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

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This document reproduces a written contribution from the United States submitted for Item 6 of the 128th OECD Competition committee meeting on 5-6 December 2017.

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

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 DFTXLVLWLRQRIWKHVWRFNRUDQSDUWRIVWRFNRUVKDUHFDSLWDORIDFRPSDQZKHUHWKH 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 A7(p12(.)]TJET/GS1 gsq.00125 -.12134 595.440002441 842.1599

RIVWRFNE SHUVRQV VROHO IRU LQYHVWPHQW DQG QRW XVLQJ WKH VDPH E\ YRWLQJ RU RWKHUZLVH to bring about, or in attempting to bring about WKH VXEVWDQWLDO OHVVHQLQJ RI FRPSHWLWLRQ. 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-

9. Section 13 of the U.S. Horizontal Merger Guidelines[13] 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]
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> *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.*
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> *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 DFTXLVLWLRQ6WDWHPHQWRI%DVLVDQ3XUSRVH)HG5HJDW-XQ

[13] 86'HS¶WRI-XWLFHDQWKH)HGTr. &RPP¶Q *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

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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,hat are

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 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 LPSOHPHQW HDFK IXQG¶V VHSDUDWH LQYHVWPHQW REMHFWLYHV DQG DFWLQJ WV EHVW LQWHUHVWV can materially affect the actions of a fund. 0RUHRYHU LQ WKH 86 D IXQG¶V ERDUG RI directors, which oYHUVHHV WKH IXQG¶V DVVHW PDQDJHU FDQ VHW SDUDPHWHUV IRU WKH DFWLRQ RI 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 VXJJHVWHG LPSRVLQJ OLPLWV RQ LQVWLWXWLRQDO LQYHVWRUV¶ DELOLW\ WR LQYHVW VLPXOWDQHRXVO 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]

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[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 IXQG PDQDJHUV¶ LQFHQWLYHV VXJJHVWV WKDW WKH\ PD\ QRW KDYH D VWURQJ LQWHUHVW LQ SHUIRUPLQJ WKH W\SH 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 (usiQJ WKHLU VLJQLILFDQW YRWLQJ SRZHU SDVVLYH LQVWLWXWLRQDO RZQHUVKLS LPSURYHV ILUPV¶ JRYHUQDQFH structures and long-term performance). See also Matvos, Gregor, and Michael Ostrovsky, 2008, &URVV-Ownership, UHWXUQV DQG YRWLQJ LQ PHUJHUV ; Fich, Eliezer M., Jarrad Harford and Anh L. 7UDQ 0RWLYDWHG 0RQLWRUV 7KH ,PSRUWDQFH RI ,QVWLWXWLRQDO ,QYHVWRUV¶ 3RUWIROLR :HLJKWV´ JFE; Ferreira, Miguel A., Massimo Massa and Pedro Matos, 2009, 6KDUHKROGHUV DW WKH *DWH" Institutional Investors and Cross-BoUGHU 0HUJHUV DQG $FTXLVLWLRQ´ *The Review of Financial Studies*.

[32] 'DQLHO 2¶%ULHQ DQG .HLWK :DKUHU, *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 DIXQG¶V 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 2¶%LHQ:DHKUHU, 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 GLUHFWRUV¶DQRIILFHUV¶SEO duties are to the company).

[35] *E.g.*