

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

**Hearing on Common Ownership by institutional investors and its impact on
competition - Note by the United States**

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More documents related to this discussion can be found at www.oecd.org/daf/competition/common-ownership-and-its-impact-on-competition.htm

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1. Introduction

1. The focus of this hearing is common ownership of partial interests in competing corporations by widely diversified institutional investors.¹ Therefore, as referred to in this paper, “common ownership” is the simultaneous ownership of stock in competing companies by a single investor, where none of the stock holdings is large enough to give the owner control of any of those companies.

2. Common ownership is distinct from cross-ownership, which describes a company holding an interest (stock or otherwise) in a competitor.² As discussed in a prior U.S. submission to the OECD,³ cross-ownership of a minority position sometimes can pose competitive concerns that may be addressed through antitrust enforcement. The discussion below addresses aspects of U.S. antitrust law that may be relevant to minority shareholding by a common investor; *i.e.*, common ownership.

3. The U.S. antitrust agencies have not litigated a case involving common ownership by a single institutional investor.⁴ Institutional investors hold trillions of dollars in assets. Given the size of these holdings, requiring institutional investors to divest holdings could have a significant effect on capital markets. Accordingly, any antitrust enforcement or policy effort in this area should be pursued only if an inquiry reveals compelling evidence

¹ “Institutional investors” include mutual fund and index fund management companies, other asset managers, and other firms that buy and hold equities on behalf of individual investors. *See* Eric A. Posner, Fiona Scott Morton, & E. Glen Weyl, *A Proposal to Limit the Anti-Competitive Power of Institutional Investors*, ANTITRUST L. J. (forthcoming 2017), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2872754 at 5. As noted in the Secretariat’s background paper, passively managed index and exchange-traded funds have grown rapidly in recent years, doubling their assets under management between 2011 and 2014. DAF/COMP (2017)10, para 23 and Fig. 3.

² Although this distinction is not always clearly articulated in the literature, it is important in the context of the issues discussed in this submission. Further, although there is significant overlap between the activities that give rise to these two conduct patterns and their potential competitive harms, they are not completely coextensive. A general discussion of ownership of “minority interests”, however, could involve analysis of both common ownership and cross-ownership, as both involve ownership of less than a majority interest in a firm. In this paper, the agencies discuss issues related to common ownership.

³ U.S. submission on Antitrust Issues Involving Minority Shareholding and Interlocking Directorates (DAF/COMP/WP3/WD (2008)).

⁴ Recently, however, the Antitrust Division of the Department of Justice (“DOJ”) obtained a fine and injunctive relief against ValueAct for violating U.S. premerger notification requirements. *See* <https://www.justice.gov/opa/pr/justice-department-obtains-record-fine-and-injunctive-relief-against-activist-investor> (describing complaint against activist investor in two merger parties that failed to make required HSR filing when investor intended to influence companies’ activities). In an older case, DOJ sued, but lost, a case against an individual under Section 7 for common ownership in Columbia Pictures and MGM Pictures. *See U.S. v. Tracinda Inv. Corp.*, 477 F.Supp. 1093 (C.D. Cal. 1979), available at <https://law.justia.com/cases/federal/district-courts/FSupp/477/1093/1418357/>.

of the anticompetitive effects of common ownership by institutional investors in concentrated industries. Consistent with long-standing agency practice and legal precedent, any such enforcement by the U.S. antitrust agencies would address actual or predicted harm to competition from a particular transaction, would not be predicated on general relationships suggested by academic papers, and would seek to avoid outcomes that would unnecessarily chill procompetitive investment.

4. Although not discussed here, common ownership raises the possibility of active efforts to coordinate the decisions of competitors by or through common owners. If an institutional investor were to orchestrate an anticompetitive agreement between two direct competitors, both competitors and the investor could be liable for a per se violation of the antitrust law. Similarly, passing competitively sensitive information between competitors through an institutional investor could expose the companies and the investor to liability.

