

Competition Authority clears sale of TAP to Atlantic Gateway

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Introduction

The privatisation of the TAP Group, which includes the Portuguese flag carrier Transportes Aéreos Portugueses SA, was one of the measures foreseen in the Financial Assistance Programme that Portugal agreed with the European Central Bank, the International Monetary Fund and the European Commission in 2011. Following a fruitless attempt in 2012, a process for partial privatisation was launched at the end of 2014 that included the sale of up to 66% of the voting shares in holding company TAP SGPS SA,⁽¹⁾ and yielded binding offers from two consortia – SAGEF and Atlantic Gateway SGPS SA. Atlantic Gateway comprises the DGN Corporation (a US company owned by the US-Brazilian aviation tycoon David Neeleman) and HPGB SGPS SA, which is part of the Portuguese Barraqueiro group controlled by Humberto Pedrosa. Its final offer was selected by the government in June 2015 and was reported to include:

- a purchase price of €10 million;
- capital injection of €340 million into TAP; and
- the maintenance of TAP's hub in Lisbon for at least 30 years.

TAP has accumulated significant debts and despite recent efforts by management, strikes by cabin and ground staff which accompanied the privatisation process further weakened TAP's finances. TAP's privatisation was the subject of intense political debate before the national elections on October 4 2015, which resulted in a parliamentary majority for the parties that oppose privatisation. Further, SAGEF and others attacked the proposed sale to Atlantic Gateway on legal grounds, claiming a breach of EU state aid and aviation rules. It was argued that Atlantic Gateway was controlled solely by DGN and David Neeleman and therefore did not meet the requirement that the operator of an EU air carrier must be controlled by an EU member state or citizen.⁽²⁾ This argument was reflected in a preliminary opinion that the Civil Aviation Authority (ANAC) issued on October 13 2015, which recommended significant amendments to Atlantic Gateway's and TAP's draft statutes and bylaws to ensure that the latter meets EU aviation requirements post-merger.⁽³⁾

Merger control proceedings

Despite the political and regulatory concern surrounding TAP's privatisation and its sale to Atlantic Gateway in particular, the Competition Authority found no competition problems in the planned transaction, which was notified on August 20 2015 and cleared in Phase 1 on October 1 2015.⁽⁴⁾

Jurisdiction

Given that Atlantic Gateway's aim and activities are confined to the acquisition and holding of TAP and the management of its shareholding, the Competition Authority considered that the notified transaction was an indirect acquisition by DGN and HPGB of voting shares in and control over TAP via Atlantic Gateway. The transaction qualified as a concentration pursuant to Articles 36(1)(b) and (3)(a) of the Competition Act.

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The Competition Authority examined Atlantic Gateway's statutes and bylaws in detail to assess the type of control that it would exercise over TAP. It held that these rules would allow DGN – despite being the minority shareholder with 49% of shares and nominating the minority of Atlantic Gateway's board members (four out of nine) – to block strategic commercial measures, such as Atlantic Gateway's budget and business plan, its financing, lending and investments (including for the benefit of TAP) and the nomination of TAP board members. Further, TAP would be indirectly recapitalised almost entirely by DGN, which, contrary to HPGB, also has significant experience in TAP's main business activity. For these reasons, the Competition Authority concluded, in line with relevant EU merger control rules,⁽⁵⁾ that TAP would be indirectly and jointly controlled by DGN and HPGB.⁽⁶⁾

As the notified transaction exceeded the thresholds for mandatory pre-merger approval under Article 37(1) of the Competition Act and the European Commission had declined jurisdiction under the EU Merger Regulation (139/2004), the Competition Authority assessed the transaction under the Competition Act.

Substance

According to the Competition Authority decision, DGN is engaged in the provision of air transport services via its Brazilian subsidiary Azul – Linhas Aéreas Brasileiras SA and operates various routes within Brazil and three international routes to the United States and French Guinea. HPGB provides road and rail transport services primarily in Portugal. TAP's principal activity is the provision of air transport, operating routes within Europe and to Africa and the Americas from its hub in Lisbon. Having analysed the parties' activities, the Competition Authority concluded that the transaction had no horizontal, vertical or conglomerate effects.

