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Minority Report: Should Merger Reviews Examine Common Ownership?

Eighteenth Report of the C.D. Howe Institute Competition Policy Council

At their October meeting, Council members discussed potential competition concerns arising from minority “common ownership” positions across competing firms.

With the growth of institutional investors’ role in equity markets, competition authorities are increasingly attuned to the potential competition concerns from “common ownership” – that is, where a shareholder holds a minority ownership in multiple competitors operating in the same product and geographic markets.

The consensus of the Council is that the Canadian Competition Bureau (the “Bureau”) would validly examine common ownership where the relevant market is already characterized by market power or in markets that exhibit oligopolistic tendencies where reduced competitive intensity and coordinated effects are a concern. Council members emphasized that passive common ownership should not itself be a concern particularly where the common ownership occurs in highly fragmented markets or where the merging parties’ closest competitors have controlling shareholders. Additionally, Council members emphasized the practical difficulties of accessing data about merging parties and their shareholders and beneficial owners that would not already be available to the Bureau through public disclosures, particularly where private companies are concerned.

Council members generally agreed that common ownership would rarely be determinative in merger reviews. When common ownership exceeds 10 percent of voting rights in multiple competitors, the Bureau would appropriately examine whether the common shareholders exercise material influence over those companies, as is the approach under the Bureau’s Merger Enforcement Guidelines.

This is the majority view of the C.D. Howe Institute’s Competition Policy Council, which held its eighteenth meeting on October 15, 2019.

The Competition Policy Council comprises top-ranked academics and practitioners active in the field of competition policy. The Council provides analysis of emerging competition policy issues and is co-chaired by Adam Fanaki, Partner, Competition and Foreign Investment Review and Litigation



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at Davies Ward Phillips & Vineberg LLP,¹ and Grant Bishop, Associate Director, Research, at the C.D. Howe Institute. Professor Edward Iacobucci, Dean at the University of Toronto Faculty of Law and Competition Policy Scholar at the Institute, advises the program. The Council, whose members participate in their personal capacities, convenes a neutral forum to test competing visions and to share views on competition policy with practitioners, policymakers and the public.

At Issue: How should Canadian merger review approach common minority ownership of competing firms?

The concern around the competitive consequences of common ownership potentially implicates both publicly and privately held firms. However, attention is primarily focused on the public company context where certain scholars allege that the growth of intermediated asset management and consolidation of asset managers have increased the extent of common ownership across publicly held companies in key sectors.

For example, the European Commission’s decision following its review of the Dow/Dupont merger discussed common shareholdings across relevant product markets, finding that the agrochemical industry is characterized by significant common shareholding (through “passive” shareholders). It found that (i) traditional concentration measures were likely to understate the degree of concentration in market structure, and (ii) large minority shareholders exert influence on individual firms with an industry-wide perspective.² Agencies’ enforcement stance regarding common ownership was also the subject of the OECD’s December 2017 roundtable, particularly focusing on the impact of passively managed investment funds on the ownership structure across firms in concentrated sectors including finance, air travel, consumer electronics and pharmacies.³

This enforcement focus partly stems from scholarly research (principally relying on data on US markets) that has indicated increasing concentration through “horizontal shareholdings” and has

1 During Adam Fanaki’s absence for the October 2019 meeting, Elisa Kearney, Partner, Competition and Foreign Investment Review and Litigation at Davies Ward Phillips & Vineberg LLP, acted as interim co-chair.

2 European Commission. 2017. *Commission Decision declaring a concentration to be compatible with the internal market and the EEA Agreement (Case M.7932 – Dow/Dupont) (March 27)* at Annex 5 (ASSESSMENT OF THE EFFECTS OF COMMON SHAREHOLDING ON MARKET SHARES AND CONCENTRATION MEASURES). Available online: https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=2_M_7932.

3 OECD. 2017. *Common ownership by institutional investors and its impact on competition*. Available online: <http://www.oecd.org/daf/competition/common-ownership-and-its-impact-on-competition.htm>.

