CPI's North America Column Presents:

FTC Hearing #8: Common Ownership

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(Paul Hastings)[1]

December 2018

The eighth of the FTC's Hearings on Competition and Consumer Protection in the 21st Century, held at New York University School of Law on December 6, 2018, focused on common ownership. Common ownership is defined as shareholdings by a single investor, short of controlling interests, in multiple companies that compete with one another.[2] Common ownership theories of antitrust harm posit that, notwithstanding the inability of a single investor to control the company in which it owns shares, holding shares in competing companies simultaneously causes those companies to compete less aggressively.

The hearing largely centered around: (1) the current state of academic literature analyzing the relationship between common ownership and higher prices within product markets; (2) how common ownership might cause higher prices; and (3) factors to determine whether antitrust intervention is warranted.

The Current State of Research Analysis

Martin Schmalz, of the University of Michigan Ross School of Business, described a number of academic papers written to date that show a correlation between common ownership and higher prices, and suggested that no empirical evidence supports efficiency enhancing effects from common ownership. Schmalz acknowledged shortcomings in the data, which Christopher Conlon, NYU Stern School of Business, later described as "unusually bad." Still, Schmalz argued that given the literature and theory, it is not reasonable to assume there is no competitive effect from common ownership.

Nancy Rose, MIT Department of Economics, expressed an openness to evidence developing that could point toward remediation, but cautioned that the research does not yet support it. She noted that in the economic modeling, for example, the use of one shareholder owning stakes in all four players in a given industry fails to capture the varied structures, scope, and size of asset managers. Further, determining that all four players in the given industry desire higher prices and will follow other players' moves (implying tacit coordination in oligopoly conditions), reveals nothing about the effect of common ownership.

Others noted additional flaws in the academic literature. Daniel O'Brien of Compass Lexecon said that the flaw in using a modified HHI/price regression analysis is that it illuminates market concentration but not the effect of common ownership. Market shares change for many reasons, he noted, that are unrelated to common ownership. Barbara Novick of Blackrock pointed to a study of the airlines industry[3] as flawed for assuming that managers hold shares of the airlines even during times of bankruptcy, which affects 29 of the 56 quarters in the study.

Schmalz and Serafin Grundl, the latter of the Federal Reserve Board, argued that criticisms of the literature set the bar too high for what can be achieved using publicly available data.

The Causation Problem

Existing antitrust laws reach active investors who affirmatively suppress competition through collusion. So-called activist investors who, for example, seek to influence the company through board seats, are not at issue in the common ownership debate. When common ownership is passive, FTC Commissioner Noah Joshua Phillips has made clear that understanding the mechanism remains critical to identifying the harm and crafting a remedy. Scott Hemphill, of NYU School of Law, noted that research has not yet linked common ownership with higher prices through a plausible causal mechanism.

Novick explained that compensation structures of public companies address long-term company strategy and growth, not product pricing. Thus, shareholders do not foster any company pricing behavior a firm would not otherwise engage in. She further noted that, while voting shares are the ultimate expression of investment stewardship, of the codes used for classifying management agendas by proxy advisors to guide on shareholder voting, none of the more than 380 relate to product pricing.

Absent a concrete mechanism for a passive investor to influence a firm's competitive behavior, William Rooney of Willkie Farr & Gallagher argued that passive investments resulting in higher prices within product markets are not actionable under Section 7 of the Clayton Act. Einer Elhauge, of Harvard Law School, argued that the Clayton Act reaches such acquisitions of such shares, echoing his notable published sentiments on the issue.[4]

Fiona Scott Morton, Yale University School of Management, acknowledged that the existing modeling does not yet trace common ownership to effects on product market competition, but urged an FTC 6(b) study to gather private data because "it's a problem we don't understand very well and it's enormous." Menesh Patel, UC Davis School of Law, agreed that the theoretical basis for a common ownership antitrust problem is real, but expressed skepticism at a causal connection.

Other participants echoed the impact an FTC study could have on the analysis. Hemphill acknowledged that an agency investigation could reveal whether institutional investors affect a company's competitive behavior, as it's a binary factual question whether a company's management feels the influence of large investors or does not.