Regarding a potential overlap between TAP and Azul's passenger airline activities, the Competition Authority deemed that (in line with relevant case law),⁽⁷⁾ the market for scheduled passenger airline services must be defined on the basis of the 'city-pair' or 'point of origin/point of destination' approach, under which each pair of cities or destinations constitutes a distinct product market.

Based on these principles, the Competition Authority concluded that there was no overlap between the domestic or international routes that TAP and Azul operate. This was clear from the Air Service Agreement between Brazil and Portugal, which allows a limited number of air carriers designated by one party to land at and depart from certain airports in the territory of the other party. However, it does not grant the right to cabotage, which means that TAP as one of the air carriers designated by Portugal is not allowed to operate domestic Brazilian routes. Azul is not a designated airline under the agreement, which excludes the overlap of business on international routes between Portugal and Brazil. The Competition Authority also concluded that Azul was not a potential competitor of TAP on transatlantic routes between Brazil and Portugal because it is a low-cost carrier with a predominantly domestic market focus and its fleet consists almost exclusively of smaller aircraft unsuitable for transatlantic flights.

Regarding a potential overlap between TAP's passenger airline activities and HPGB's passenger rail and road transport activities, the Competition Authority held that in light of relevant case law, only short-distance high-speed train connections under certain conditions were sufficiently interchangeable with respective flight connections. Since HPGB operates urban rail connections in Lisbon and no passenger rail services between any relevant airports or cities, TAP and HPGB were found not to overlap.

In the absence of any horizontal, vertical or conglomerate effects, the Competition Authority concluded that the notified transaction was unlikely to significantly impede effective competition in a national market (Article 41(3) CA) and should therefore not be opposed.

Subsequent developments

The intended sale of TAP to Atlantic Gateway passed the merger-control test,⁽⁸⁾ but the transaction was still facing significant obstacles, including a complex renegotiation of TAP's debts. However, in the meantime, TAP's finances kept worsening such that it was considered to be close to financial collapse. Following an acceleration of efforts and a commitment by the government to TAP's creditors to buy TAP back in case of non-performance of its credit obligations or a decrease in TAP's

capital ratio below a certain threshold, the transaction was closed on November 12 2015 and part of the fresh capital promised by Atlantic Gateway injected into TAP immediately. Although TAP's privatisation has therefore been completed, it remains to be seen whether this status will be of a lasting nature, given that ANAC has yet to approve the transaction (which is likely to require amendments to the planned governance of Atlantic Gateway and TAP which may call into question the commercial ratio of the deal for DGN) and that the new parliamentary majority seeks to partially or fully reverse the privatisation (which Portugal will even have to do if TAP fails to meet its credit obligations).

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Endnotes

- (1) Of the 66% of TAP's voting shares to be sold, 5% will be offered to TAP personnel. The remaining 34% will be retained by Portugal via its holding company Parpública – Participações Públicas SGPS SA.
- (2) Article 4(f) of EU Regulation 1008/2008.
- (3) For further details please see www.anac.pt/vPT/Generico/Noticias/noticias2015/Paginas/ComunicadodeImprensa052015.aspx.
- (4) Competition Authority, Decision of October 1 2015 in Case *Ccent 41/2015 – Atlantic Gateway v TAP*, accessible in Portuguese at www.concorrencia.pt/FILES_TMP/2015_41_final_net.pdf.
- (5) European Commission, Consolidated Jurisdictional Notice, OJ 2008 C 95/1, paras 62 *et seq.*
- (6) Depending on the amendments to Atlantic Gateway's and TAP's draft statutes and bylaws which are required for the transaction to be approved by ANAC under civil aviation rules, the result of that assessment may need to be revised and another merger approval from the Competition Authority required. In its preliminary opinion, *supra* fn 4, ANAC considered that significant changes were necessary (eg, Atlantic Gateway board resolutions on the nomination of TAP board members should be taken by simple majority, which – based on the board's existing composition – would allow HPGB to outvote DGN).
- (7) For example, European Commission, Case COMP/M7333 – *Alitalia v Etihad*; Competition Authority, Case *Ccent 57/2006 – TAP v PGA*.
- (8) The transaction was also cleared by the Brazilian competition authority in August 2015.

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