Committee Secretary
Standing Committee on Economics
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18 October 2021

Answer to question on notice:
HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON ECONOMICS

INQUIRY INTO THE IMPLICATIONS OF COMMON OWNERSHIP AND CAPITAL CONCENTRATION IN AUSTRALIA

CO- MS01QON:

Dr LEIGH: What about accounting for common ownership in merger decisions?

Prof. Schmalz: The European Commission is ahead on this topic. It has considered common ownership in merger decisions. It's a complicated matter. I'd like to take that on notice, if I may, and submit a separate comment on it.

Dr LEIGH: I'd be grateful for that.

Answer:
I would like to note at the outset that my understanding is that Australia Merger law, like US merger law, is not really limited to mergers. It applies to the acquisition of any stock or assets that may substantially lessen competition; see section 50 of Australia Trade Practices Act. The law thus applies (like US law) to horizontal shareholdings themselves, and not just to mergers. How the competition authority thinks about mergers may nevertheless change as a result of taking common ownership into account.

I would now like to offer some basic and deliberately informal considerations that are meant merely to illustrate why the answer may involve nuance and can even point in opposite directions. I will then point to the leading formal scholarship on the question.

As a first informal consideration, one may take from the literature that common ownership may increase effective industry-concentration. For example, three partially commonly owned firms compete less aggressively than three separately owned firms. Market outcomes may be closer to the outcome expected in the case of separately owned duopolists or even monopoly.
One may deduce from that a first straightforward implication, namely that merger screens should be tighter. For example, if as a matter of practice, the competition authority scrutinized all five-to-four mergers as well as mergers resulting in even fewer major players, the screen should perhaps be that all four-to-three mergers (and fewer) should be scrutinized. As a second implication, on substance, the competition authority may be even more skeptical about any given merger if what the authority is worried about are high levels of concentration after the merger. The authority may then more likely block mergers. I

believe the common reading of the European Commission's mentions of common ownership in the Bayer-Monsanto and Dow-DuPont mergers as an element of context goes in that direction. Thirdly, the first evidence on anticompetitive effects of common ownership from Azar, Schmalz and Tecu's Journal of Finance article on airline competition indicates that the anticompetitive effects of common ownership may be concentrated in more highly concentrated markets. As such, leaning against increasing concentration may help to fight anticompetitive effects of common ownership.

If, by contrast, the competition authority was mainly concerned with the marginal increase in concentration due to the merger (but not at all concerned with the resulting level of concentration), the opposite implication might follow: if the firms were already commonly owned before the merger to a large degree, consummating the merger may lead to a lesser increase in concentration than if the firms had been separately owned before the merger. This consideration may lead the authority to become laxer towards mergers (but keep a closer eye on increasing levels of common ownership in the first place).

That said, the authority should consider that a merger can make a more concentrated market structure permanent since mergers are hard to attack once allowed; when common ownership (or "horizontal shareholdings") increases after the merger, this may make the merger anticompetitive but is in principle challengeable when it happens under Australian law. One should not assume that current horizontal shareholding levels are a given. If the regime is not going after horizontal shareholding in general, it has to take into account that post-merger those horizontal shareholding levels can rise.

Third, many antitrust scholars will argue that concentration per se – whether in levels or increases – should be no concern, but economic efficiency should be the focus. In that context, one may imagine a theoretical argument in which anticompetitive effects of common ownership can occur without formal mergers, but efficiency gains require actual integration of the companies. If that is the theory the authority has in mind, it should also be much more mindful of common ownership between formally separate companies but may be more lenient towards mergers as well. Again, this is reserved for cases in which large efficiency improvements that outweigh increases in market power are deemed likely by the authority. (The recent literature using U.S. data casts strong doubts on the efficiency rationale for mergers in recent years.)

The above examples are meant to illustrate that based on theory, merger enforcement can become more stringent or laxer, as a result of including common ownership in the considerations.

In terms of the leading scholarship on the question, I would like to first point to Einer Elhauge's Harvard Business Law Review Article on "How Horizontal Shareholding Harms Our Economy - And Why Antitrust Law Can Fix It"[1]. Paraphrasing his views given on pages 280-285 of the article amends my informal illustration given above as follows.

[1] Einer Elhauge, "How Horizontal Shareholding Harms our Economy – And Why Antitrust Law Can Fix It", Harvard Business Law Review, 2020. Permanent link to freely accessible working paper version: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3293822

First, Elhauge reaffirms the view first pronounced in Azar, Schmalz, and Tecu's Journal of Finance article "Anticompetitive Effects of Common Ownership" that, when assessing mergers of financial institutions and asset managers in particular, competition authorities should consider not only their impact on the product markets in the financial sector, but also whether they create anticompetitive horizontal shareholding in the underlying product markets of their portfolio firms.

Second, Elhauge notes that considering horizontal shareholding when doing merger analysis raises none of the administrative issues raised about directly going after horizontal shareholding.

Third, if the agency is not directly going after horizontal shareholding, then when doing merger analysis, it must consider not only the immediate post-merger levels of market concentration and horizontal shareholding, but also the fact that future acquisitions of horizontal shareholding will be permissible and that those future acquisitions can make the merger anticompetitive even when it otherwise would not be. Quoting from p. 282, Elhauge writes: "Thus, if a regime allows unimpeded horizontal shareholding, mergers that create high concentration levels with no immediate anticompetitive effects would fail prophylactic merger analysis whenever it seemed likely that post-merger horizontal stock acquisitions would combine with that concentration level to create anticompetitive effects."

Fourth, horizontal shareholding can also alter which mergers we consider to be horizontal in the first place. "The reason is that even if the merging firms compete in different markets (making the merger non-horizontal under traditional merger analysis), the merger can increase shareholder overlap between the merged firm and its competitors in a way that increases horizontal shareholding levels and predictably lessens horizontal competition." (p.283).

Fifth, horizontal shareholding means rising national concentration levels for various products can be relevant to general policy debates even if concentrations are not increasing in local geographic markets.

Other leading scholarship, which is more focused on the question of common ownership in merger enforcement but with which I am personally less familiar, includes Azar and Tzanaki, "Common Ownership and Merger Control Enforcement", Ioannis Kokkoris (ed.) Research Handbook in Competition Enforcement (Edward Elgar Publishing, Forthcoming), 2021; working paper version available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3822444.