2. U.S. Laws on Minority Stakes and Common Agents

5. U.S. antitrust law applies to the ownership of partial interests. By its terms, Section 7 of the Clayton Act,⁵ the U.S. merger law, applies to direct or indirect acquisitions of the “whole or any part” of stock or share capital of a company where the effect may be substantially to lessen competition. As the Supreme Court has explained, Congress intended the Clayton Act to identify competition concerns in their incipiency, well before the effects would warrant enforcement as an unreasonable restraint of trade or unlawful monopolization under the Sherman Act.⁶

6. The Clayton Act also reflects an underlying policy of broad support for investment through stock purchases, when such purchases are not part of an effort to control or influence management of the firm.⁷ Section 7 specifically exempts acquisitions

⁵ 15 U.S.C. §18; *see also* *U.S. v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963); *U.S. v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586 (1957).

⁶ *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586, 589 (1957) (interpreting original Section 7); *Brown Shoe Co. v. United States*, 370 U.S. 294, 318 n.32 (1962) (interpreting original and amended Section 7); *American Crystal Sugar Co. v. Cuban-American Sugar Co.*, 152 F. Supp. 387, 394-5 (S.D.N.Y. 1957), *aff'd*, 259 F.2d 524 (2d Cir. 1958).

⁷ The size of the ownership interest relevant for control under U.S. antitrust law may be different than that under other U.S. law. For example, under the U.S. federal securities laws, Rule 12b-2 defines control as the direct or indirect possession of the power to direct the management and policies of a person through the ownership of a voting class of securities, by contract or otherwise. The determination of who is in control of an issuer will therefore vary depending on the particular facts and circumstances. While minority ownership may be viewed with skepticism for purposes of establishing control, and thus seen as an insufficient basis upon which court could rely to impose culpable participation liability on firms or individuals, ownership of a majority position and/or the ability to appoint directors are commonly cited as representative indicia of control and serve as reasonable grounds upon which to rely in support of a claim seeking to impose such liability. *See* Securities Act of 1933 at Section 15, 15 U.S.C. § 77a (1933) and Securities Exchange Act of 1934 at Section 20(a), 15 U.S.C. § 78a (1934).

Similarly, U.S. securities regulation includes provisions that recognize the concept of “normal corporate governance activities” within the idea of passive investment. Section 13(d)(5) of the Securities Exchange Act of 1934, and Rule 13d-1(b) and (c) thereunder, contain filing requirements unique to certain “passive” investors who acquire more than 5% but apply only in

of stock by persons “solely for investment and not using the same by voting or otherwise to bring about, or in attempting to bring about, the substantial lessening of competition.” This exemption was intended to minimize the impact of merger review on capital markets.⁸

7. The acquisition of a minority shareholding, if larger than specified thresholds, generally is reportable under the Hart-Scott-Rodino Act⁹ and is subject to premerger review in the United States. In keeping with the jurisdictional limits of Section 7, however, acquisitions solely for the purpose of investment of 10 percent or less of the outstanding voting securities of the issuer are exempt from premerger notification.¹⁰ On the other hand, acquisitions of stock with the intent of seeking control are generally reportable under the HSR Act, assuming statutory thresholds are met and no exemption applies.

8. In addition, certain institutional investors can acquire 15 percent or less of an issuer’s voting securities, if solely for investment, without filing premerger notification.¹¹ The agencies adopted a higher threshold for investments by institutional investors because, for a variety of reasons applicable at the time, it was understood that most of these entities did not participate in or affect the management of the companies whose stock they bought.¹²

instances where these investors do not hold the subject class of equity securities with the purpose or with the effect of changing or influencing control of the issuer.

⁸ See S. Rep. No. 94-803 at 66 (May 6, 1976).

⁹ 15 U.S.C. §18a.