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observed correlation with rising consumer prices in sectors with concentration through common ownership.⁴ Broadly, the expressed concern is that common ownership could affect firm objectives and behavior and ultimately product market outcomes by reducing the incentive of a firm to compete as the firm, independently or by tacitly colluding with commonly owned firms in its market, seeks to maximize the cumulative returns for investors who also invest in its competitors.

With this intensified attention to common ownership, the Council's October 2019 meeting considered (i) whether common ownership represents a valid concern under Canadian competition law, (ii) what theories of harm justify scrutiny of common ownership, and (iii) whether it is appropriate for the Bureau to request data from merging parties on minority ownership positions as a matter of course in all merger reviews.

The consensus of the Council is that Bureau would validly be concerned with common ownership where the relevant pre-merger market is already characterized by market power or in markets that exhibit oligopolistic tendencies where reduced competitive intensity and coordinated effects is a concern. However, Council members emphasized that passive common ownership should not itself be a concern particularly where the common ownership occurs in highly fragmented markets. It should also be less of a concern where many competitors have controlling shareholders. Council members recommended that the analysis of common shareholdings should not constitute a high priority for the Bureau in the majority of merger reviews.

Council members supported empirical work to assess the state of common ownership, the presence of controlling shareholders in markets that exhibit common ownership and inter-locking directorates in the Canadian economy.

Does Common Ownership Represent a Valid Concern for Canadian Competition Law?

As an initial matter, members observed that a plain reading of the *Competition Act* supports jurisdiction for the Bureau to consider the competitive effects of the acquisition of minority interests in a competitor or minority interests in competing firms.

Specifically, section 91 of the *Act* defines a “merger” as “the acquisition or establishment, direct or indirect, by one or more persons, whether by purchase or lease of shares or assets, by amalgamation or by combination or otherwise, of control over or significant interest in the whole or a part of a

⁴ Greenspon, Jacob. 2019. “How Big a Problem Is It That a Few Shareholders Own Stock in So Many Competing Companies?” *Harvard Business Review*. Available online: <https://hbr.org/2019/02/how-big-a-problem-is-it-that-a-few-shareholders-own-stock-in-so-many-competing-companies>.

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business of a competitor, supplier, buyer or other person. “The threshold for significant interest is low. The Bureau’s Merger Enforcement Guidelines (“MEGs”) define “significant interest” as “the ability to materially influence the economic behaviour of the target business” and identify the acquisition of a greater than 10 percent voting interest as potentially constituting a “significant interest.”

Notably, the Bureau adopted draft template merger review questions that require merging parties to identify minority shareholdings above 10 percent that they hold in any competitor in the relevant market. As well, merging parties are required to identify minority shareholdings above 10 percent in any competitor in the relevant market held directly or indirectly by any entity that has a 10 percent or greater interest in one of the merging parties.⁵

These questions effectively seek to identify any possible “significant interest” across multiple firms in the given market. Council members generally agreed that, in reviewing mergers, identifying ownership interests over a 10 percent threshold is appropriate in order to identify any investors which might hold “significant interests” across multiple competitors in the same market.⁶ Certain members also regarded the draft template questions as providing a degree of certainty and predictability that is welcome by merging parties and their advisors.

However, certain Canadian practitioners do not support the Bureau’s formulaic approach to minority shareholding as a disproportionate response to an unsubstantiated issue that risks “chilling” Canadian capital markets. Council members understand that these template questions were adopted to standardize the information requested in different merger reviews, but many believe these formulations are burdensome – particularly in the private equity context.

Nonetheless, certain Council members also observed the theoretical possibility that, while no one shareholder would cross a 10 percent ownership threshold in any one company in a relevant market, multiple shareholders might have cumulative significant interests (i.e., together exercising >10 percent voting rights) in multiple competitors – and thereby have an aligned interest in suppression

5 Competition Bureau. *Merger Enforcement Guidelines* at s.1.4 and 1.10. Available online: https://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03420.html#s1_2.

6 The Council did not discuss in detail the distinction between voting and non-voting shares (i.e., where a shareholder has an economic interest in a firm but no voting rights). The Competition Bureau’s MEGs identify a 10 percent threshold for voting rights as the level below which ownership would not generally constitute a significant interest. Paragraph 1.10 of the MEGs further distinguishes between publicly and privately held companies, noting that “While inferences about situations that result in a direct or indirect holding of between 10 percent and 50 percent of voting interests are more difficult to draw, a larger voting interest is ordinarily required to materially influence a private company than a widely held public company.”

