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"Taking Stock: Assessing Common Ownership"

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Introduction

Thank you for that introduction, Scott. I also want to thank Concurrences Review and NYU Stern for holding this excellent conference. I'm pleased to be here delivering my first public remarks as an FTC Commissioner, and humbled to address some of the smartest and most thoughtful scholars and practitioners of antitrust across the globe.

Two important caveats:

First, the remarks I give today represent my own thoughts, not those of the FTC or any of my fellow Commissioners.

Second, I am well aware that my remarks are all that stands between you and drinks, so I'll try to be brief.

I want to end the day by returning to a topic discussed earlier – that is, the competitive effects and antitrust implications, if any, of "common ownership". Common ownership refers to the situation wherein diversified institutional investors hold partial interests in competing corporations. It is distinct from "cross-ownership", when a company holds an interest in one of its competitors, and other joint venture or co-partner scenarios, which have long been a focus of U.S. antitrust law.

Common ownership is a reality of today's economy. As Americans increasingly invest their retirement savings with large institutional investors, which in turn offer diversification and a multitude of investment options, the many billions of dollars those companies manage in one fund or another increasingly include substantial shares in competitors.

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In its submission to the OECD last year, the United States found insufficient "evidence of anticompetitive effects", and stated:

> Given the ongoing academic and research 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.[4]

Unfortunately, I was unable to attend this morning's panel. But I hope the debate continues to inspire the careful study that will help all of us – enforcers, practitioners, and scholars – understand the economic reality and build sound policy around it.

I agree with the submission the United States made and, today, I would like to lay out why, as well as some areas where I believe additional study is warranted.

The Empirics, and the Evidence

While this subject is doubtless familiar to many in the audience, let me summarize briefly the common ownership debate. It began in earnest with two papers analyzing effects on consumer prices from common ownership in two sectors: U.S. airline routes and consumer checking accounts. Jose Azar, Martin Schmalz,

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http://ec.europa.eu/competition/mergers/cases/decisions/m7932_13668_3.pdf ("[A]s for current price competition, the presence of significant common shareholding is likely to negatively affect the benefits of innovation competition for firms subject to this common shareholding."); Martin C. Schmalz, *Common Ownership and Competition: Facts, Misconceptions, and What to Do About It*, Isabel Tecu and Sahil Raina have made an important contribution to economic scholarship, and the conversation we are having attests to that. [5]

That work is, however, not without its critics. Among other things, some note that it looks at heavily-regulated and otherwise idiosyncratic industries; some express concerns with the measure of common ownership used; others conduct similar analyses but reach different conclusions.[6] The authors of the original papers have responded to the criticisms, and I look forward to seeing these conversations develop.

In particular, I look forward to forthcoming work examining other industries. In his excellent paper, Menesh Patel demonstrates the high level of contingency in the theory of how common ownership causes anticompetitive harm – what I will call "the common ownership story" – noting that many factors, like the nature and extent of common ownership in the relevant market, its structure and other variables, all impact whether and to what extent common ownership might cause

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[5] José Azar, Martin C. Schmalz & Isabel Tecu, *Anticompetitive Effects of Common Ownership*, 73(4) J. FIN. 1 (2018); José Azar, Sahil Raina & Martin C. Schmalz, *Ultimate Ownership and Bank*

then is shared with other portfolio companies. Nor do we have evidence of corporate managers consulting with their large shareholders about whether and how not to compete with rivals – or thinking internally about them. This "economic blockbuster" thus seems a little light on plot.

In short, the empirics remain unsettled. And there has not been a clear showing of how common ownership actually causes anticompetitive harm.

A Counter-Intuitive Intuition

For these reasons, much of the common ownership debate focuses on confire

Let's go back, as we always should, to the time of the founding of our republic. The second best thing written in 1776 was Adam Smith's The Wealth of Nations. In it, the great economist famously quipped:

> The directors of such [joint-stock] companies…being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own…Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.[12]

In the 1930s, Adolf Berle and Gardiner Means had a similar concern, "that the owners most emphatically will not be served by a profit-seeking controlling group"[13] – that is, management.