¹⁰ 15 U.S.C. §18a(c)(9). HSR Rule 801.1(i)(1) provides that voting securities are acquired “solely for the purposes of investment” if the acquirer “has no intention of participating in the formation, determination or direction of the basic business decisions of the issuer.” 16 C.F.R. 801.1(i)(1).

¹¹ Rule 802.64 (16 C.F.R. 802.64) lists the types of institutional investors subject to this exemption: (1) A bank within the meaning of 15 U.S.C. 80b-2(a)(2); (2) Savings bank; (3) Savings and loan or building and loan company or association; (4) Trust company; (5) Insurance company; (6) Investment company registered with the U.S. Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.); (7) Finance company; (8) Broker-dealer within the meaning of 15 U.S.C. 78c(a)(4) or (a)(5); (9) Small Business Investment Company or Minority Enterprise Small Business Investment Company regulated by the U.S. Small Business Administration pursuant to 15 U.S.C. 662; (10) A stock bonus, pension, or profit-sharing trust qualified under section 401 of the Internal Revenue Code; (11) Bank holding company within the meaning of 12 U.S.C. 1841; (12) An entity which is controlled directly or indirectly by an institutional investor and the activities of which are in the ordinary course of business of the institutional investor; (13) An entity which may supply incidental services to entities which it controls directly or indirectly but which performs no operating functions, and which is otherwise engaged only in holding controlling interests in institutional investors; or (14) A nonprofit entity within the meaning of sections 501(c) (1) through (4), (6) through (15), (17) through (20), or (d) of the Internal Revenue Code.

¹² “Some of these investors, such as non-profit entities, are constrained by law or by their charters from participating in the management of most business corporations. Pension trusts, insurance companies and others are limited by their fiduciary duty to the ultimate beneficiaries of their investment. Entities such as broker-dealers and investment companies frequently engage in acquisitions that may meet the criteria of the act, but they generally have no interest in affecting the management of the companies whose stock they buy. The rule thus attempts to reduce the

9. Section 13 of the U.S. Horizontal Merger Guidelines¹³ describes situations in which the agencies will review acquisitions of minority positions even if the minority position does not completely eliminate competition between the parties to the transaction. Although the section is concerned more directly with cross-ownership, it has some relevance to acquisitions resulting in common ownership. As stated in the Guidelines, partial acquisitions that do not result in effective control may nonetheless affect competition in three ways:

*First, a partial acquisition can lessen competition by giving the acquiring firm the ability to influence the competitive conduct of the target firm. A voting interest in the target firm or specific governance rights, such as the right to appoint members to the board of directors, can permit such influence. Such influence can lessen competition because the acquiring firm can use its influence to induce the target firm to compete less aggressively or to coordinate its conduct with that of the acquiring firm.*¹⁴

*Second, a partial acquisition can lessen competition by reducing the incentive of the acquiring firm to compete. Acquiring a minority position in a rival might significantly blunt the incentive of the acquiring firm to compete aggressively because it shares in the losses thereby inflicted on that rival. This reduction in the incentive of the acquiring firm to compete arises even if cannot influence the conduct of the target firm.*¹⁵ *As compared with the unilateral competitive effect of a full merger, this effect is likely attenuated by the fact that the ownership is only partial.*

*Third, a partial acquisition can lessen competition by giving the acquiring firm access to non-public, competitively sensitive information from the target firm. Even absent any ability to influence the conduct of the target firm, access to competitively sensitive information can lead to adverse unilateral or coordinated effects.*¹⁶ *For example, it can enhance the ability of the two firms to coordinate*

disruption that could result from requiring them to report and observe a waiting period before such acquisitions.” Statement of Basis and Purpose, 43 Fed. Reg. 33450 at 33503 (Jul. 31, 1978).

¹³ U.S. Dep’t of Justice and the Fed. Tr. Comm’n, *Horizontal Merger Guidelines* (2010), available at <https://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf>.