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of competition in the relevant sector. Council members did not have a view on how the Bureau could effectively screen for such a situation. However, many Council members viewed such concerns as unlikely to arise practically and stressed that such theoretical possibilities should not dictate the Bureau's default screening processes for regular merger reviews.

Nonetheless, Council members generally agreed that potential anti-competitive effects from common ownership may represent a valid concern for the competitiveness of the Canadian economy and that a preliminary consideration of the extent to which companies that compete in a relevant market exhibit common owners is relevant for the Bureau's review of mergers. While it is unlikely that a merger would be rejected on the basis of common ownership alone, it could be a relevant contextual factor for assessing the extent of pre- and post-merger competitive intensity in the given market.

Many Council members support the Bureau in its efforts to address common ownership up front. Other commentators express some scepticism that the benefits of examining common ownership in all merger reviews will exceed the costs for both merging parties and agencies.⁷

As well, Council members stressed that institutional investors can be rationally attracted to holding minority positions in a cross-section of competitors in an oligopolistic industry for reasons that have nothing to do with competition. Moreover, correlation between such common ownership concentration and above-market returns does not clearly evidence causation.⁸ Council members agreed that common ownership may have legitimate diversification motives – particularly in concentrated sectors. For an institutional investor, common ownership across multiple firms across a sector can hedge against idiosyncratic profit risk for a single company.

Council members also generally agreed that in certain more limited contexts, common ownership may create a setting in which a merger would likely substantially lessen or prevent competition. Council members stressed that any concern raised by common ownership would be highly context-dependent. Council members noted that common ownership between the merging parties themselves does not raise a distinct concern. Concern may be raised by the market power of the combined entity, not by the existence of common shareholdings prior to the merger.

7 See, e.g., Campbell, Neil. 2018. *A Competition Law Analysis of Common Shareholdings*. Competition Policy International. Available online: <https://www.competitionpolicyinternational.com/wp-content/uploads/2018/10/CPI-Campbell.pdf>.

8 Ginsberg, Douglas. 2018. *Why Common Ownership is Not an Antitrust Problem*. Harvard Law School Forum on Corporate Governance and Financial Regulation. Available online: <https://corpgov.law.harvard.edu/2018/12/04/why-common-ownership-is-not-an-antitrust-problem/>.

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Members concluded that a context where common ownership would be a concern would be markets where lack of competitive intensity would be expected to already trigger heightened scrutiny of any merger, based on the risk of lessened competition through the post-merger entity's unilateral or coordinated conduct. The risk of coordinated conduct, in which each firm competes less vigorously in recognition that doing so will invite vigorous competition in response, is higher where there is common ownership: the benefits of competing to gain market share, for example, may be non-existent for a shareholder that owns shares in both competing firms.

Finally, certain Council members pointed out a “causation problem” in a scenario where other companies in a market (i.e., other than the merging parties) are held by common minority shareholders because the market would already be susceptible to reduced competition irrespective of the merger and the proposed merger would not itself cause a substantial lessening of competition.

What Theories of Harm Justify Scrutiny of Common Ownership?

The “horizontal” (i.e., between competitors) theory of harm specific to the common ownership context is that a firm acting to maximize the profits of its owners will take into account the effect its actions on profits those owners also get from their ownership of competitors. However, where any firm could increase its own profits through intensified competition, its shareholders should benefit from those higher profits – except where they hold shares in another company whose profits would be reduced. Therefore, Council members observed that any theory requires minority shareholders to have significant influence over the firms’ managers – such that the managers will weigh the joint returns (i.e., from the multiple firms in which they hold positions) for those minority owners over the returns for other shareholders.⁹

Certain Council members also pointed out potential “vertical” anti-competitive harm through common ownership: for example, if common ownership provides opportunity for a supplier to gain information through common ownership of minority shareholders in a firm that buys from that supplier and its competitors. In markets where bidding on contracts is common, such channelling of information could facilitate disciplining of competitors. Common ownership across upstream and downstream firms could also become a channel for raising rivals’ costs.

