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Corporate Governance, Institutional Investors, and Common Ownership

NYU School of Law, New York, NY
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Good morning and thank you very much to the FTC staff, for putting this hearing together; and to NYU Law School for hosting the event.

I'd also like to give a special welcome to Commissioner Robert Jackson, of the Securities and Exchange Commission. Commissioner Jackson has spoken publicly about his desire to bring competition economics to the SEC, and is here with us today. I only hope that this does not augur some sort of inter-agency power grab attempt. The FTC may be older, but we're scrappy and don't shy from a fight.

Today we explore an issue in which I am particularly interested—in fact, my first public remarks as a FTC Commissioner focused on it—that is, the competitive effects and antitrust implications, if any, of “common ownership”. The U.S. antitrust

* The views expressed below are my own and do not necessarily reflect those of the Commission or of any other Commissioner.

agencies define common ownership as “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 these companies”.¹

Common ownership is distinct from “cross -ownership”, wherein a company holds an interest in one of its competitors, and other joint venture or co-

common ownership would up end “the basic structure of the financial sector”,² for example by limiting asset managers to holding no more than 1% of a given industry unless they do so in a purely passive manner.

This debate is not just academic. Antitrust enforcers around the world are watching its development, and some are incorporating common ownership into their analyses. For instance, last year the OECD also held common ownership hearings; and European antitrust enforcers have begun citing these theories in their decisions.³

I find the common ownership particularly interesting because it takes place at the intersection of antitrust, corporate, and securities law and policy. In a sense, historically, this is fitting: the FTC in a way grew out of the Department of Commerce’s Bureau of Corporations.⁴

In my June remarks, I noted an important way in which the intuition behind the antitrust theory of harm from common ownership runs counter to the long-standing concerns of those other bodies of law. Corporate law in particular is concerned with the ancient principal-agent problem, and ensuring that managers

² Eric A. Posner, Fiona Scott Morton, & E. Glen Weyl,

work on behalf of shareholders, the owners of the corporation. Management neglect of minority holders is a particular concern. The common ownership theory, or at least one version of it—more on that a bit later—is concerned that managers show too much solicitude to shareholders, and in particular to certain minority holders.

In June, I identified several areas of research that I, as an antitrust enforcer, would like to see developed before shifting policy on common ownership. They were:

- x How common ownership impacts a broad set of industries;
- x Whether a clear mechanism of harm can be identified;
- x A rationale as to why managers put the interests of one set of shareholders above the others; and
- x A rigorous weighing of the harms against the procompetitive effects of institutional shareholding.

How Common Ownership Impacts a Broad Set of Industries

The first question stems from the fact that common ownership is so ubiquitous. Is it also ubiquitously causing anti-competitive harm, and if so, how?

Professor Menesh Patel, from whom we'll also hear today, writes about the sensitivity of harm theories to various factors, including the structure of a given industry. ⁵

less opaque than critics claim, noting that it would “include all the ordinary

for instance, “pure passivity” as a solution. If passivity itself is the problem, it can hardly be the solution as well.

Second, at a time of concern about a lack of competition in the economy generally, is chilling shareholder input the right move? Should we not be considering mechanisms that would encourage companies to compete? The Hart - Scott-Rodino Act explicitly exempts from filing requirements acquisitions made “solely for the purpose of investment”, which the antitrust agencies have interpreted to mean as applying to purely passive shareholders.¹⁴ If we don’t get enough encouragement to compete, is that right approach?

Henry Manne explained that the market for corporate control helps to rectify the disparate power and incentives of firm managers versus shareholders, and affords “to these shareholders both power and protection commensurate with their interest in corporate affairs”.¹⁵ Actions that undermine the effective operation of the market for corporate control, including antitrust policy that fails to consider this market, may prove very harmful to investors, but also to consumers.

Third, how can we identify the marginal, and purportedly negative, effect of common ownership where shareholders already have little incentive to encourage the firm to compete more aggressively, and maybe less given the structure of a given market? Consider liability under Section 7 of the Clayton Act—a theory propounded in the common ownership literature—where acquisitions are only

¹⁴ 15 U.S.C. § 18a.

¹⁵ Henry G. Manne, Mergers and the Market for Corporate Control, 73 J. POL. ECON. 110, 112 (1965).

unlawful if they are likely substantially to lessen competition. At what point do the effects of a share acquisition meet that threshold?