¹⁴ In *TC Group, LLC*, the FTC charged two private equity firms, which together held a 50% interest in the general partner controlling an energy company, with violating Section 7 by acquiring a combined 22.6% interest in a competing energy company. The FTC alleged that a complete merger of the two energy companies would have substantially lessened competition in eleven markets, and in addition to their partial interests, the private equity firms had their own representatives on each company’s board. The FTC concluded that this representation, which came with the right to veto certain decisions at the competing firm as well as access to competitively sensitive information about both competitors, was sufficient to trigger a Section 7 violation. See <https://www.ftc.gov/enforcement/cases-proceedings/0610197/tc-group-llc-riverstone-holdings-llc-carlyriverstone-global>.

¹⁵ See, e.g., *In re GlaxoSmithKline, plc*, Dkt. C-4498 (Nov. 26, 2014) (36.6 percent share in joint venture selling competing product would give firm increased incentive to raise prices on its own products, and make up some lost sales through profits in the joint venture).

¹⁶ See, e.g., *In re Medtronic, Inc.*, Dkt. C-3842 (Oct. 1, 1998) (through an investment agreement, firm owned less than 10 percent of the overall securities in a competitor, but also had rights to receive competitively sensitive non-public information, appoint one member to the competitor's

*their behavior, and make other accommodating responses faster and more targeted. The risk of coordinated effects is greater if the transaction also facilitates the flow of competitively sensitive information from the acquiring firm to the target firm.*¹⁷

10. U.S. law also places limits on shared management, a somewhat similar phenomenon to common ownership. Section 8 of the Clayton Act, as amended by the Antitrust Amendments Act of 1990, bans most director and officer interlocks between competing corporations.¹⁸ Subject to certain minimum thresholds, Section 8 prohibits a person from serving as a director or an officer of two or more corporations that are horizontal competitors.¹⁹ Here, the concern is not about ownership, but rather control or influence over the decisions of two competitors via a common agent or representative.

3. Scholarship Related to Common Ownership

11. Several areas of scholarship study the question of how institutional investors exercise influence in corporations. One strand of the literature has produced recent evidence on the potential competitive effect of common horizontal ownership by institutional investors in concentrated industries with sometimes conflicting results.

12. While it has occasioned increased commentary,²⁰ the empirical literature on the competitive implications of common ownership by institutional investors is still in its early stages.²¹ To date, scholars have directly tested and presented results of their work studying the impact of common ownership on prices in just two industries, banking and passenger airline travel.²² In one study of the airline industry, the authors find that

board of directors, and vote on all matters requiring a shareholder vote; the FTC order required passive investment and limited access to non-public competitively sensitive information).

¹⁷ Horizontal Merger Guidelines, *supra* n.13 at § 13.

¹⁸ Pub. L. 101-588 (codified at 15 U.S.C. § 19).

¹⁹ See U.S. submission on Antitrust Issues Involving Minority Shareholding and Interlocking Directorates, DAF/COMP/WP3/WD (2008). This submission does not focus on interlocking directorate issues, which may occur separately or simultaneously with common ownership.

²⁰ For example, some commentators have concluded that common ownership represents an antitrust concern, *see, e.g.*, Einer Elhauge, *Horizontal Shareholding*, 129 HARV. L. REV. 1267 (2016), while others reject the possibility and are critical of some of the methods of empirical analysis, *see, e.g.*, Edward B. Rock and Daniel L. Rubinfeld, *Antitrust for Institutional Investors*, NYU Law and Economics Research Paper No. 17-23 (2017), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2998296.