⁹ The Council did not discuss in detail whether voting or merely a non-voting economic interest would be a prerequisite for this theory of harm. As discussed below, the scholarly literature is divided on whether influence through voting rights is necessary for common owners to exert pressure on management or whether an economic interest is sufficient, such that a company’s managers who know the identity of the company’s shareholders will act in their interest.

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The concern around common ownership is therefore not the presence of minority shareholdings across multiple competitors *per se* but whether these shareholders can exert influence over the “directing mind” of those multiple firms – for example, where the minority shareholder has a position of control or through interlocking directorates. The MEGs identify “interlocking directorates” (i.e., where directors participate on the boards of multiple competitors in a market) as a potential competitive concern.

Other scholars contend that explicit influence is unnecessary for horizontal shareholdings to have anticompetitive effects. Knowing the identity of minority shareholders, corporate managers face an incentive to account for common holdings when deciding on the level of competition with rivals.¹⁰ However, commentators have observed that a mechanism for minority shareholders to coordinate behaviour has not been well identified and that managers face countervailing incentives to maximize the firm-specific returns for all its shareholders – particularly where a firm’s controlling shareholder does not have minority shareholdings across other competitors.¹¹

Council members agreed that any specific concerns from common ownership would be mitigated where the competitors have distinct controlling shareholders. Controlling shareholders have incentives to maximize the firm’s profits alone and are not threatened by minority shareholder influence.

Conclusion: A Viable Theory of Harm should Motivate Examining Common Ownership

Council members generally agreed that common ownership would rarely be determinative in merger reviews. The Council’s consensus was that 10 percent of voting rights is an appropriate threshold for a possible “significant interest.” However, holding greater than 10 percent of voting rights will also not be determinative unless the common shareholders have the ability to materially influence the companies’ management in the given context. If any of the relevant companies have a separate controlling shareholder, common ownership should not generally raise concerns. This reflects the stated approach under the Bureau’s Merger Enforcement Guidelines for examining whether the common shareholders exercise material influence over competing firms.

Certain Council members emphasized that alleged mechanisms for competitive harm from common ownership are highly theoretical, rarely (if ever) arise in practice, and do not warrant evaluation as

10 Elhauge, Einer. 2016. “Horizontal Shareholding.” 109 *Harvard Law Review* 1267. Available online: <https://harvardlawreview.org/2016/03/horizontal-shareholding/>.

11 Backus, Matthew, Christopher Conlon and Michael Sinkinson. 2019. The Common Ownership Hypothesis: Theory and Evidence. Brookings Institution. Available online: https://www.brookings.edu/wp-content/uploads/2019/02/ES_20190205_Common-Ownership.pdf.

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a standard part of merger review. At most, common ownership is likely to be a contextual factor in understanding the extent of competition in a market and in analyzing the likelihood of a merger to substantially lessen or prevent competition in an already concentrated market or market in which a significant number of players have shareholders in common.

Additionally, Council members emphasized the practical difficulties of accessing data about merging parties and their shareholders and beneficial owners that would not already be available to the Bureau through public disclosures, particularly in instances where minority interests are held by passive investors in limited partnerships managed by private equity funds or asset managers. Specifically, although merging parties will be able to identify their own shareholders and direct investors, they would have no ability to compel their shareholders to, in turn, disclose their shareholders or beneficial owners of limited partnerships managed by private equity funds or asset managers.

Most Council members agreed that, where such data cannot be accessed, the Bureau should not hold up approval of a notified merger because of the potential for common ownership concerns unless they can present a viable theory of harm for a substantial lessening or prevention of competition to be caused by, or increased by, the presence of common ownership.

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Members of the Council participate in their personal capacities, and the views collectively expressed do not represent those of any individual, institution or client.

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* Not in attendance, October 15, 2019.

During Adam Fanaki's absence for the October 2019 meeting, Elisa Kearney, Partner, Competition and Foreign Investment Review and Litigation at Davies Ward Phillips & Vineberg LLP, acted as interim co-chair.