Whichever theory you subscribe to, or scares you, I look forward to today's discussion of the evidence. I'd be remiss not to mention two of our hosts, Professors Scott Hemphill and Marcel Kahan, who conclude thusly with regard to the mechanisms of harm: "First, several mechanisms in the literature are not, in fact, empirically tested. . . . Second, some mechanisms are ineffective in raising portfolio value or would pose major implementation problems for [common concentrated owners (CCOs)]. Third, because most institutional CCOs have only weak incentives to increase portfolio value, they are likely not to benefit from pursuing mechanisms that carry significant reputational costs or legal liability".¹⁶

Rationale regarding Managers' Responsiveness to Shareholders

The third question I raised in June was asking for a rationale regarding managers' responsiveness to shareholders, and certain ones apparently over others. This is another context where the assumptions underlying common ownership run up against assumptions underlying other legal regimes. If the principal-agent problem concerns you, and you think about shareholder neglect—or, put differently, too little competition—understanding how shareholders and managers behave is critical to ensuring we have coherent legal regimes that accurately capture harmful behavior and encourage beneficial behavior.

shareholders; whereas corporate law assumes managers, unless forced to behave otherwise, will act to maximize their own interests over that of the shareholders generally, and of minority shareholders specifically. So, in a real sense, corporate law tends to worry very much that managers will not be responsive enough to their shareholders, while common ownership theories presume loyalty to a select few — often passive—investors.

Professors Azar and Elhauge point to modeling demonstrating that, if managers seek to maximize expected share of votes or likelihood of being re-elected, then they will seek to maximize the weighted average of their shareholders' profits from all their shareholdings.¹⁷ This model also demonstrates that shareholder variation in levels of common ownership will “alter[] the precise weight managers put on each shareholder”.¹⁸ But skeptics have raised questions as to the practical application and real-world predictability of such models. Are managers so acutely attuned to the shareholding levels and desires of their various shareholders? Do they respond in precise fashion to those changing shareholding levels and desires?¹⁹ Do boards and senior managers of major companies even get involved in decisions about issues like price?

¹⁷ Elhauge, *supra* note 9, at 8 (citing José Azar, Portfolio Diversification, Market Power, and the Theory of the Firm, at 12-14 (Aug. 23, 2017), <https://ssrn.com/abstract=2811221>).

¹⁸ Elhauge, *supra* note 9, at 8-9.

¹⁹ See, e.g., Edward B. Rock & Daniel L. Rubinfeld, *See* (h)-17 Tf 0.0Bot0Tc 0.001 Ashifich71 (w)-1.1u(b)5.7sPorwboobific

As noted earlier, common ownership theory proponents have responded, in part, that non-common shareholders might likewise benefit from softer competition, and so managers are not actually acting against the interests of most holders. ²⁰

But, again, if all, or most, shareholders benefit from soft competition such that none have incentives to actively encourage the firm toward more aggressive competition, what additional impact do common owners add?

Much of this comes down to what shareholder incentives actually are. There are reasons why they might prefer softer competition. But there are also reasons why they might not. For instance, if they are diversified across industries, as investors in customers to those setting oligopoly prices, they might not always benefit from oligopoly pricing in discrete industries. The answer can only be complex, measuring those harms against the gains from softening competition. What's an asset manager to do? To the extent the answers are nuanced – different shareholders with different preferences, incentives changing frequently over time – to the corporate manager, isn't competition the safest, and most legal, bet?

Another issue: in my remarks thus far, I've been a little irresponsible in using words like "own". Some are investment advisors or investment managers are "beneficial owners" but are not the economic owners of the shares. ²¹ Professors Hemphill and Kahan criticize "the empirical literature to date [as paying] insufficient attention to the systematic differences in the incentives of different

policies that could find index funds as they exist today are fundamentally incompatible with antitrust laws, we need to keep these very real benefits in mind. Many Americans simply do not have the funds available to buy into more expensive investments.

Scholars have also placed great hope in large, sophisticated institutional investors to have the incentives to make corporate governance better. Are they doing so? I look forward to hearing about stewardship practices today, and how their development should be considered in this context. John Bogle, the inventor of the index fund, wrote last week about his concern that too few people control corporate governance in America. ²⁷ Are those concerns valid, and how should they factor in—if at all?

Conclusion

The common ownership discussion has remained vigorous since last I had the opportunity to speak publicly about it. I am heartened to see that serious scholarship continues to examine critically the theories and empirics at play, and pleased the FTC has included this topic in the hearings. Our panelists today will grapple with a number of intriguing questions, and I'm excited to hear from them all.