And, in the 1970s, Michael Jensen and William Meckling wrote a paper that defined modern corporate legal scholarship.[14] The principal problem (pun intended) they addressed – like Smith, Berle, Means and others before them – was the cost of agency, that is, the problem of aligning the incentives of the principal – the shareholders of a corporation – with their agents – the managers. The existence of the problem was nothing new then, and it remains with us today. The distinction between ownership and control is fundamental, and fundamentally problematic. But not in the direction that would reinforce the common ownership story.

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[12] Adam Smith, The Wealth of Nations 700 (Cannan ed., Modern Library 1937) (1776).
[13] Adolf A Berle & Gardiner C. Means, The Modern Corporation and Private Property 114 (Transaction Publishers 1991) (1932).
[14] Michael Jensen & William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3(4) J. FIN. ECON. 305 (1976).

For centuries, literally, we have concerned ourselves with the problem of making managers care more about shareholders – precisely because there are innumerable reasons to fear that they do not. Yet the common ownership story rests squarely on the belief that managers care quite a bit about some shareholders, specifically those who hold shares in competitors, and quite a bit less about others.

Consider this: it is a fundamental precept of corporate law that, "[i]n carrying out their managerial roles, directors are charged with an unyielding fiduciary duty to the corporation and its shareholders"[15] – not a particular subset thereof. In the real world, however, agency costs are serious concerns, and managers have incentives that may not accord with these duties.[16] So, we have laws that help guide them. Managers simply may not take care – that is, they may exhibit the negligence about which Adam Smith worried. That concern animates the "duty of care" at the heart of the legal regime for corporate managers. Managers may also seek to enrich themselves. That animates the "duty of loyalty." They may defraud shareholders – a risk our securities laws operate to prevent.[17] The list goes on, but the point remains: managers have such strong, demonstrated incentives to derogate from their duties to shareholders that we have erected robust common law and statutory regimes to keep them from doing so.

We have seen many cases where managers failed shareholders generally. And we have seen cases where management – or others – favored the majority over

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[15] *Smith v. Van Gorkum*, 488 A. 2d 858, 872 (Del. 1985).
[16] Betrand & Mullainathan, *Enjoying the Quiet Life? Corporate Governance and Managerial Preferences*, 111(5) J. POL. ECON. 1043 (2003) (examining outcomes from state level changes in anti-takeover laws and finding that when insulated from takeovers, profits and produc (d)2.2g a (d5.3 (h)e7.8 (15e-)9.9 (a

the minority. The takeover fights of the 1970s and 1980s were rife with such behavior.[18] But I am not aware of a demonstrated tendency of management to favor a particular set of minority shareholders without some other incentive. (Management favoring their own holdings, which may be the minority, would be a different matter.)

The common ownership story seems at odds with this history and legal tradition in a few ways. For common ownership to generate competitive harm, it seems that managers would have to put the interests of certain shareholders above the others'. But managers would need a reason for such preferential treatment. To warrant a dramatic change in antitrust policy, we need a showing of how and why that preferential treatment works.

The common ownership story may, in fact, require managers to put shareholder interests over their own financial well-being. While some work points to the fact that managers are frequently paid in ways that reward industry over a lessening of competition in a particular industry, which only one or a few shareholders see.

institutional investors do not exercise a great deal of control. Scholars of corporate law have more often criticized such companies for not asserting their interests enough.[24] Chancellor Leo E. Strine, Jr., of the Delaware Court of Chancery, lamented in 2014 that "the reality is that the segment of the investment community that is best positioned to vote with an eye toward sustainable value creation is the least active in exercising voice and judgment in American corporate governance: index funds."[25] Lucian Bebchuk and others have observed that, in many respects, the power dynamic works in the opposite direction, leading them to conclude that "it is implausible to expect that index fund managers would seek to facilitate significant anticompetitive behavior".[26]

Given the persistent and sometimes troublesome divide between ownership and control within a corporation, practitioners and scholars have long placed great

other companies in their portfolio, which do business with the commonly-owned competitors, may experience negative price effects of common ownership.[31]

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