FTC Commissioner Rohit Chopra struck an aggressive tone, saying that executive compensation structures and increasing corporate debt may be distorting firm behavior in a way that poses issues for consumer protection and competition enforcement and settlements. Chopra did not take on the critiques of common ownership theory, but floated possible ways to force lower levels of corporate debt and tighten governance.

Factors to Determine Whether Government Intervention is Warranted

Discussion at the hearing alluded to potential remedies but avoided an in-depth discussion. Scott Morton has advocated a limit on the holdings under common ownership: hold either no more than 1% of the total size of the industry or only the shares of a single firm in the industry.[5] This approach was criticized as eliminating diversification, such as through sector or index funds.

Critics of common ownership theories of harm urged caution among enforcers and policy makers, warning of unintended consequences. Allison Bennington of ValueAct Capital noted the recent history of engagement between corporate management, boards, and shareholders seen following the financial crisis. She said the common ownership proposals break the chain of accountability between shareholders, a company's board, and management. Scott Hirst of Boston University School of Law called proposed changes costly and counterproductive.

Other collateral consequences identified were that restricting voting of shares would disenfranchise shareholders, entrench management at the expense of long-term owners, reduce diversification by investors, increase transaction costs, and reduce participation in capital markets. Heather Slavkin Corzo, AFL-CIO, and Kenneth Bertsch, Council of Institutional Investors, expressed concern about false positives from regulators that would jeopardize management's accountability to shareholders. They noted that the issue brings institutional investors and the AFL-CIO into rare agreement.

FTC Commissioner Phillips noted the importance of weighing the procompetitive benefits of common ownership against harms, highlighting how institutional investors make investing affordable for many American consumers. Commissioner Phillips warned that some of the remedies proposed to address common ownership could chill participation by investors.

Patel noted that the fact-specific nature of the inquiry does not counsel disregarding the research findings. Instead, he argued, a remedy could be narrowed to reach only those situations where attributes similar to the existing models are present. Elhauge argued that it would be better to allow efficiency-enhancing mergers and address the more narrow common ownership issue than to require more structural fragmentation but allow common ownership. Scott Morton expressed concern that harms from common ownership would affect a large majority of American consumers who face the higher prices but do not participate in public company investing. She lamented that such consumers were not represented in the hearing.

It was also acknowledged that common ownership might not be a competition problem. SEC Commissioner Robert Jackson described common ownership as a corporate governance and investor protection problem that leaves investors in the dark. Jackson advocated for SEC rules that take advantage of institutional voting to empower individual investors to understand how their money is voted.

Conclusion

The FTC hearing on common ownership laid bare the fault lines dividing those who favor vigorous antitrust intervention in this area and those who oppose it: namely, the lack of connecting the theory of harm to a concrete mechanism by which shareholders influence company competitive behavior that would support a causal link between common ownership and higher prices. While further academic and regulatory study is needed if proponents of intervention are to validate their concerns, query whether this is a top priority for limited resources given the myriad other dynamics and potential enforcement and policy discussions embodied in existing FTC efforts, including those discussed in other hearings in the series. Still further away are a rigorous balancing of the potential evidence that might one day surface against the benefits of participation in capital markets and, if in turn merited, fashioning an appropriate remedy that minimizes collateral damage to corporate governance.

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[2] The hearing can be viewed at https://www.ftc.gov/news-events/audio-video.

[3] See Azar, José and Schmalz, Martin C. and Tecu, Isabel, Anticompetitive Effects of Common Ownership (May 10, 2018). Journal of Finance, 73(4), 2018. Available at SSRN: https://ssrn.com/abstract=2427345 or http://dx.doi.org/10.2139/ssrn.2427345

[4] *See* Einer Elhauge, *Horizontal Shareholding*, 129 HARV. L. REV. 1267 (2016).

[5] *See* Eric A. Posner, Fiona Scott Morton & E. Glen Weyl, *A Proposal to Limit the Anti-Competitive Power of Institutional Investors*, 81 ANTITRUST L. J. Vol. 3 (2018).