dublin airport. Both examples have been discussed in the decision.

¹⁴¹ For example, BA has exited completely, while BMI and CityJet have significantly reduced capacity on the London to Dublin route; Luxair have exited the Manchester to Dublin route; easyJet have exited the London to Shannon (as have Aer Lingus now) and Cork routes; BMI and bmibaby (as well as Aer Lingus) have exited the Manchester to Cork routes; Loganair have exited the Glasgow to Dublin routes; and Aer Lingus has notionally exited from a number of routes on which they previously competed with Aer Arann and/or Ryanair but now Aer Arann operates under an Aer Lingus franchise agreement.

290. Some Aer Lingus shareholders told the OFT that they expect that other shareholders were influenced by Ryanair at shareholder meetings although none considered that they, themselves were influenced.

ASSESSMENT

291. Between September 2006 and July 2008, Ryanair built up a 29.8 per cent shareholding in Aer Lingus. The OFT considers that this shareholding confers on Ryanair the ability materially to influence Aer Lingus within the meaning of section 26(3) of the Act. In particular, the OFT notes that Ryanair has the ability to block special resolutions of Aer Lingus which, according to OFT guidance, presumptively confers the ability materially to influence the target company. Indeed, Ryanair has consistently blocked the disapplication of pre-emption rights at Aer Lingus' annual general meetings which denies Aer Lingus this particular funding option.

292. The OFT also notes that on recent shareholder attendance at Aer Lingus annual general meetings Ryanair requires only a relatively small number of additional votes in order to block an ordinary resolution and it may be the case, looking forward, that it will be able to do so unilaterally in the future. Further, irrespective of whether it could decide the fate of ordinary resolutions unilaterally, the OFT believes that it is not inconceivable that Ryanair could seek and obtain the additional votes to enable it to take up a position on the Aer Lingus Board. It may also be possible that Ryanair, as the largest shareholder and a large operator within the industry, could influence other shareholders which may allow Ryanair to materially influence the commercial policies of Aer Lingus.

293. Taking the above evidence in the round, the OFT considers that Ryanair's 29.8 per cent shareholding in Aer Lingus has led to those two enterprises ceasing to be distinct pursuant to section 26(3) of the Act.

294. The merger parties account for more than 80 per cent of passengers between the UK and Ireland and 60 per cent of flights. Therefore, the OFT considers that the share of supply test as set out in section 23 of the Act is met in this case.

295. Finally, in terms of relevant time periods, the OFT considers that it is within time to make a finding of a relevant merger situation as a result of section

122(3) of the Act and the fact that the conditions in section 122(4) of the Act apply in the circumstances of this case. This has been confirmed by both the Competition Appeal Tribunal and the Court of Appeal.

296. Therefore, the OFT believes that it is or may be the case that a relevant merger situation has been created.

297. The OFT has assessed the merger on the basis of scheduled airline services on origin and destination overlaps involving the UK.

298. The OFT has taken as the counterfactual in this case Aer Lingus without the shareholding of Ryanair. In applying the counterfactual the OFT has taken account of current marketplace dynamics and has not simply relied on the conditions of competition from before September 2006.

299. The OFT has examined four broad theories of harm in this case:

- Aer Lingus has been or may be weakened as a competitor
- Ryanair has reduced incentives to compete against Aer Lingus
- Aer Lingus has reduced incentives to compete against Ryanair, and
- coordination between the merger parties may be created or strengthened.

Aer Lingus as a weakened competitor

300. As a result of its ability to block special resolutions and its potential voting power on ordinary resolutions, the OFT considers that Ryanair may be able to restrict Aer Lingus' commercial options sufficiently so as to: diminish Aer Lingus' ability to expand on routes on which the merger parties currently overlap; and diminish Aer Lingus' ability to enter on routes on which there is no current overlap but Ryanair operate between the UK and Ireland and Aer Lingus is the most likely entrant. Such restrictions are crucial given that an expansion of Aer Lingus could deliver substantially more competition on the Key Overlap Routes (given that the parties are either duopolists or hold a significant majority of passengers) and that Aer Lingus is the most likely entrant against Ryanair on the Ryanair Routes

(where Ryanair currently faces no material competition). The OFT considers that freed from such constraints Aer Lingus may be a more active and stronger competitor. Ryanair may be able to achieve this by restricting Aer Lingus' funding options, restricting the flexibility of how Aer Lingus uses its London Heathrow slots and blocking significant acquisitions such as a package of London Heathrow airport slots or new aircraft.

301. Moreover, Ryanair's shareholding could weaken its rival, Aer Lingus by preventing another airline investing in Aer Lingus so as to diminish Aer Lingus' ability to enter or expand on routes in competition with Ryanair. By extension, Ryanair may be able to act as 'gate-keeper' to rivals wishing to invest in Aer Lingus by making clear to those who would benefit Ryanair's own interests that it would not be a disruptive, blocking shareholder where their interests are not in conflict.

302. That reduced likelihood of a takeover of Aer Lingus may in itself dampen managerial discipline and make Aer Lingus a weaker, less efficient competitor.

303. The OFT believes that, as a result of the prospect of Aer Lingus being a weakened competitor by reason of the minority stake, it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition on the Key Overlap Routes and the Ryanair Routes.

Ryanair has reduced incentives to compete

304. If Ryanair diminishes its competitive offering (for example, increases price), it will lose customers, some of which will divert to Aer Lingus. However, by acquiring shares in Aer Lingus Ryanair may be able to re-capture a proportion of the value of those lost customers that divert to Aer Lingus, through its shareholding. Once Ryanair takes these additional investment profits into account, it may have an incentive to compete less strongly against Aer Lingus.

305. The OFT considers that the effect on Ryanair's incentives may have an increased incentive to compete less strongly against Aer Lingus and diminish its competitive offering. Such an effect, should it arise, would occur on the Key Overlap Routes (where the parties are either duopolists or hold a

significant majority of passengers), where the diversion ratio from Ryanair to Aer Lingus is likely to be greatest.

306. The OFT believes that, as a result of the prospect of Ryanair having reduced incentives to compete, it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition on the Key Overlap Routes.

Aer Lingus has reduced incentives to compete and coordination

307. The OFT also investigated whether the merger could be expected to lead to a reduction in Aer Lingus' incentives to compete against Ryanair and, separately, whether the merger is likely to create or strengthen coordination between the parties.

308. However, given its findings on the first three theories of harm the OFT has not found it necessary to conclude on the last two.

309. Consequently, the OFT believes that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

310. The OFT has therefore decided to refer the completed acquisition by Ryanair Holdings plc of a minority interest in Aer Lingus Group plc to the Competition Commission pursuant to section 22 of the Act.