²¹ See, *e.g.*, Martin C. Schmalz, *Common Ownership, Concentration, and Corporate Conduct*, ANN. REV. OF FIN. ECON. (forthcoming 2018), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3046829

²² Some other scholars connect common or cross ownership to measures of firm profitability using data from a broad range of industries. See, *e.g.*, Jin He & Jiekun Huang, *Product Market Competition in a World of Cross-Ownership: Evidence from Institutional Blockholdings*, REV. OF FIN. STUDIES (forthcoming 2017), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2380426; José Azar, *A New Look at Oligopoly: Implicit Collusion Through Portfolio Diversification*, Princeton Univ. Dissertation (2012), available at <http://www.princeton.edu/~smorris/pdfs/PhD/Azar.pdf>.

changes in specific measures reflecting the degree of common ownership at the route-level strongly correlate with changes in pricing.²³ A subsequent study finds, however, that this relationship does not exist under alternative econometric approaches, and questions the economic foundations of the estimating equations.²⁴ Moreover, one study of retail banking finds that increases in common ownership correlate with higher prices and fees paid by consumers.²⁵ However, another study finds that the impact of common ownership on banks' prices and quantities is highly sensitive to the choice of econometric specification, and that any effect is small.²⁶ The literature in applying these measures does not confront the question of what form of competition might be susceptible to the influence that some of the studies attribute to common ownership.

13. The empirical literature on the effects of common ownership largely has reported conclusions about competitive effects based on correlation between common ownership and outcomes such as price effects, executive compensation, and voting rights. These authors posit possible mechanisms by which common ownership may lead to price increases,²⁷ but only a few papers directly examine the mechanisms through which common ownership may affect the conduct of firm managers. One such paper hypothesizes that common owners may prefer to compensate managers of companies they own with incentive schemes based on an entire industry's performance in order to encourage a softening of competition.²⁸ Some research suggests that such contracts are

²³ See José Azar, Martin C. Schmalz, and Isabel Tecu, *Anti-Competitive Effects of Common Ownership*, J. FIN. (forthcoming 2017), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2427345&rec=1&srcabs=2430713&alg=1&pos=8.

²⁴ Pauline Kennedy, Daniel O'Brien, Minjae Song, and Keith Waehrer, *The Competitive Effects of Common Ownership: Economic Foundations and Empirical Evidence* (2017), available at <https://ssrn.com/abstract=3008331>. In turn, the authors of the initial study of the airline industry addressed some of the criticisms of their empirical analysis, though they have not addressed questions about the economic foundation of their estimating equation. See José Azar, Marin C. Schmalz, and Isabel Tecu, *The Competitive Effects of Common Ownership: Economic Foundations and Empirical Evidence: Reply* (September 28, 2017), available at <https://ssrn.com/abstract=3044908>.

²⁵ José Azar, Sahil Raina, and Martin C. Schmalz, *Ultimate Ownership and Bank Competition* (2016); available at <https://ssrn.com/abstract=2710252>. Note that Azar and Schmalz also are authors of the paper finding harm in airline markets (see n.22 and accompanying text).

²⁶ See Jacob Gramlich and Serafin Grundl, *Testing for Competitive Effects of Common Ownership*, Finance and Economics Discussion Series 2017-029, Washington: Board of Governors of the Federal Reserve System (2017), available at <https://doi.org/10.17016/FEDS.2017.029r1>.

²⁷ E.g., Jose Azar et al., *Anti-competitive Effects of Common Ownership*, *supra* note 23, at 31-32 (positing that management may have weak incentives to compete vigorously unless they are pressed to do so by influential shareholders, and common owners may not have the incentive to press managers to compete); Jose Azar et al., *Ultimate Ownership and Bank Competition*, *supra* note 26, at 4-5 (positing that price increases could occur due to a form of natural selection of board members, who may be voted out of office by common investors if the board does not work to maximize industry-wide profits).

²⁸ See Elhauge, *supra* n.20.

more common in industries with greater common ownership.²⁹ Other research, however, emphasizes that the specific characteristics of institutional investment are not conducive – or are even antithetical – to coordinated intervention by these firms in the product markets of companies that they own.³⁰ We note that the new research does not explore the disparate incentives and frictions that complicate the analysis of institutional ownership and its effects on operating companies.³¹ An asset manager has a fiduciary duty to implement each fund’s separate investment objectives and act in its best interests, which can materially affect the actions of a fund. Moreover, in the U.S., a fund’s board of directors, which oversees the fund’s asset manager, can set parameters for the actions of the asset manager. Others posit that it is an unanswered empirical question whether common ownership leads to company managerial behavior that violates fiduciary obligations and harms competition.³²

14. Though the literature analyzing potential competitive effects resulting from institutional common ownership is still nascent, some scholars have proposed policy changes that are designed to curb claimed anticompetitive effects. One proposal has suggested imposing limits on institutional investors’ ability to invest simultaneously in multiple firms within a given industry.³³ However, other scholars warn that adopting such changes could have harmful unanticipated consequences,³⁴ and some advise taking a more measured approach that is akin to applying the rule of reason.³⁵

²⁹ See Miguel Anton, Florian Ederer, Mireia Gine, and Martin C. Schmalz, *Common Ownership, Competition, and Top Management Incentives*, Ross School of Business Paper No. 1328 (2017), available at <https://ssrn.com/abstract=2802332>.

³⁰ See Lucian A. Bebchuk, Alma Cohen, and Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSPECTIVES 89 (2017), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2982617. In particular, an analysis of index fund managers’ incentives suggests that they may not have a strong interest in performing the type of active monitoring that would be required to facilitate more coordinated interaction in product markets, even if that would work to the benefit of investors.

³¹ For example, see Appel, Ian and Gormley, Todd A. and Keim, Donald B., *Passive Investors, Not Passive Owners* (February 6, 2016). *Journal of Financial Economics (JFE)*, Forthcoming (using their significant voting power, passive institutional ownership improves firms’ governance structures and long-term performance). See also Matvos, Gregor, and Michael Ostrovsky, 2008, “Cross-ownership, returns, and voting in mergers.” Fich, Eliezer M., Jarrad Harford and Anh L. Tran, “Motivated Monitors: The Importance of Institutional Investors’ Portfolio Weights,” *JFE*. Ferreira, Miguel A., Massimo Massa and Pedro Matos, 2009, “Shareholders at the Gate? Institutional Investors and Cross-Border Mergers and Acquisitions.” *The Review of Financial Studies*.

³² Daniel O’Brien and Keith Waehrer, *The Competitive Effects of Common Ownership: We Know Less than We Think* (2017), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2922677.

³³ See Posner et al., *supra* n.1.

³⁴ In critique of papers that advocate for the existence of potential antitrust concerns in this area, some point out that legal restrictions or challenges to common ownership could increase the cost of managing index funds, a cost that likely would be borne by consumers who rely on them for retirement. Some proposals could limit diversification and the benefits that it can bring. A limit on a fund’s holding could require a larger institutional investor to split itself into multiple independent units, again causing increased costs to investors. Finally, limits on institutional investing could have significant effects on corporate governance. See Rock and Rubinfeld, *supra* n.20, at 36-39;

4. Conclusion

15. Creating across-the-board limitations on common ownership without sufficient evidence of anticompetitive effects could impose unintended real-world costs on businesses and consumers by making it more difficult to diversify risk. Given the ongoing academic research and debate, and its early stage of development, the U.S. antitrust agencies are not prepared at this time to make any changes to their policies or practices with respect to common ownership by institutional investors. The agencies evaluate new learning from the academic community and are prepared to take action when appropriate. Where sufficient evidence exists that the effect of particular acquisitions may be substantially to lessen competition, the agencies will consider appropriate responses, including possible enforcement actions.

see also O'Brien and Waehrer, *supra* n. 32 (arguing that management incentives do not depend on uniform incentives across industries and that laws on fiduciary duty obligations make clear that directors' and officers' obligations are to the company).

³⁵ *E.g.*, Manesh Patel, *Common Ownership, Institutional Investors, and Antitrust*, ANTITRUST L. J. (forthcoming 2017) available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2941031.